4 PUBLIC SECTOR FINANCE

- Overview
- Federal Government
- Information Box 1: Highlights on the 2016 Government of Malaysia's Global Sukuk
- External Debt
- Public Sector Debt
- State Governments
- General Government
- Non-Financial Public Corporations
- Consolidated Public Sector
- Prospects

4 PUBLIC SECTOR FINANCE

Overview

Fiscal Policy in 2016

Fiscal consolidation to continue

The Government continues to consolidate its fiscal position, while ensuring economic growth remains sustainable. Given the current economic challenges including lower global crude oil prices, the Government will leverage existing resources and continue to undertake fiscal reforms. Therefore, the fiscal deficit is targeted to reduce further from 3.2% of gross domestic product (GDP) in 2015 to 3.1% in 2016.

The Government's measures to enhance revenue and optimise expenditure are expected to help strengthen the fiscal position. The implementation of the Goods and Services Tax (GST) since 2015, reduction of tax leakages at duty-free islands, optimisation of revenue from the redistribution and bidding process of telecommunication spectrum, relaxation on income tax penalty and enhancement of foreign workers levy are expected to diversify the revenue base. The spending optimisation measures across ministries and agencies will be continued, with emphasis on minimising non-critical expenditure without affecting public service delivery. Furthermore, improvement to enhance control mechanism on Government physical projects management were introduced in September 2016, which prohibits any variation and addition to the initial approved scope and cost of the projects. This is to ensure all Government projects are implemented based on actual needs in line with implementation of efficient project management towards achieving prudent spending. These initiatives will continue to strengthen the Government's financial position.

The Fiscal Policy Committee (FPC) continues to play an active role in charting the direction of the fiscal consolidation initiatives. To further strengthen the fiscal management framework, the FPC has agreed to form the Fiscal Risks and Contingent Liability Technical Committee in May 2016. The Committee is responsible for evaluating and proposing measures to rein in the Federal Government's fiscal risks and contingent liability to ensure medium- and long-term fiscal sustainability. It comprises the Ministry of Finance; the Economic Planning Unit and the Public Private Partnership Unit of the Prime Minister's Department; and Bank Negara Malaysia. Meanwhile, the Government continues to adopt the Medium-Term Fiscal Framework (MTFF) which outlines fiscal projections that will enable an efficient and effective public finance management.

Federal Government

The Government proactively responded to lower crude oil prices and recalibrated the 2016 Budget on 28 January 2016. In this recalibration, the average Brent crude oil price assumption was revised from USD48 to USD30 per barrel which will result in a lower revenue estimate by RM9.4 billion. However, due to secondary effect on corporate income tax arising from lower oil price, the revenue is expected to further decline by RM3.7 billion despite oil price averaging USD42 per barrel from January to September 2016.

Likewise, under the budget recalibration, expenditure was rationalised by RM9.5 billion to mitigate the impact of the lower revenue. In line with the latest revenue estimates, expenditure was further reduced by RM3.6 billion. Therefore, fiscal deficit target remains at 3.1% of GDP in 2016.

TABLE 4.1

Federal Government Financial Position 2015 – 2017

	RM million			% Change			% of GDP		
	2015	**2016[1]**	**2017[2]**	**2015**	**2016[1]**	**2017[2]**	**2015**	**2016[1]**	**2017[2]**
Revenue	219,089	212,595	219,726	*-0.7*	*-3.0*	*3.4*	*18.9*	*17.2*	*16.6*
Operating expenditure	216,998	207,126	214,800	*-1.2*	*-4.5*	*3.7*	*18.8*	*16.8*	*16.2*
Current balance	**2,091**	**5,469**	**4,926**	***101.6***	***161.5***	***-9.9***	***0.2***	***0.4***	***0.4***
Gross development expenditure	40,768	45,000	46,000	*3.2*	*10.4*	*2.2*	*3.5*	*3.7*	*3.5*
Less: Loan recovery	1,483	804	730	*41.0*	*-45.8*	*-9.2*	*0.1*	*0.1*	*0.1*
Net development expenditure	39,285	44,196	45,270	*2.2*	*12.5*	*2.4*	*3.4*	*3.6*	*3.4*
Overall balance	**-37,194**	**-38,727**	**-40,344**	***-0.6***	***4.1***	***4.2***	***-3.2***	***-3.1***	***-3.0***

[1] Revised estimate.
[2] Budget estimate, excluding 2017 Budget measures.
Note: Total may not add up due to rounding.

Revenue

GST collection partly offset lower revenue

Federal Government's revenue in 2016 is expected to decline 3% (2015: -0.7%) to RM212.6 billion mainly due to the lower collection of petroleum-related revenue by 34.4% following lower crude oil prices. However, this is expected to be cushioned by better collection of GST and additional revenue from measures announced during the budget recalibration. Thus, total revenue as a percentage to GDP is estimated at 17.2% (2015: 18.9%).

Tax revenue remains the main source of Federal Government's revenue, accounting for 78.6% of total revenue. Tax revenue is projected to increase marginally by 1% in 2016 to RM167.1 billion (2015: 0.8%; RM165.4 billion) or 13.6% of GDP. ***Direct tax***, contributing 52% to total revenue, is projected to reduce 1.1% to RM110.5 billion in 2016 (2015: 51%; -11.8%; RM111.8 billion). Corporate income tax (CITA), constituting 37.8% of total tax revenue, is estimated to decline 0.8% to RM63.2 billion (2015: -2.4%; RM63.7 billion). This is partly due to the reduction in CITA rate from 25% to 24%, while for small and medium enterprises (SMEs) from 20% to 19% beginning the year of assessment 2016. Meanwhile, individual income tax collection is expected to increase 7% to RM28.2 billion, underpinned by stable growth of employment and income. Collection of petroleum income tax (PITA), representing 5.1% of total tax revenue, is estimated to reduce 26.3% to RM8.5 billion (2015: 7%; -57.1%; RM11.5 billion) due to lower assumption of crude oil price at USD40 per barrel (2015: USD52 per barrel).

Efforts in improving tax administration, increasing tax compliance and strengthening tax audit are continuously undertaken. The relaxation on tax penalty as well as an increase of 3.6% in revenue collection from other direct taxes mainly stamp duty and real property gains tax (RPGT), is expected to partly offset the reduction in direct tax collection.

Indirect tax is forecast to increase 5.5% to RM56.6 billion, mainly contributed by substantial GST collection. Since its implementation, the number of registrants has increased to 423,920 as of 30 September 2016. GST collection in 2016 is expected to surge 42.5% to RM38.5 billion compared with RM27 billion in 2015, reflecting a full year implementation. Excise duties are estimated to decline 0.7% to RM11.8 billion following expected lower sales volume of motor vehicles to 580,000 units (2015: 666,674 units)[1]. In line with lower commodity prices and smaller export volume, export duties are projected to drop 21.7% to RM0.8 billion (2015: -45.1%; RM1 billion).

Non-tax revenue[2] is anticipated to decline 15.2% to RM45.5 billion (2015: -4.9%; RM53.6 billion), due to lower receipts from investment income mainly from Petroliam Nasional Berhad (PETRONAS) dividend of RM16 billion

TABLE 4.2

Federal Government Revenue 2015 – 2017

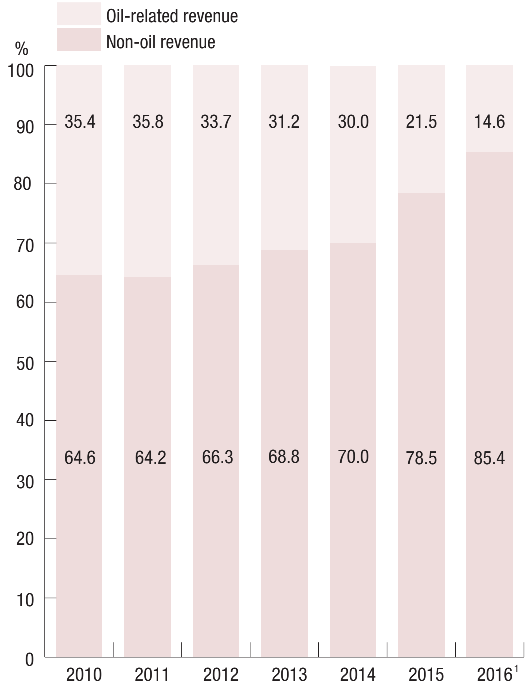
	RM million			% Change			% Share		
	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
Tax revenue	**165,440**	**167,101**	**180,580**	***0.8***	***1.0***	***8.1***	***75.5***	***78.6***	***82.2***
Direct tax	111,770	110,500	120,739	*-11.8*	*-1.1*	*9.3*	*51.0*	*52.0*	*55.0*
of which:									
CITA	63,679	63,193	69,193	*-2.4*	*-0.8*	*9.5*	*29.1*	*29.7*	*31.5*
Individuals	26,321	28,163	29,853	*7.8*	*7.0*	*6.0*	*12.0*	*13.2*	*13.6*
PITA	11,559	8,517	10,637	*-57.1*	*-26.3*	*24.9*	*5.3*	*4.0*	*4.8*
Indirect tax	53,670	56,601	59,841	*43.3*	*5.5*	*5.7*	*24.5*	*26.6*	*27.2*
of which:									
GST	27,012	38,500	40,000	-	*42.5*	*3.9*	*12.3*	*18.1*	*18.2*
Excise duties	11,890	11,801	13,111	*-8.0*	*-0.7*	*11.1*	*5.4*	*5.6*	*6.0*
Import duty	2,732	2,736	3,008	*2.3*	*0.1*	*9.9*	*1.2*	*1.3*	*1.4*
Export duty	1,039	813	731	*-45.1*	*-21.7*	*-10.1*	*0.5*	*0.4*	*0.3*
Non-tax revenue	**53,649**	**45,494**	**39,146**	***-4.9***	***-15.2***	***-14.0***	***24.5***	***21.4***	***17.8***
of which:									
Licences and permits	12,540	11,843	12,061	*-12.0*	*-5.6*	*1.8*	*5.7*	*5.6*	*5.5*
Investment income	32,838	23,299	17,591	*-2.7*	*-29.0*	*-24.5*	*15.0*	*11.0*	*8.0*
Total revenue	**219,089**	**212,595**	**219,726**	***-0.7***	***-3.0***	***3.4***	***100.0***	***100.0***	***100.0***
% of GDP	***18.9***	***17.2***	***16.6***						

[1] Revised estimate.
[2] Budget estimate, excluding 2017 tax measures.
Note: Total may not add up due to rounding.

[1] Malaysian Automotive Association Press Release on 1st Half of 2016 Motor Vehicles Sales and Production Performance on 20 July 2016.
[2] Consists of licences and permits (including petroleum royalties and levy on foreign workers), investment income, service fees, fines and penalties, sales of goods, non-revenue receipts as well as revenue from the Federal Territories.

CHART 4.1

Share of Oil-Related and Non-Oil Revenue to Total Revenue



[1] Revised estimate.
Source: Ministry of Finance, Malaysia.

(2015: RM26 billion). Total receipts from licences and permits are expected at RM11.8 billion, contributed mainly by petroleum royalties at RM3.7 billion (2015: RM5.1 billion), levy on foreign workers at RM2.8 billion (2015: RM2.2 billion) and motor vehicles licence at RM2.8 billion (2015: RM2.6 billion). In addition, the redistribution and bidding process of telecommunication spectrum are expected to contribute RM1 billion to the collection of service fees. Furthermore, monetisation of asset is expected to contribute RM1.1 billion to the non-tax revenue collection.

Expenditure

Reprioritising expenditure

The Federal Government's total expenditure in 2016 is estimated to decrease 2.2% to RM252.1 billion with a share of 20.5% to GDP (2015: -0.5%; RM257.8 billion; 22.3%). A sum of RM207.1 billion (82.2%) is allocated for operating expenditure, while RM45 billion (17.8%) is for development expenditure. Government expenditure continues to focus on programmes and projects with high multiplier effect to the economy amid a challenging environment, while ensuring the well-being of the rakyat.

Operating expenditure (OE) is expected to decline 4.5% to RM207.1 billion with its share to GDP at 16.8% (2015: -1.2%; RM217 billion; 18.8%) on account of measures to optimise and rasionalise supplies and services, grants and subsidies as well as purchase of assets. These measures are implemented mainly through scaling down of programmes and activities as well as minimising duplication of roles and functions among agencies, hence further enhancing spending efficiency.

Emoluments remain the largest component, constituting 35.7% of OE (6% of GDP). It is expected to grow 5.4% to RM73.9 billion (2015: 4.6%; RM70 billion) contributed mainly by special financial assistance in January and June 2016 to ease the cost of living as well as a salary increment in July 2016 and the implementation of Minimum Wages Order 2016. The size of civil service is maintained at 1.6 million in efforts to contain the growth in emolument bill. At the same time, the Government continues to focus on increasing the productivity and efficiency of the public service.

Supplies and services, constituting 14.3% of OE, is estimated to decrease 18.3% to RM29.7 billion (2015: 16.8%; 6.2%; RM36.4 billion). In terms of percentage to GDP, supplies and services is estimated at 2.4%, lower than the annual average of 3.2% for the past five years. The decrease is due to a large reduction in non-critical expenses such as outlays on travel and transport, utilities, refurbishment and renovation as well as events and functions. The Government, through the National Blue Ocean Strategy (NBOS), continues to reduce cost and redundancies mainly by optimising information and communications technology (ICT) systems as well as government-owned facilities and premises for trainings and events.

Debt service charges[3], which must be served before all other commitments, are projected to increase 9.7% to RM26.6 billion (2015: 7.5%; RM24.3 billion) and remain manageable at 12.9% of total OE. ***Retirement charges***[4], accounting for 9.2% of OE, is expected to grow 0.6% to RM19 billion (2015: 8.7%; 3.6%; RM18.9 billion).

The Government remains committed to subsidy rationalisation. In this regard, ***subsidies and social assistance*** is expected to decline 9.6% to RM24.6 billion, contributing 11.9% to total OE (2015: -31.3%; RM27.3 billion; 12.6%). However, the Government will continue to subsidise essential services such as education, health and public transportation. To further assist low-income households, 1Malaysia People's Aid (BR1M) payment was increased up to RM1,050 per recipient. This is expected to cost the Government RM5.4 billion this year benefiting 4.2 million households and 3.1 million single individuals.

Grants to statutory bodies are anticipated to decline significantly by 16.4% to RM12.9 billion (2015: -5.3%; RM15.5 billion) due to rationalisation of grants. This measure is aimed at reducing dependency of statutory bodies on federal grants, particularly entities with a steady income stream, high reserves and self-sustaining.

[3] Consist of coupon and interest payments, as well as management charges and fees.
[4] Consist of pension payments, gratuities (including cash awards in lieu of leave) and transfers to the Retirement Fund Incorporated (KWAP).

TABLE 4.3

Federal Government Operating Expenditure by Object 2015 – 2017

	RM million			% Change			% Share		
	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
Emoluments	70,050	73,866	77,422	*4.6*	*5.4*	*4.8*	*32.3*	*35.7*	*36.0*
Retirement charges	18,872	18,993	21,763	*3.6*	*0.6*	*14.6*	*8.7*	*9.2*	*10.1*
Debt service charges	24,283	26,639	28,866	*7.5*	*9.7*	*8.4*	*11.2*	*12.9*	*13.4*
Grants and transfers to state governments	6,921	6,931	8,058	*6.0*	*0.2*	*16.3*	*3.2*	*3.3*	*3.8*
Supplies and services	36,373	29,702	32,020	*6.2*	*-18.3*	*7.8*	*16.8*	*14.3*	*14.9*
Subsidies and social assistance	27,269	24,642	22,431	*-31.3*	*-9.6*	*-9.0*	*12.6*	*11.9*	*10.4*
Grants to statutory bodies	15,487	12,948	9,396	*-5.3*	*-16.4*	*-27.4*	*7.1*	*6.3*	*4.4*
Refunds and write-offs	947	924	802	*-29.1*	*-2.4*	*-13.2*	*0.4*	*0.4*	*0.4*
Others	16,796	12,481	14,042	*23.0*	*-25.7*	*12.5*	*7.7*	*6.0*	*6.5*
Total	**216,998**	**207,126**	**214,800**	***-1.2***	***-4.5***	***3.7***	***100.0***	***100.0***	***100.0***
% of GDP	***18.8***	***16.8***	***16.2***						

[1] Revised estimate.
[2] Budget estimate, excluding 2017 Budget measures.

Note: Total may not add up due to rounding.

About 55% of the grants is channelled to public universities, while the remaining is allocated for regional and agricultural development authorities as well as trade and investment promotion agencies. Meanwhile, RM6.9 billion is allocated to ***state governments*** as provided under the Constitution as well as other transfers.

A sum of RM260 billion was allocated for **development expenditure (DE)** under the Eleventh Malaysia Plan (11MP). The first rolling plan (RP1: 2016 – 2017) outlines about 4,500 projects and programmes, emphasising on economic and social sectors. About 70% involves physical projects, while the remaining includes funds and grants for strategic initiatives, human capital development and ICT.

DE for 2016, which marks the first year of the RP1 is projected to increase 10.4% to RM45 billion (2015: 3.2%; RM40.8 billion) and accounts for 17.3% of the total 11MP ceiling. In terms of sectoral allocation, the economic sector accounts for the largest allocation at 61.4% followed by the social (24%), security (11.2%) and general administration (3.4%) sectors.

The ***economic sector*** is allocated RM27.6 billion (2015: RM23.3 billion) in tandem with efforts to enhance productivity and competitiveness of the nation. Expenditure in this sector will focus on developing transport infrastructure, enhancing industrial and entrepreneurial development, improving public utilities as well as accelerating agriculture and rural development.

The transport subsector is the largest recipient, constituting 18.7% of total DE or RM8.4 billion (2015: 16.4%; RM6.7 billion), mainly to finance the construction, maintenance and upgrading of roads and bridges, airports and ports as well as railways. Road projects are focused in rural areas, particularly in Sabah and Sarawak to stimulate economic activity through improving connectivity to urban commercial centres. Major ongoing projects include the Pan Borneo Highway, West Coast Expressway, Sungai Besi – Ulu Kelang Elevated Expressway and Damansara – Shah Alam Elevated Expressway.

A sum of RM6 billion is allocated for the *trade and industry subsector* in 2016, which accounts for 13.3% of total DE (2015: RM5.6 billion; 13.8%). Among others, allocation is for regional corridors development as well as upgrading infrastructure facilities in industrial areas to attract new investments. In addition, financial assistance for entrepreneurship is provided through various institutions such as Perbadanan Usahawan Nasional Berhad (PUNB) and Majlis Amanah Rakyat (MARA).

The *public utilities and energy subsector* is channelled RM3.3 billion or 7.3% of total DE in 2016 (2015: RM3.6 billion; 8.9%) focusing on public amenities such as water and electricity supply, telecommunication facilities as well as sewerage services. The projects are mainly concentrated in rural areas, particularly in Sabah and Sarawak to bridge the urban-rural divide. Other projects in the subsector include enlargement of dams, building water treatment facilities and improving urban drainage system. Meanwhile, the *agriculture and rural development subsector* is provided RM2.9 billion or 6.4% of total DE (2015: RM3.1 billion; 7.6%). The allocation is mainly for high value-added and commercially-viable agriculture programmes to raise the income of farmers.

Expenditure under the ***social sector***, the second largest component, is estimated at RM10.8 billion or 24% of total DE (2015: RM11.2 billion; 27.4%). Of this, RM3.9 billion (2015: RM4.8 billion) is for the *education and training subsector* which includes research and development (R&D), scholarships, upgrading and maintenance of infrastructure in schools, skills training centres, community colleges and universities. Among the major ongoing projects include the construction of MARA High Skills College

TABLE 4.4

Federal Government Development Expenditure by Sector 2015 – 2017

	RM million			% Change			% Share		
	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
Economic	**23,286**	**27,623**	**25,862**	***-0.2***	***18.6***	***-6.4***	***57.1***	***61.4***	***56.2***
of which:									
Transport	6,693	8,419	10,599	*-7.9*	*25.8*	*25.9*	*16.4*	*18.7*	*23.0*
Trade and industry	5,638	5,996	4,927	*20.3*	*6.3*	*-17.8*	*13.8*	*13.3*	*10.7*
Public utilities and energy	3,637	3,270	2,582	*4.4*	*-10.1*	*-21.0*	*8.9*	*7.3*	*5.6*
Agriculture and rural development	3,105	2,877	2,416	*8.0*	*-7.3*	*-16.0*	*7.6*	*6.4*	*5.3*
Social	**11,161**	**10,812**	**12,180**	***6.4***	***-3.1***	***12.7***	***27.4***	***24.0***	***26.5***
of which:									
Education and training	4,758	3,874	5,904	*-3.4*	*-18.6*	*52.4*	*11.7*	*8.6*	*12.8*
Housing	2,008	2,476	870	*224.9*	*23.3*	*-64.9*	*4.9*	*5.5*	*1.9*
Health	1,442	1,481	1,532	*4.1*	*2.7*	*3.4*	*3.5*	*3.3*	*3.3*
Security	**4,754**	**5,041**	**5,286**	***9.7***	***6.0***	***4.9***	***11.7***	***11.2***	***11.5***
General administration	**1,567**	**1,524**	**2,671**	***16.6***	***-2.7***	***75.3***	***3.8***	***3.4***	***5.8***
Total	**40,768**	**45,000**	**46,000**	***3.2***	***10.4***	***2.2***	***100.0***	***100.0***	***100.0***
% of GDP	***3.5***	***3.7***	***3.5***						

[1] Revised estimate.
[2] Budget estimate, excluding 2017 Budget measures.
Note: Total may not add up due to rounding.

in Selama, Perak, acquisition of teaching equipments as well as funds for technical and vocational education and training (TVET).

The *housing subsector* is allocated a sum of RM2.5 billion or 5.5% of total DE (2015: RM2 billion; 4.9%), among others, to build affordable houses for the poor- and low-income groups as well as quarters for civil servants. In efforts to provide affordable housing, the implementation of public housing projects such as 1Malaysia People's Housing (PR1MA), 1Malaysia Civil Servants Housing (PPA1M) and People's Housing Programme (PPR) was accelerated, while initiatives to revive abandoned projects have been undertaken. A substantial allocation of RM1.5 billion or 3.3% of total DE (2015: RM1.4 billion; 3.5%) is provided to the *health subsector*. Major ongoing projects include the construction of a teaching hospital in Universiti Putra Malaysia and an obstetric complex in Hospital Tengku Ampuan Rahimah, expansion of Hospital Kuala Krai as well as acquisition of additional ambulances and provision of mobile clinics.

Expenditure for the ***security sector*** is estimated at RM5 billion or 11.2% of total DE (2015: RM4.7 billion; 11.7%). A total of RM4.1 billion is allocated for the *defence subsector*, including for acquisition of patrol vessels and upgrading facilities in Eastern Sabah Security Zone (ESSZONE). Meanwhile, RM0.9 billion is allocated for *internal security,* particularly procurement of helicopters for the Royal Malaysian Police, upgrading of ICT and surveillance systems at immigration checkpoints and prisons nationwide.

The ***general administration sector*** is allocated RM1.5 billion or 3.4% of total DE (2015: RM1.6 billion; 3.8%). This is on account of concerted efforts to enhance productivity as well as to improve the public sector delivery system through the implementation of projects such as Big Data Analytics and 1GovNet.

Financing

Higher demand for Shariah-compliant instrument

The Federal Government maintains its funding mainly from domestic sources, which is expected to constitute 93.2% of total gross borrowings. This strategy helps to lessen

TABLE 4.5

Federal Government Financing 2015 – 2016

	RM million		% Share	
	2015	2016[2]	2015	2016[2]
Gross borrowings	**98,059**	**92,853**	***100.0***	***100.0***
Domestic	**92,500**	**86,500**	***94.3***	***93.2***
MGS	51,500	44,000	*52.5*	*47.4*
MGII	41,000	42,500	*41.8*	*45.8*
External	**5,559**	**6,353**	***5.7***	***6.8***
Market loans	5,303	6,087	*5.4*	*6.5*
Project loans	256	266	*0.3*	*0.3*
Repayments	**58,402**	**53,341**	***100.0***	***100.0***
Domestic	53,569	48,141	*91.7*	*90.3*
External	4,833	5,200	*8.3*	*9.7*
Net borrowings	**39,658**	**39,512**	-	-
Domestic	38,931	38,359	-	-
External	727	1,153	-	-
Change in assets[1]	**-2,464**	**-785**	-	-
Total financing needs	**37,194**	**38,727**	-	-

[1] (+) indicates a drawdown of assets; (-) indicates accumulation of assets.
[2] Estimate.
Note: Total may not add up due to rounding.

the impact of adverse exchange rate movements on debt valuation and debt servicing, while not crowding out private sector financing given the ample liquidity in the market. In 2016, total Federal Government gross borrowings is estimated at RM92.8 billion mainly for principal repayment amounting to RM53.3 billion, while the balance is for deficit financing.

Gross domestic borrowings for 2016 are expected to record RM86.5 billion. Malaysian Government Securities (MGS) remain as the major source of domestic funding, amounting to RM44 billion or 50.9% (2015: RM51.5 billion; 55.7%) while the balance are Malaysian Government Investment Issues (MGII).

The growing demand for Islamic financial instruments has resulted in higher issuance of MGII. During the ten year period, the share of MGII issuance of total gross borrowings will almost double in 2016 compared with 25.7% in 2006. For 2016, MGII issuance is expected to grow to RM42.5 billion or 45.8% of total gross borrowings (2015: RM41 billion; 41.8%). The increase reflects the continuous efforts and commitment to promote Islamic financial instruments and provide a benchmark as well as to support the increasing demand for Shariah-compliant papers.

For the first half of 2016, both instruments issuance have been oversubscribed by an average of 2.3 times, reflecting a strong demand for Government papers. Yields on 5-year MGS ranged between 3.340% and 3.615%, while yields on 10-year MGS ranged between 3.744% and 3.930%. On average, MGII offers a higher yield of 15 basis points over MGS. As share of MGII issuance increase, the yield variance between the two instruments is narrower, which translate to lower financing cost to the Federal Government.

Gross offshore borrowings for 2016 are expected to amount to RM6.3 billion mainly through market loan issuance. In April 2016, the Federal Government successfully issued a dual-tranche (10-year and 30-year) Wakalah Global Sukuk of USD1.5 billion. The 10-year tranche was priced at 3.179% while the 30-year tranche at 4.080%. This sukuk issuance is the first sovereign sukuk utilising 100% non-physical assets, positioning Malaysia as the leader in Islamic finance innovation. In addition, a total of RM266 million is expected to be drawn down for project loans through bilateral (RM238 million) and multilateral (RM28 million) arrangements to finance ongoing programmes and projects.

Debt

Debt to finance investment activities

The management of Federal Government debt is based on various legal provisions. Under Article 111 of the Federal Constitution, the Federal Government shall not borrow except under the authority of federal law. There are several legislations that empowers the Federal Government to borrow or to raise funds including Loan (Local) Act 1959 [Act 637], Government Funding Act 1983 [Act 275], External Loans Act 1963 [Act 403] and Treasury Bills (Local) Act 1946 [Act 188]. Apart from empowering the Federal Government to borrow or raise funds, these acts also impose certain restrictions on the Federal Government to ensure prudent management of federal debts.

Act 637 and Act 275 set the debt ceiling at 55% of GDP, which is confined to the outstanding of MGS, MGII and Malaysian Islamic Treasury Bills (MITB) instruments. Hence, as at end-June 2016, the debt outstanding from these instruments stood at 48.5% of GDP, reflecting a strict adherence to the Acts. The accumulated offshore borrowing is limited at RM35 billion under Act 403, while Malaysian Treasury Bills (MTB) is set at a threshold of RM10 billion as provided under Act 188.

The **Federal Government debt** stood at RM655.7 billion (53.2% of GDP) as at end-June 2016, mainly due to higher domestic debt issuance to finance DE. Domestic debt continued to account for the largest share of total debt at 95.9%, while the remaining is from offshore borrowing.

TABLE 4.6

Federal Government Debt 2015 – 2016

	RM million		% Share		% of GDP	
	2015	2016[2]	2015	2016[2]	2015	2016[2]
Domestic debt	**609,063**	**628,791**	***96.6***	***95.9***	***52.6***	***51.0***
Treasury bills	4,700	4,500	*0.8*	*0.7*	*0.4*	*0.3*
MGS	340,063	365,891	*53.9*	*55.8*	*29.4*	*29.7*
MGII	214,000	230,000	*33.9*	*35.1*	*18.5*	*18.7*
Housing Loan Fund[1]	50,300	28,400	*8.0*	*4.3*	*4.3*	*2.3*
Offshore borrowing	**21,477**	**26,954**	***3.4***	***4.1***	***1.9***	***2.2***
Market loans	15,179	20,291	*2.4*	*3.1*	*1.3*	*1.6*
Project loans	6,298	6,663	*1.0*	*1.0*	*0.6*	*0.6*
Total	**630,540**	**655,745**	***100.0***	***100.0***	***54.5***	***53.2***
Memorandum item:						
Non-resident holdings of ringgit-denominated Government debt securities	175,963	206,182	*28.9*	*32.8*	*15.2*	*16.7*

[1] Effective 1 January 2016, Housing Loan Fund under the Housing Loan Fund Act 1971 has been discontinued. A sum of RM21,900 million term loan has been transferred to LPPSA. The remaining debt comprise of Sukuk Pinjaman Perumahan.

[2] As at end-June 2016.

Note: Total may not add up due to rounding.

Info Box 1

Highlights on the 2016 Government of Malaysia's Global Sukuk

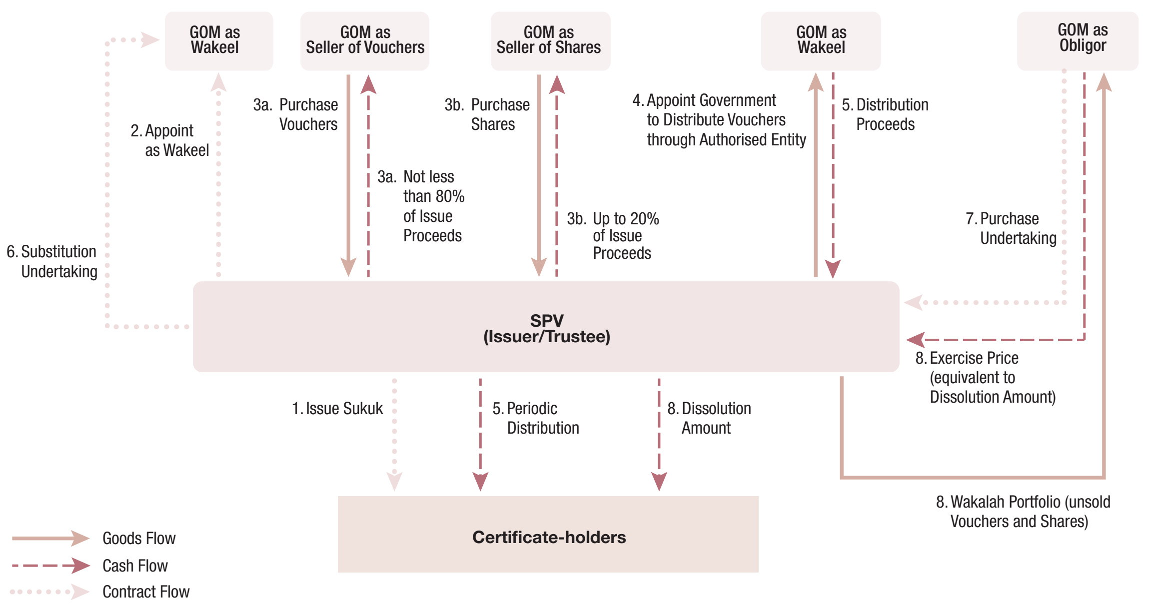
Introduction

The Government, via Malaysia Sukuk Global Berhad (a special purpose vehicle – SPV) once again tapped into the international market to issue sukuk in April 2016. This offering marks the Government's fifth USD-denominated global sukuk issuance, following successful issuances in 2002, 2010, 2011 and 2015. The Government issued a USD1.5 billion sukuk to redeem the existing USD1.2 billion sukuk due in July 2016 as well as to finance development expenditures. The sukuk was issued in two tranches, 10-year and 30-year. The sukuk represents a major breakthrough in sovereign sukuk in terms of structure and was competitively priced despite uncertainties in the global economy.

The global sukuk offering was structured under the Shariah principle of Wakalah. The underlying assets for the offering comprised of 100% non-physical assets, namely, vouchers representing travel entitlement on public transport and Shariah-compliant shares. This unique combination of underlying assets represent a major innovation in sovereign sukuk issuance, being the first time a sovereign has raised sukuk without utilising physical assets (such as land and buildings) or commodity murabahah. This innovative sukuk structure not only paves the way for other sovereigns to follow suit but also further reaffirms Malaysia's position as the leader in international Islamic finance market.

CHART 1

Sukuk Structure and Transaction Flow Diagram



GOM = Government of Malaysia.
Source: Ministry of Finance, Malaysia.

Step	Description
1	SPV as an issuer will issue sukuk to certificate-holders in consideration for the proceeds.
2	The Government is appointed as an agent of the certificate-holders ("*Wakeel*") subject to terms and conditions of the *Wakalah* Agreement.
3	On issue date, the Trustee will use the proceeds to form the *Wakalah* Portfolio as follows: a. minimum 80% of issue proceeds to buy vouchers of travel entitlements on public transport ("Vouchers"); and b. maximum 20% of the issue proceeds to buy Shariah-compliant shares related to social and economic development ("Shares") by way of transfer of beneficial ownership from the Government to the SPV.

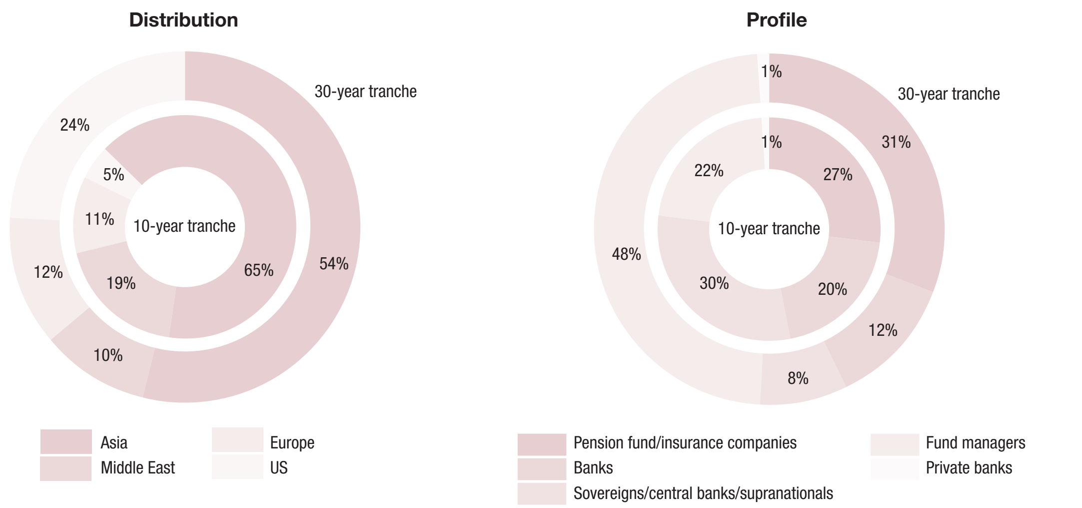
4	*Wakeel* will be authorised by the Trustee to act as a distributor of the Vouchers, through an authorised entity.
5	On each periodic distribution date, the Trustee will distribute returns from the *Wakalah* Portfolio to certificate-holders. Any excess returns shall be retained by the *Wakeel* as an incentive fee.
6	The Government has irrevocable rights to substitute the Wakalah Portfolio with any new vouchers, new Shariah-compliant shares and/or lease assets ("New Assets"), throughout the tenure of the sukuk. New Assets shall form part of the *Wakalah* Portfolio.
7	The Government as an Obligor undertakes to purchase the *Wakalah* Portfolio from the Trustee upon the maturity date or the declaration of dissolution at the exercise price.
8	On maturity or dissolution date, the Government as a Purchaser will pay the exercise price and the proceeds will be used to redeem the sukuk from the Certificate-holders.

The extensive roadshow has engaged more than 130 investors across global financial centres, including Malaysia, Hong Kong, Singapore, Abu Dhabi, Dubai, London and New York. The roadshow received overwhelming response from global investors, attracting an aggregate order exceeding USD6.3 billion from a combined investor base of over 195 accounts, representing a subscription rate of 4.2 times over the offering size. Many of the investors placed orders in large ticket sizes of above USD10 million, which in aggregate made up more than 75% of the final order book.

Following the resounding support from investors, the 10-year tranche was priced at 3.179%, while the 30-year tranche was priced at 4.080%. This represents a zero to minimal new issue premium against the Government's secondary yield curves and is lower than the typical new issue premium paid by sovereigns globally.

CHART 2

Investors' Distribution and Profile



Source: Ministry of Finance, Malaysia.

Conclusion

The overwhelming response to the 2016 Government's global sukuk issuance reflects global investors' continued confidence in the country's economic fundamentals. This has enabled Malaysia not only to strengthen its position as a top investment destination, but also reaffirms Malaysia's position as the leader in international Islamic finance market.

As at end-June 2016, the Federal Government ***domestic debt*** registered RM628.8 billion, comprising mainly MGS and MGII. MGS, the largest instrument of Government issuance, stood at RM365.9 billion or 55.8% of total Federal Government debt, while MGII registered RM230 billion. The share of MGII to total Federal Government debt has increased to 35.1% compared to 21.8% in 2010, reflecting continuous Government's efforts to promote Malaysia as an international Islamic finance hub. In addition, given the well-capitalised domestic institutions and advanced domestic capital market, the Federal Government domestic debt were held mostly by large and long-term investors. The bulk of MGS and MGII were held by financial institutions at 27.1%, followed by the Employees Provident Fund (23.1%) and insurance companies (4.9%).

To ensure better cash-flow management, MTB and MITB are issued periodically with maturities 12-month and below. As at end-June 2016, total outstanding MTB and MITB stood at RM4.5 billion (0.3% of GDP), accounting for 0.7% of total Federal Government debt. Following the increase in Islamic instrument issuance in the recent years, MGII and MITB accounted for 35.3% of total Federal Government debt (end-2015: 34.2%), while the remaining were conventional instruments.

The maturity profile of Federal Government debt remains well-spread, with average time to maturity of 9.7 years. Instruments with maturity below five years constitute 51%, 6 to 10 years 33.6%, while maturity more than 10 years represent 15.4% of total outstanding debt. Since most instruments will mature in the medium- and long-term, it reflects a low refinancing risk as only 8.1% of MGS and MGII will mature in 2016 (2015: 10%).

On 1 January 2016, the corporatised Treasury Housing Loan Division, now known as the Public Sector Home Financing Board (LPPSA) commenced its operations. The establishment of LPPSA will enable a more efficient and effective management of civil servant housing loan scheme while maintaining existing benefits and terms of the loan facilities. LPPSA will manage assets and liabilities independently. As part of the corporatisation exercise, a sum of RM21.9 billion of RM50.3 billion from the existing liabilities was transferred to LPPSA. This resulted in a lower total Federal Government debt by 1.8% of GDP at the beginning of 2016.

Offshore borrowings which consist of market and project loans, stood at RM26.9 billion. Of this, outstanding market loans accounted for 75.3%, while the remaining were for project loans. The outstanding project loans were from previous bilateral and multilateral arrangements to finance specific programmes and infrastructure projects such as housing, sewerage and reservoir.

External Debt

Malaysia's **external debt**[5] stood at RM848.2 billion (68.8% of GDP) as at end-June 2016 (end-2015: RM833.7 billion; 72.1%). The bulk of the debt comprised of deposits and ringgit-denominated debt securities held by non-residents at RM309.6 billion or 25.1% of GDP, followed by private sector debt at RM166.7 billion or 13.5% of GDP. Meanwhile, the public sector offshore borrowings accounted for 9.9% of GDP, of which the Federal Government debt constituted only 2%.

TABLE 4.7

External Debt
2015 – 2016

	RM million		% Share		% of GDP	
	2015	2016[3]	2015	2016[3]	2015	2016[3]
Offshore borrowing	**463,621**	**466,743**	***55.6***	***55.0***	***40.1***	***37.9***
Medium and long-term debt	285,900	288,373	*34.3*	*34.0*	*24.7*	*23.4*
Public sector	128,319	121,671	*15.4*	*14.3*	*11.1*	*9.9*
Federal Government	21,477	24,654	*2.6*	*2.9*	*1.9*	*2.0*
Public corporations	106,842	97,017	*12.8*	*11.4*	*9.2*	*7.9*
Private sector	157,581	166,702	*18.9*	*19.7*	*13.6*	*13.5*
Short-term debt	177,721	178,370	*21.3*	*21.0*	*15.4*	*14.5*
Non-resident holdings of ringgit-denominated debt securities	**211,347**	**232,258**	***25.3***	***27.4***	***18.3***	***18.8***
Medium and long-term debt	184,131	215,763	*22.1*	*25.4*	*15.9*	*17.5*
Federal Government	172,629	202,823	*20.7*	*23.9*	*14.9*	*16.5*
Others[1]	11,502	12,940	*1.4*	*1.5*	*1.0*	*1.0*
Short-term debt	27,216	16,495	*3.2*	*1.9*	2.4	1.3
Non-resident deposits	**81,616**	**77,330**	***9.8***	***9.1***	***7.1***	***6.3***
Others[2]	**77,233**	**71,911**	***9.3***	***8.5***	***6.6***	***5.8***
Total	**833,817**	**848,242**	***100.0***	***100.0***	***72.1***	***68.8***

[1] Include private sector and public corporations.
[2] Comprise trade credits, IMF allocation of Special Drawing Rights and miscellaneous.
[3] As at end-June 2016.
Note: Total may not add up due to rounding.

[5] Comprises offshore borrowing by the Federal Government, public corporations and the private sector as well as non-resident holdings of ringgit-denominated debt securities, non-resident deposits, trade credit provided by foreign trade counterparts and other debt liabilities.

Offshore borrowings increased 0.7% to RM466.7 billion as at end-June 2016. This was mainly contributed by issuances of foreign currency debt papers, which include the issuance of Wakalah Global Sukuk of USD1.5 billion in April 2016; drawdown of interbank borrowings; long-term offshore loans by banks; and intercompany loans by non-bank private corporations. The Federal Government offshore debt increased to RM24.6 billion due to valuation effect as well as pre-funding issuance for the redemption of global sukuk USD1.2 billion in July 2016 and remained low at 5.3% of total offshore borrowings. Similarly, the short-term offshore borrowings was also on the uptrend, registering RM178.4 billion or 14.5% of GDP. As at end-June 2016, the debt service ratio[6] for offshore borrowings stood at 13.9%.

Non-resident holdings of ringgit-denominated debt securities, largely in the form of medium- and long-term securities, increased to RM232.2 billion as at end-June 2016. As majority of the investors were asset managers, central banks and pension funds, it reflects an improved investors' confidence in domestic economic fundamentals as well as increased appetite for quality instruments with higher returns. Foreign investors' holdings of MGS and MGII accounted for 34% (end-2015: 31.2%).

Public Sector Debt

Public sector debt[7] consists of total debt of general government[8] and non-financial public corporations (NFPCs), which reflects the accumulated borrowing by all layers in the public sector. As the Federal Government is a guarantor to other entities of public sector debt, the amount of guarantees is included in the consolidated public sector debt. The provision of a comprehensive public sector debt is essential to enable effective and efficient management of public sector finance.

As at end-2015, Malaysia's public sector debt stood at RM870 billion or 75.2% of GDP. Federal Government debt constituted the largest component, accounting for RM630.5 billion or 72.5% of total public sector debt. NFPCs debt amounted to RM199.5 billion or 22.9% of total debt, while the remaining comprised of statutory bodies debt. The debt incurred by the NFPCs was primarily to finance core investment activities in oil and gas, energy and transport sectors, as well as asset acquisitions. Meanwhile, debt of the statutory bodies was sourced domestically, mainly to finance their mandated roles such as in areas of education and rural development.

State Governments

High current account surplus

Consolidated revenue of the **state governments** is projected at RM21.1 billion (2015: RM21.7 billion) of which 71% is state-generated revenue while the remaining from Federal Government grants. ***Tax revenue***, largely from direct taxes, is estimated at RM4.3 billion or 20.4% of consolidated revenue (2015: RM3.8 billion; 17.6%). Of this, direct taxes is expected to increase 18.8% to RM2.5 billion (2015: 6.2%; RM2.1 billion) primarily contributed by land-based taxes. ***Non-tax revenue*** is expected to register RM11.3 billion, accounting for 53.4% of consolidated revenue (2015: RM13.1 billion; 60.5%), mainly from investment income and royalties from petroleum. Meanwhile, ***non-revenue receipts***, consisting mainly grants from the Federal Government is estimated at RM5.5 billion or 26.2% of consolidated revenue (2015: RM4.7 billion; 21.8%).

State-generated revenue is expected to record RM15 billion (2015: RM15.8 billion), of which royalties from petroleum, land premiums and investment income, are the major contributors, accounting for 51.3% or RM7.7 billion. Sarawak, Sabah, Selangor and Johor are estimated to account for 80.9% of the state-generated revenue.

TABLE 4.8

Public Sector Debt
2014 – 2015

	RM million		% Share		% of GDP	
	2014	2015	2014	2015	2014	2015
Federal Government	**582,828**	**630,540**	***74.1***	***72.5***	***52.7***	***54.5***
Domestic	566,052	609,063	*72.0*	*70.0*	*51.2*	*52.6*
Offshore	16,776	21,477	*2.1*	*2.5*	*1.5*	*1.9*
Statutory bodies	**38,546**	**39,972**	***4.9***	***4.6***	***3.5***	***3.5***
Domestic	38,546	39,972	*4.9*	*4.6*	*3.5*	*3.5*
of which: Guaranteed	38,546	39,972	*4.9*	*4.6*	*3.5*	*3.5*
Offshore	-	-	-	-	-	-
Non-financial public corporations	**165,041**	**199,470**	**21.0**	**22.9**	**14.9**	**17.2**
Domestic	112,592	123,455	*14.3*	*14.2*	*10.2*	*10.7*
of which: Guaranteed	112,592	123,455	*14.3*	*14.2*	*10.2*	*10.7*
Offshore	52,449	76,015	*6.7*	*8.7*	*4.7*	*6.5*
of which: Guaranteed	3,813	3,665	*0.5*	*0.4*	*0.3*	*0.3*
Total	**786,415**	**869,982**	**100.0**	**100.0**	**71.1**	**75.2**

Note: Total may not add up due to rounding.

[6] Measures the principal and interest repayment of the loan to gross exports of goods and services.

[7] In this compilation exercise, the statistic covers all debt owed domestically and offshore by Federal Government, statutory bodies and NFPCs (29 major and others). For statutory bodies and NFPCs, domestic debt is confined to guaranteed debt, while external debt covers both guaranteed and non-guaranteed debt.

[8] Consists of the Federal Government, state governments, local authorities and statutory bodies.

TABLE 4.9

Consolidated State Governments' Financial Position 2015 – 2016

	RM million		% Change	
	2015	**2016[1]**	**2015**	**2016[1]**
Revenue	21,676	21,114	*-10.7*	*-2.6*
Operating expenditure	10,619	11,340	*1.0*	*6.8*
Current balance	**11,057**	**9,774**	***-19.6***	***-11.6***
Gross development expenditure	8,367	10,510	*3.2*	*25.6*
Development Fund	8,213	10,297	*3.5*	*25.4*
Water Supply Fund	154	213	*-11.0*	*38.3*
Less: Loan recovery	273	156	*-3.5*	*-42.9*
Net development expenditure	8,094	10,354	*3.4*	*27.9*
Overall balance	**2,963**	**-580**		
% of GDP	***0.26***	***-0.05***		

[1] Estimate.

Note: Total may not add up due to rounding.

Total consolidated expenditure of state governments is expected to be higher by 15.1% to RM21.8 billion (2015: 2%; RM19 billion). This is mainly due to significant increase in DE by 25.6% to RM10.5 billion (2015: 3.2%; RM8.4 billion), in line with efforts to enhance public housing, agricultural and rural development as well as energy and public amenities. OE is expected to increase 6.8% to RM11.3 billion (2015: 1%; RM10.6 billion).

Overall, the state governments' consolidated financial position in 2016 is expected to record a current account surplus of RM9.8 billion. However, after taking into account higher DE, the state governments' overall balance is estimated to register a small deficit of RM0.6 billion or 0.05% of GDP.

General Government

The consolidated financial position of the **general government** is expected to register a higher current account surplus of RM17.5 billion in 2016 (2015: RM15.9 billion) due to greater decline in OE as compared with that of revenue. The DE of the general government is expected to rise to RM54.7 billion (2015: RM48.9 billion) largely due to higher Federal Government DE. Thus, the consolidated financial position of the general government is estimated to record an overall deficit of RM37.2 billion (3% of GDP) in 2016.

Non-Financial Public Corporations

Higher investment activity

The consolidated current account balance of **NFPCs** in 2016 is expected to improve by 73.8% to RM56.6 billion (2015: -48%; RM32.6 billion) as the growth in revenue (9.9%) is higher than current expenditure (4%). The increase in revenue is largely contributed by PETRONAS on account of expected higher trading volume of petroleum products and the effect of US dollar exchange rate against the ringgit.

The consolidated overall balance of NFPCs is expected to improve with a smaller deficit of RM50.5 billion (2015: RM56.8 billion). Capital expenditure by NFPCs is estimated to grow 19.7% to RM107.1 billion (2015: -22.2%; RM89.4 billion) mainly to finance major ongoing projects such as the Refinery and Petrochemical Integrated Development (RAPID) in Pengerang, hydroelectric plant in Ulu Jelai, Jimah East Power plant in Port Dickson, Mass Rapid Transit Line 1 Sungai Buloh – Kajang (MRT Line 1 SBK) and extension of Light Rail Transit (LRT) for Ampang and Kelana Jaya lines.

TABLE 4.11

Consolidated NFPCs[1] Financial Position 2015 – 2016

	RM million		% Change	
	2015	**2016[2]**	**2015**	**2016[2]**
Revenue	387,948	426,220	*-17.3*	*9.9*
Current expenditure	355,367	369,608	*-12.6*	*4.0*
Current balance	**32,581**	**56,612**	***-48.0***	***73.8***
Capital expenditure	89,433	107,084	*-22.2*	*19.7*
Overall balance	**-56,852**	**-50,472**	***8.8***	***-11.2***
% of GDP	***-4.9***	***-4.1***		

[1] Refers to 29 major NFPCs.
[2] Estimate.

Note: Total may not add up due to rounding.

TABLE 4.10

Consolidated General Government Financial Position 2015 – 2017

	RM million			% Change		
	2015	**2016[1]**	**2017[2]**	**2015**	**2016[1]**	**2017[2]**
Revenue	257,268	250,509	256,980	*-1.7*	*-2.6*	*2.6*
Operating expenditure	241,343	232,961	241,261	*-0.1*	*-3.5*	*3.6*
Current balance	**15,925**	**17,548**	**15,719**	***-21.2***	***10.2***	***-10.4***
Development expenditure	48,912	54,759	56,006	*-1.6*	*12.0*	*2.3*
Overall balance	**-32,987**	**-37,211**	**-40,287**	***-11.8***	***12.8***	***8.3***
% of GDP	***-2.9***	***-3.0***	***-3.0***			

[1] Revised estimate.
[2] Budget estimate, excluding 2017 Budget measures.

Note: Total may not add up due to rounding.

TABLE 4.12

Consolidated Public Sector Financial Position 2015 – 2017

	RM million			% Change		
	2015	2016[1]	2017[2]	2015	2016[1]	2017[2]
Revenue	211,989	222,242	231,355	*4.9*	*4.8*	*4.1*
Operating expenditure	241,075	232,685	241,088	*-0.1*	*-3.5*	*3.6*
NFPCs current balance	77,392	84,395	85,518	*-36.5*	*9.0*	*1.3*
Public sector current balance	**48,305**	**73,952**	**75,785**	***-41.6***	***53.1***	***2.5***
Development expenditure	138,597	161,671	160,087	*-15.7*	*16.6*	*-1.0*
General government	49,164	54,587	55,866	*-0.8*	*11.0*	*2.3*
NFPCs	89,433	107,084	104,221	*-22.2*	*19.7*	*-2.7*
Overall balance	**-90,292**	**-87,719**	**-84,302**	***10.4***	***-2.8***	***-3.9***
% of GDP	***-7.8***	***-7.1***	***-6.4***			

[1] Revised estimate.
[2] Budget estimate, excluding 2017 Budget measures.
Note: Total may not add up due to rounding.

Consolidated Public Sector

The financial position of the consolidated public sector, which consists of general government and NFPCs, is expected to record a higher current surplus of RM73.9 billion (2015: RM48.3 billion). The increase of 53.1% is mainly due to higher projection of NFPCs' revenue. The consolidated DE of the public sector is anticipated to increase 16.6% to RM161.7 billion (2015: -15.7%; RM138.6 billion) mainly due to higher expenditure of NFPCs and the general government to RM107.1 billion and RM54.6 billion, respectively (2015: RM89.4 billion; RM49.2 billion). Hence, the overall deficit of the consolidated public sector, after netting off all transfers and net lending is estimated at RM87.7 billion (7.1% of GDP) in 2016.

Prospects

Financial Position in 2017

The Government will continue to consolidate its fiscal position in 2017 while promoting economic growth and implementing rakyat-centric programmes and projects. Public sector reforms will be accelerated to further strengthen fiscal management and improve public service delivery. With the measures in place, fiscal deficit is projected at RM40.3 billion or 3% of GDP in 2017 (2016: RM38.7 billion; 3.1%).

The Federal Government revenue collection in 2017 is expected to grow 3.4% to RM219.7 billion due to higher collection of tax revenue, largely from CITA. The non-oil related revenue continue to be the major contributor to total revenue with a share of 86.2%, attributed mainly to higher GST collection of RM40 billion.

The Federal Government expenditure is expected to increase 3.4% to RM260.8 billion (2016: -2.2%; RM252.1 billion), with 82.4% allocated for OE and the remaining for DE. Emoluments, the largest component of **OE**, will be allocated RM77.4 billion (2016: RM73.9 billion). Charged expenditure, which includes debt service charges, retirement charges and transfers to state governments, will amount to RM58.7 billion, while supplies and services is expected at RM32 billion. Subsidies and social assistance will continue to be provided with an allocation of RM22.4 billion (2016: RM25 billion).

A total of RM46 billion will be allocated for **DE** in 2017. The bulk of DE will be provided to the economic sector (56.2%), followed by the social sector (26.5%), security (11.5%) and general administration (5.8%) sectors. The allocation for the ***economic sector*** will be utilised mainly for upgrading physical infrastructure such as improving roads and public transport system to enhance access and connectivity. In addition, funds will also be allocated to enhance telecommunication and energy infrastructure, particularly in rural areas.

A sum of RM12.2 billion will be allocated to the ***social sector*** to provide better quality of life for the rakyat. Of this, RM5.9 billion is set aside for the education and training subsector which aims at building a progressive and inclusive society. Another RM1.5 billion is allocated to improve health facilities and services for the rakyat while RM0.9 billion is allocated for the housing subsector.

The ***security sector***, which comprises defence and internal security, will be provided RM5.3 billion to enhance the capability and capacity of the armed forces and police through the construction and upgrading of facilities and equipment. For the ***general administration sector***, RM2.7 billion will be allocated for upgrading of government facilities and ICT system nationwide.