SECTION 4

Debt Management

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Overview

Global government debt reached an unprecedented level, nearing 100% to world gross domestic product (GDP) in 2020 and is projected to remain elevated in 2021 and 2022. Meantime, global economic recovery is progressing, albeit slower than anticipated, due to a high degree of uncertainty resulting from the resurgence of COVID-19 cases with the emergence of new variants. Governments continue to provide fiscal support to accelerate economic recovery with fiscal injections estimated at USD16.9 trillion.[1] Therefore, the supply of government securities in the market is projected to remain high as governments resort to borrowing to fund stimulus measures. Nevertheless, monetary policy easing to address financial market volatility, global economic conditions and inflationary pressures led to a low-interest-rate environment, benefiting governments with lower financing costs.

In line with global trends, the Government unveiled another four assistance and stimulus packages. In addition, the resumption of the strict containment measures beginning May 2021 amid rising COVID-19 cases has led to the downward revision of growth projections which is expected to impact the fiscal deficit. Consequently, to provide fiscal flexibility and enable a smooth implementation of the additional packages, the Dewan Rakyat has approved the increase of statutory debt ceiling from 60% to 65% to GDP under the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830]. Nonetheless, the steady progress of the National COVID-19 Immunisation Programme (PICK), as an integral part of the National Recovery Plan (NRP), is expected to accelerate the resumption of economic and social activities and catalyse the recovery.

Financing

In 2021, the Government announced four additional assistance and stimulus packages, namely Perlindungan Ekonomi dan Rakyat Malaysia (PERMAI), Strategic Programme to Empower the People and Economy (PEMERKASA), Strategic Programme to Empower the People and Economy Plus (PEMERKASA+) and National People's Well-Being and Economic Recovery Package (PEMULIH), totalling RM225 billion with a fiscal implication of RM25 billion. The packages aim to provide assistance to the rakyat and businesses to cushion the impact of the COVID-19 pandemic, which was exacerbated by the emergence of new and more infectious variants, resulting in the prolonged Movement Control Orders (MCO). Thus, the Government reviewed its annual borrowing requirements for the year, taking into account the increase in Federal Government spending and reduced revenue collection. Consequently, the initial fiscal deficit target of 5.4% to GDP has been revised upward to 6.5% to accommodate the additional financing requirement following the announcement of the packages.

The Federal Government's **total gross borrowings** are expected to record RM210.8 billion or 13.9% to GDP in 2021, with RM110.4 billion to be utilised for principal repayments while RM98.8 billion for deficit financing. Principal repayments consist of maturing Malaysian Government Securities (MGS)

[1] IMF October 2021 Fiscal Monitor.

at RM38.7 billion, Malaysian Government Investment Issues (MGII) at RM29 billion, treasury bills at RM33 billion, Government Housing Sukuk (SPK) at RM6 billion and offshore borrowings at RM3.7 billion.

Gross domestic borrowings are estimated to reach RM205.5 billion or 97.5% of total gross borrowings. Given sufficient liquidity in the domestic market, the Government has been able to fund its additional borrowing requirements across various tenures. The issuance of MGS is expected to remain substantial at RM83 billion or 39.4% of total gross borrowings, while MGII at RM77 billion or 36.5%. In addition, treasury bills issuance is estimated to be higher at RM45.5 billion or 21.6% of total gross borrowings to address short-term cash flow needs.

TABLE 4.1. *Federal Government Financing 2020 – 2021*

	RM MILLION		SHARE (%)	
	2020	2021[2]	2020	2021[2]
Gross borrowings	**181,067**	**210,777**	***100.0***	***100.0***
Domestic	**181,067**	**205,500**	***100.0***	***97.5***
MGS	73,000	83,000	*40.3*	*39.4*
MGII	76,466	77,000	*42.2*	*36.5*
Treasury bills	31,601	45,500	*17.5*	*21.6*
Offshore	-	**5,277**	-	***2.5***
Market loans	-	5,277	-	*2.5*
Project loans	-	-	-	-
Repayments	**94,477**	**110,376**	***100.0***	***100.0***
Domestic	94,146	106,700	*99.6*	*96.7*
Offshore	331	3,676	*0.4*	*3.3*
Net borrowings	**86,590**	**100,401**	-	-
Domestic	86,921	98,800	-	-
Offshore	-331	1,601	-	-
Change in assets[1]	**1,054**	**-1,624**	-	-
Total deficit financing	**87,644**	**98,777**	-	-

[1] (+) indicates a drawdown of assets; (-) indicates accumulation of assets
[2] Estimate
Source: Ministry of Finance, Malaysia

The issuance profile was adjusted with the increase in issuances of short- and medium-term instruments. The composition of short-term papers (less than a year) and medium-term papers (3 to 7 years) is anticipated to be higher at 58.2% of total gross domestic borrowings, while issuances of long-term papers (exceeding 10 years) are expected to be lower at 41.8%. In general, higher issuances of short-term papers lower the overall funding costs and average time to maturity while increase refinancing risk.

The Government financing operations are mostly conducted through open market auctions, constituting 84.7% of total domestic issuances in view of the market's ability to absorb the additional supply. In 2021, the Government increased the re-opening of the benchmark papers, accounting for 94.6% of 37 issuances compared to 88% of 34 issuances in 2020, to ensure a well-distributed supply throughout the year. A higher re-opening will lead to larger outstanding issuance sizes and facilitate investors' index-tracking activities in accessing the domestic debt market, thus further improve the secondary market trading liquidity. Accordingly, the Government has taken a proactive approach in effectively communicating to the market with regard to additional funding needs and revisions to financing strategies. The Federal Government remains committed to its debt management objective of minimising funding costs while maintaining a well-spread debt maturity profile.

The Government received a total bid of RM186 billion for market issuances of RM87 billion during the first eight months of 2021, reflecting a stable demand for government securities. The bid-to-cover (BTC) ratio at 2.14 times indicates the Government's ability to manage surging borrowing needs without undermining the functioning of the domestic bond market despite the challenging economic environment. However, the BTC ratio was lower than the corresponding period in 2020 at 2.27 times. The demand for short- and medium-term papers was slightly lower at the BTC ratio of 1.89 times compared to long-term papers at 2.42 times. Investor preferences and market trends mainly influenced the BTC ratio, with investors' demand for shorter tenure securities hampered by the likelihood of the US interest rate normalisation in June 2021. On the other hand, institutional investors, namely insurance companies and pension funds favour long-term issuances to match the maturity profile of their liabilities.

Several initiatives were implemented in ensuring an orderly domestic financial market. As at end-September 2021, the Monetary Policy Committee (MPC) of Bank Negara Malaysia (BNM) maintained the Overnight Policy Rate (OPR) at 1.75%. BNM also announced the extension of temporary flexibility for banking institutions to use MGS and MGII to meet the Statutory Reserve Requirement (SRR) until the end-December 2022 to ensure sufficient liquidity in supporting financial intermediation activity. The SRR ratio remains unchanged at 2.00% and this measure has released approximately RM46 billion worth of liquidity into the banking system. In addition, ongoing initiatives by BNM to enhance the domestic Government bond market has resulted in Malaysia being removed from the FTSE Russell Watch List and retained on the World Government Bond Index.

Despite the increase in the supply of government securities, the cost of borrowing remained low, buoyed by the low-interest-rate environment due to policy easing. However, the outcome of the 2020 US Elections has influenced the dynamics of US Treasury (UST) yields, where the yields rose in tandem with the improvement of the US economy, following the easing of lockdowns and faster-than-expected vaccination rollout. The spillover effect from the rise in UST yields has influenced the performance of MGS yields, with the benchmark coupon rates of 3-, 5- and 10-year MGS increased to 2.34%, 2.68% and 3.20%, respectively as at end-August 2021. Nevertheless, the Government's strategy to re-open papers with lower coupon rates has resulted in a noticeable decline in the Government's weighted average borrowing costs from 4.18% in 2017 to 3.70% as at end-August 2021.

The domestic bond market recorded 14 months of continuous net foreign inflows since April 2020. However, the trend reversed beginning July 2021 due to lower foreign holdings of short-dated securities, particularly the Malaysian Treasury Bills (MTB). This followed the expectation of the US policy rate normalisation as well as increased domestic risk factors following escalating daily COVID-19 cases, the extension of MCO and political uncertainties. Despite the challenging environment, total net foreign inflows in the first eight months of 2021 reached RM28.4 billion, with foreign demand for MGS registering a net inflow of RM14.4 billion. The positive fund flows also demonstrated investors' confidence in the Government's ongoing effort to expedite the vaccination rate through PICK, an integral part of the NRP.

Malaysia remained the leader in the global sukuk market with a commendable market share of 40.9% of the global sukuk outstanding as at end-June 2021.[2] The issuance of MGII is expected to account for 36.5% of total gross borrowings, while MITB at 14.2%. Since the beginning of 2021, spreads between the 3- and 5-year Government's bond and sukuk yields have been narrowing, with yields on MGII declining at a faster pace compared to its MGS equivalent. As at end-August 2021, the 5-year yields on MGII were 4 basis points lower than the corresponding MGS yields of similar maturity. In addition, the majority of the bidding interest was skewed towards MGII, which recorded a BTC ratio of 2.34 times compared to MGS at 1.96 times. The oversubscribed issuances reflected strong demand for Shariah-compliant government papers, supported by the enabling environment in the domestic market.

Gross offshore borrowings as at end-August 2021 amounted to RM5.3 billion due to issuances of the dual-tranche sukuk of USD1.3 billion on 28 April 2021. The sukuk issuance with a maturity period of 10-year and 30-year was much anticipated by investors as Malaysia has a successful track record in issuing innovative Shariah-compliant products. The 10-year tranche being the world's first sovereign USD Sustainability Sukuk was priced at 2.070%, while the 30-year tranche was 3.075%. The sukuk structure is unique as its underlying assets are 100% non-physical, comprising travel vouchers of clean energy public transport, which is fully aligned with the concept of sustainability. The issuance further reinforced Malaysia's position as a leading Islamic financial hub in the global market.

[2] RAM Sukuk Snapshot 2Q2021.

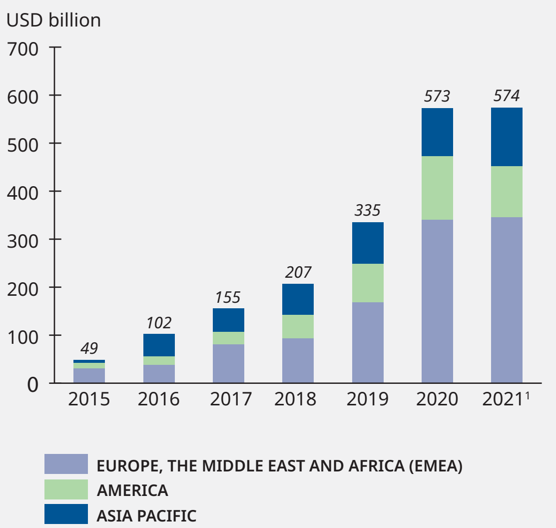
FEATURE ARTICLE

Government of Malaysia's 2021 Global Sukuk

Background

The prolonged COVID-19 crisis and the ensuing fiscal response by countries worldwide have resulted in a huge increase in the sovereign borrowing requirements. Since the beginning of the pandemic in January 2020, a total of USD16.9 trillion in fiscal injections for economic recovery plans has been collectively announced by countries. The heightened focus on COVID-19 response efforts has motivated policymakers and investors to seek different financing strategies as reflected in the recent momentum in environmental, social and governance (ESG) initiative. Furthermore, the 2030 Agenda for Sustainable Development (2030 Agenda), which was established on 25 September 2015, sets a new global framework for sustainable development financing by aligning the policies and flow of funds with economic, social and environmental priorities. Accordingly, the global Green, Social, Sustainability and Sustainability-linked (GSSS) bonds reached USD574 billion in the first half of 2021, more than entire issuances in 2020 (Figure 1).

FIGURE 1. *GSSS Global Bond Issuances*



[1] End-June 2021
Source: Bloomberg

Malaysia's venture into sustainable finance commenced in 2014 with the formulation of the Sustainable and Responsible Investing (SRI) Sukuk Framework by the Securities Commission Malaysia. The Framework has paved the way for the alignment of sustainable finance and investment to the values and principles of Islamic finance. In addition, the Sustainable Development Goals (SDG) have been localised and integrated within the national development planning framework since the Government's formal adoption of the 2030 Agenda, as reflected in the alignment to key strategic thrusts of the Eleventh Malaysia Plan (11MP), 2016-2020. To boost the implementation of its sustainable finance plan, the Government has also announced measures to support the development of sustainable finance ecosystem in the 2021 Budget.

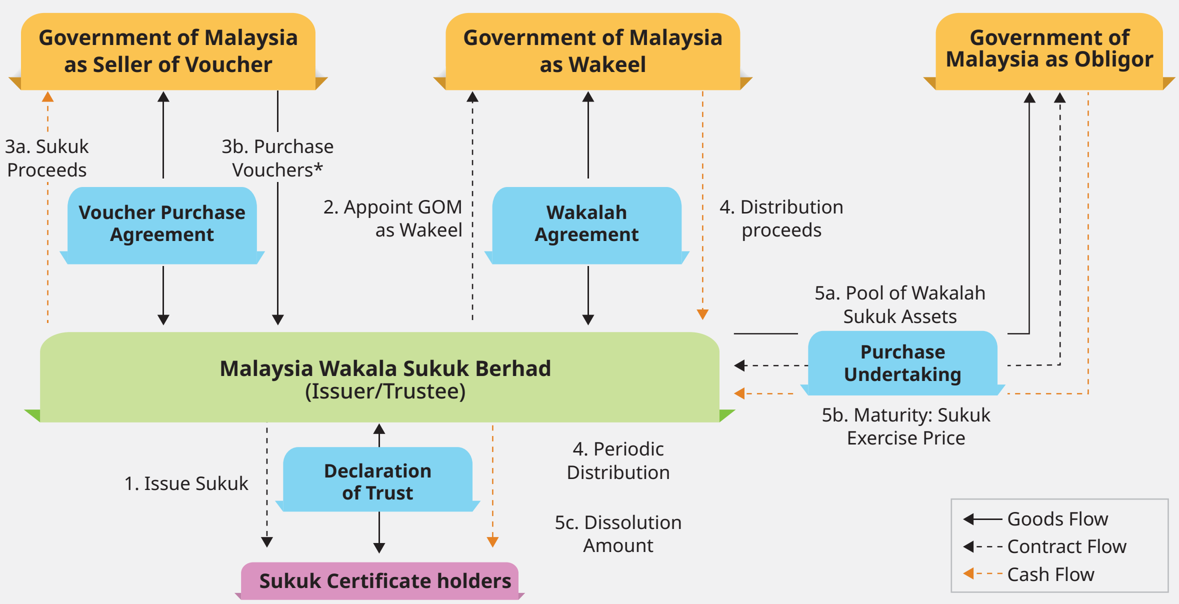
Malaysia's 2021 Global Sukuk Issuance

After a series of successful issuances of USD-denominated sukuk since 2002, the Government once again tapped into the global market with the issuance of a dual-tranche USD1.3 billion sukuk on 28 April 2021. The first tranche of a 10-year, USD800 million issuance records a new milestone as the world's first sovereign USD-denominated sustainability sukuk, signifying Government's latest commitment towards advancing sustainable development. At the same time, the Government also issued a 30-year tranche of USD500 million sukuk. The transaction also set a new benchmark as the lowest priced global USD sukuk by the Government of Malaysia.

The Sukuk Structure and Transaction Flow

The sukuk was structured under the Shariah principle of *Wakalah.* The underlying assets are unique and in line with the spirit of the sustainability tranche, being 100% non-physical assets, namely vouchers representing travel entitlement on Malaysia's Light Rail Transit (LRT), Mass Rapid Transit (MRT) and KL Monorail networks. These modes of clean transportation are fully aligned with the SDG 9 Goal of Industry, Innovation and Infrastructure as well as SDG 11 Goal of Sustainable Cities and Communities. Thus, the transaction also set a new record as the first sovereign issuance with such assets in a sukuk structure, demonstrating Malaysia's global leadership in Islamic finance and reinforcing the country's position as the world's largest sukuk market. The sukuk structure and transaction flows are shown in Figure 2.

FIGURE 2. *Sukuk Structure and Transaction Flow*



Step	Description
1	Malaysia Wakala Sukuk Berhad (MWSB), a special purpose vehicle (SPV), issued Trust Certificates to sukuk certificate holders in consideration for the proceeds.
2	The Government was appointed as an agent of the certificate-holders (*Wakeel*) to act as the Issuer's agent in providing certain services in relation to the Wakalah sukuk assets, subject to terms and conditions of the Wakalah Agreement.
3	a) On the issuance date, SPV as the Trustee, would utilise 100% of the proceeds to buy vouchers of travel entitlement on public transport (Vouchers[1]) b) In return, the Government will supply the Vouchers to MWSB as the Trustee, which will then declare a trust over the Vouchers for and on behalf of the certificate holders.
4	The returns from the sale of vouchers will be paid by the Trustee to the certificate-holders on each periodic distribution date.
5	a) Upon maturity or redemption date, the Government as an Obligor will purchase the Wakalah sukuk assets from the Trustee at the exercise price on the scheduled maturity date of the Trust Certificates. b) and c) The funds received from the exercise price will be used to redeem the sukuk from the certificate-holders

[1] The Government has irrevocable rights to substitutes the Vouchers with new vouchers and/or replacement assets, provided that such assets are Shariah-compliant tangible assets as approved by Shariah Adviser at the time of substitution

Source: Ministry of Finance, Malaysia

The sukuk transaction involved legal documents based on Malaysian and English Law. The main legal documents binding the transaction are as shown in Figure 3.

FIGURE 3. *Main Transaction Agreement*

Declaration of Trust
Sets the Delegate's terms of appointment. The Issuer declares themselve as Trustee of the Trust Assets, including the Wakalah assets purchased with the sukuk proceeds for and on behalf of the certificate-holders.

Voucher Purchase Agreement
Specifies transaction of Vouchers (representing an entitlement to a specified number of travel units) between the Trustee and the Issuer.

Wakalah Agreement
Defines the appointment and duties of GOM as Wakeel to act as the Issuer's agent in respect of the underlying assets for the sukuk.

Purchase Undertaking
Prescribes GOM's purchase of trust assets from the Trustee as stipulated in the transaction agreement.

Substitution Undertaking
Defines the undertaking pledged by the Trustee to transfer the trust assets to GOM for the purpose of new assets substitution that comply the eligibility requirements.

Source: Ministry of Finance, Malaysia

Government of Malaysia's SDG Sukuk Framework

Since national development plan has always been geared towards economic, social and environmental agenda, the formulation of the Government of Malaysia SDG Sukuk Framework[1] is aligned with its five-year national development plans, which utilises the government development budget. The SDGs alignment process is realised through an expenditure mapping exercise involving the coordination of the action plans, initiatives and outcomes of national development plans to the SDGs' goals, targets and indicators.

The Sustainability Sukuk is issued based on the newly established Framework. The Framework was formulated based on four key components, namely use of proceeds; project evaluations and selections; management of proceeds; and reporting (Figure 4). It also outlines the criteria for Eligible Social and Green Expenditure to be made with the Sukuk proceeds (Figure 5).

[1] More information on the Government of Malaysia SDG Sukuk Framework and the Second Party Opinion can be found at www.mof.gov.my/en/economy/sustainability

FIGURE 4. *Key Components of the Framework*

Use of Proceeds

Proceeds from this issuance are used by the Government **to finance Shariah compliant general purposes**, which has eligible social and green focus as defined in the Framework and also for the purpose as described under the External Loans Act 1963 [Act 403] and Development Funds Act 1966 [Act 406].

Project Evaluations and Selections

The evaluations and selection process ensures that **proceeds from any GOM SDG Sukuk are linked to Eligible Expenditures**, as set forth in the Framework.

Management of Proceeds

The proceeds of each GOM SDG Sukuk issued will be **managed in accordance with Act 406** and can be used both for the **financing and refinancing of Eligible Expenditures**, where the utilisation will be tracked as stipulated in the Framework.

Reporting

The Government will prepare the **SDG Sukuk Report** annually for each SDG Sukuk issued, from the beginning of the transaction until maturity of the SDG sukuk.

Source: Ministry of Finance, Malaysia.

FIGURE 5. *Eligible Social and Green Expenditures*

ELIGIBLE SOCIAL EXPENDITURES

Healthcare
GOOD HEALTH AND WELL-BEING 3

- Construction or upgrading of health facilities
- Providing mobile healthcare or flying doctor services
- Providing pandemic-related support programmes and projects

Education and Training
QUALITY EDUCATION 4

- Construction or upgrading schools, universities and higher learning institutions
- Providing professional development and training
- Providing upskilling and reskilling training
- Awarding grants and scholarships

Basic Infrastructure

- Construction of affordable housing
- Providing access to water and electricity supply
- Widening broadband infrastructure
- Construction or upgrading basic social amenities

NO POVERTY 1 · CLEAN WATER AND SANITATION 6 · SUSTAINABLE CITIES AND COMMUNITIES 11

Support for SMEs

- Providing loans or other financial support for SMEs
- Providing funding and/or training to support export competitiveness

DECENT WORK AND ECONOMIC GROWTH 8

ELIGIBLE GREEN EXPENDITURES

Clean Transportation
SUSTAINABLE CITIES AND COMMUNITIES 11

- Developing clean public transportation system
- Procurement of electric or hydrogen-powered vehicles for public transportation
- R&D and manufacturing of electric vehicles and associated infrastructure

Sustainable Management of Natural Resources
LIFE ON LAND 15

- Conservation of habitat and biodiversity through sustainable management
- Implementation of sustainable agriculture techniques and production

Renewable Energy

- Development, manufacturing, installation and operation of solar and mini hydro projects
- Building solar energy projects

AFFORDABLE AND CLEAN ENERGY 7

Green Buildings

- Construction of government buildings or facilities that met the criteria of a recognised green building certification

INDUSTRY, INNOVATION AND INFRASTRUCTURE 9 · SUSTAINABLE CITIES AND COMMUNITIES 11

Source: Ministry of Finance, Malaysia

The Framework received a Second Party Opinion from Sustainalytics, which opined that the Framework is credible and impactful as well as aligned with the country's current development plan. Sustainalytics also considers the proceeds are expected to facilitate the country's transition to a low-carbon economy and lead to positive social impacts in Malaysia. The Framework was also declared as being aligned with the four core components of the Green Bond Principles 2018, the ASEAN Sustainability Bond Standards 2018 and Social Bond Principles 2020.

The Government will update the Framework regularly, taking into account latest developments in the upcoming Malaysia development plans particularly in relation to additional achievable SDG goals and development projects which meets international standards.

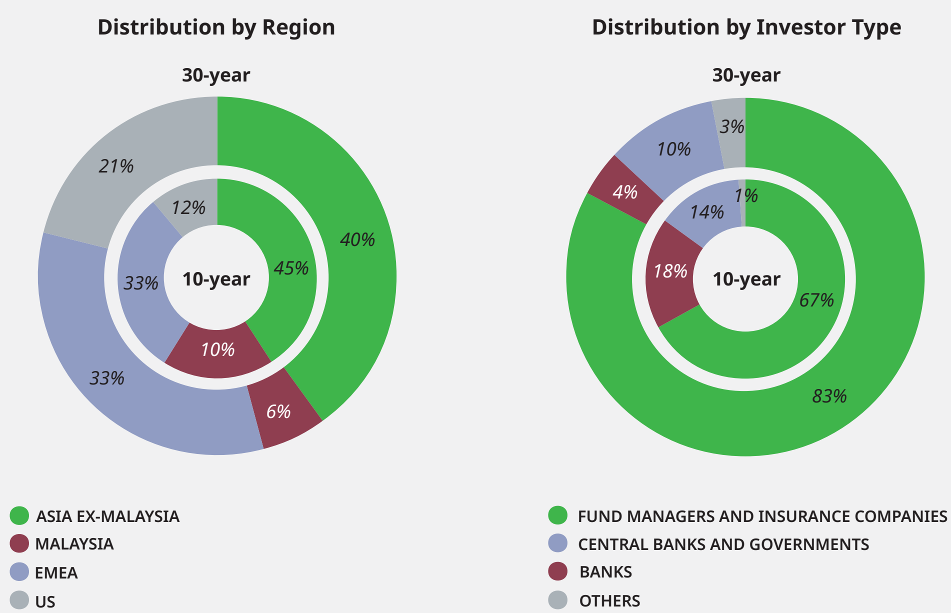
Sukuk Transaction

A two-day virtual roadshow was held prior to the issuance covering Asia, the Middle East, Europe and the US. The issuance received an overwhelming response, attracting orders from over 220 global and domestic investors. This reflected investors' confidence in Malaysia's strong economic fundamentals despite a challenging economic environment due to the COVID-19 pandemic. The strong demand also resulted in the lowest ever yield and spread for a USD sukuk issuance by Malaysia, with both the 10-year and 30-year tranches priced at 2.070% and 3.075%, respectively.

Investors' Distribution and Profile

Following the immense response from investors during the roadshow, the sukuk offerings were oversubscribed by 6.4 times. The final allocation was well-distributed globally, with almost 90% of the 10-year Sustainability Sukuk allocated to investors in Asia, the Middle East and Europe, particularly Singapore, Hong Kong, the United Arab Emirates and the UK. In terms of investors' profiles, fund managers and insurance companies were the largest investors at 67%, followed by banks (18%) as well as central banks and governments (14%).

FIGURE 6. *Investors' Profile*



Source: Ministry of Finance, Malaysia

In addition, a total of 46% of the 30-year sukuk was distributed to investors in Asia, followed by Europe, the Middle East and Africa (33%) and the US (21%). Fund managers and insurance companies also dominated the subscription of the 30-year tranche at 83%, followed by central banks and governments (10%) and banks (4%), as shown in Figure 6.

Conclusion

Since the successful global sukuk issuance in 2016, Malaysia re-entered the market with the Government's sixth USD-denominated sukuk issuance. Despite the COVID-19 pandemic impacting the global economy, the Government's resilient credit profile has resulted in the lowest yield and spread to the US Treasury. The issuance of the world's first sovereign USD Sustainability Sukuk demonstrates the Government's unwavering commitment to building a sound financing system to support the national sustainable development agenda. The issuance has further reinforced Malaysia's position as a leading international Islamic financial hub in the global market.

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Federal Government Debt

The issuances and management of the Federal Government debt are governed under several legislations according to the types of instruments. Conventional domestic securities, namely MGS and MTB are issued under the Loan (Local) Act 1959 [Act 637] and Treasury Bills (Local) Act 1946 [Act 188], respectively, while the Government Funding Act 1983 [Act 275] regulates Islamic instruments issuance, namely MGII and MITB. In addition, the External Loans Act 1963 [Act 403] governs the issuance of offshore borrowings. These legislations also stipulate the usage of proceeds and the limits on the amount of outstanding debts for each instrument.

As at end-June 2021, the overall Federal Government debt stood at RM958.4 billion or 63.3% to GDP. In terms of statutory debt limits, accumulated domestic debts of MGS, MGII and MITB constituted 58.8% to GDP, below the 65% threshold governed under Act 830. Meanwhile, the MTB has reached the RM10 billion ceiling as provided for under Act 188. Offshore borrowings at RM33.6 billion is still within the permissible amount of RM35 billion under Act 403.

The Federal Government debt is mainly denominated in ringgit, constituting 96.5% of the total, while the remaining 3.5% is in foreign currency. Domestic debt stood at RM924.8 billion, comprising mainly MGS (51.4%) and MGII (42.3%), with maturities ranging between 3 to 30 years. In contrast, treasury bills, comprising MTB (RM10 billion) and MITB (RM24 billion), are short-dated instruments with 3-, 6-, 9- or 12-month maturity totalling RM34 billion. In addition, the outstanding balance of the SPK, which was issued by the Government before the establishment of the Public Sector Home Financing Board (LPPSA), reduced further to RM24.1 billion and will be fully redeemed by 2024.

Offshore borrowings, comprising market and project loans mainly denominated in US dollar (63%) and yen (36.5%), increased to RM33.6 billion as at end-June 2021 due to the USD global sukuk issuance. Market loans, consisting of global sukuk and Samurai bond, stood at RM28.7 billion, while projects loans totalled RM4.9 billion, mainly for financing existing programmes and projects for universities, sewerage plants and water transfer infrastructure under bilateral and multilateral arrangements.

TABLE 4.2. *Debt Legislative Guidelines*

ACT	STATUTORY LIMIT	END-JUNE 2021
Loan (Local) Act 1959 **Government Funding Act 1983** **Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020**	Outstanding MGS, MGII and MITB not exceeding 65% to GDP	**58.8% to GDP (RM890.7 billion)**
External Loans Act 1963	Offshore borrowings not exceeding RM35 billion	**RM33.6 billion**
Treasury Bills (Local) Act 1946	MTB not exceeding RM10 billion	**RM10 billion**

Source: Ministry of Finance, Malaysia

TABLE 4.3. *Federal Government Debt by Instrument 2020 – 2021*

COMPONENT	RM MILLLION		SHARE (%)		SHARE TO GDP (%)	
	2020	2021[2]	2020	2021[2]	2020	2021[2]
Domestic debt	**851,284**	**924,784**	***96.8***	***96.5***	***60.1***	***61.1***
MGS	436,418	475,418	*49.6*	*49.6*	*30.8*	*31.4*
MGII[1]	375,266	391,266	*42.7*	*40.8*	*26.5*	*25.8*
SPK	24,100	24,100	*2.7*	*2.5*	*1.7*	*1.6*
Treasury bills	15,500	34,000	*1.8*	*3.6*	*1.1*	*2.3*
Offshore borrowings	**28,276**	**33,604**	***3.2***	***3.5***	***2.0***	***2.2***
Market loans	23,055	28,703	*2.6*	*3.0*	*1.6*	*1.9*
Project loans	5,221	4,901	*0.6*	*0.5*	*0.4*	*0.3*
Total	**879,560**	**958,388**	***100.0***	***100.0***	***62.1***	***63.3***
Memorandum item: Non-resident holdings of ringgit-denominated debt securities	208,190	233,826	*24.5*	*25.3*	*14.7*	*15.4*

[1] Including Sukuk Prihatin
[2] End-June 2021
Source: Ministry of Finance, Malaysia

For 2021, the debt service charges (DSC) to revenue ratio is estimated to increase to 17.6% (2020: 15.3%) due to the anticipated reduction in revenue collection as most of the economic sectors was not allowed to operate during the MCO. The financing costs for domestic debt instruments is expected to reach RM38.1 billion, while the balance of RM0.9 billion is for foreign-currency loans. The weighted average interest rate for outstanding domestic debt is estimated to be lower at 3.957% (2020: 4.032%), reflecting the low-interest-rate environment, despite higher reopenings for current year issuances.

In terms of debt maturity profile, the weighted average time to maturity shortened to 8.1 years as at end-June 2021 (2020: 8.6 years). The share of medium- and long-term papers with a remaining maturity of 6 years and above decreased to 52.1% (end-2020: 56.6%), while the share of securities with a remaining maturity of 5 years and below increased to 47.9% (end-2020: 43.4%). This is in line with the Government debt management strategy to balance the market demand with immediate financing needs.

As at end-June 2021, the share of resident holdings to total debt slightly decreased to 72.6%. Resident holdings amounted to RM696.1 billion, mainly consisting of large and long-term institutional investors, such as Employees Provident Fund (24.1%), insurance companies (4.6%) and Retirement Fund (Incorporated) (2.9%). Other resident holders include banking institutions (33.6%), development financial institutions (1.9%) and others (5.5%).

Non-resident holdings remained stable at RM262.3 billion, accounting for 27.4% of total debt. Long term institutions, such as pension funds, insurance companies as well as central bank, supranational and sovereigns, held a sizeable share of 13.6%, while fund managers accounted for 9.4%. The balance was contributed by banking institutions with 3.6% holdings and other non-residents (0.8%). Furthermore, non-resident investment in MGS was sustained at 40.4% of the total MGS outstanding (end-2020: 40.6%), reflecting renewed investors' confidence and interest in Government bonds.

TABLE 4.4. *Federal Government Debt by Holder 2020 – 2021*

COMPONENT	RM MILLION		SHARE (%)		SHARE TO GDP (%)	
	2020	2021[3]	2020	2021[3]	2020	2021[3]
Resident	**647,697**	**696,067**	***73.6***	***72.6***	***45.7***	***46.0***
Employees Provident Fund	219,828	230,894	*25.0*	*24.1*	*15.5*	*15.3*
Retirement Fund (Incorporated)	25,027	27,598	*2.8*	*2.9*	*1.8*	*1.8*
Insurance companies	40,987	44,057	*4.7*	*4.6*	*2.9*	*2.9*
Banking institutions	288,475	322,499	*32.8*	*33.6*	*20.3*	*21.3*
Development financial institutions	16,670	17,817	*1.9*	*1.9*	*1.2*	*1.2*
Others[1]	56,710	53,202	*6.4*	*5.5*	*4.0*	*3.5*
Non-resident	**231,863**	**262,321**	***26.4***	***27.4***	***16.4***	***17.3***
Fund manager	77,553	90,237	*8.8*	*9.4*	*5.5*	*6.0*
Central bank, supranational and sovereigns	70,877	81,654	*8.1*	*8.5*	*5.0*	*5.4*
Banking institutions	32,684	33,993	*3.7*	*3.6*	*2.3*	*2.2*
Pension funds	35,913	41,106	*4.1*	*4.3*	*2.5*	*2.7*
Insurance companies	7,712	7,646	*0.9*	*0.8*	*0.6*	*0.5*
Others[2]	7,124	7,685	*0.8*	*0.8*	*0.5*	*0.5*
Total	**879,560**	**958,388**	***100.0***	***100.0***	***62.1***	***63.3***

[1] Includes other non-bank financial institutions, statutory bodies, nominees and trustee companies, co-operatives, securities placed by institutional investors at the central bank and unclassified items
[2] Include nominees/custodians, individuals, non-financial corporations, multilateral and bilateral institutions as well as unidentified sectors
[3] End-June 2021
Source: Ministry of Finance, Malaysia

FEATURE ARTICLE

Malaysia's Debt Sustainability Analysis 2021

Introduction

The COVID-19 pandemic has severely affected the global economy and led countries to implement expansionary fiscal measures, particularly providing support to households, businesses and health services. With limited fiscal space, most countries have resorted to raising additional borrowings to cater for additional expenditure to save lives and livelihood, businesses and the economy. Thus, assessing debt sustainability is imperative to ensure medium and long-term fiscal robustness in weathering the impact of external economic shocks.

Debt sustainability for a country can be defined as a situation in which a sovereign is expected to be able to continue servicing its current and future payment obligations without exceptional financial assistance or going into default. In general, Debt Sustainability Analysis (DSA) framework, developed by the International Monetary Fund (IMF), aims to:

a) Assess the current debt situation, its maturity structure, whether it has fixed or floating rates, whether it is indexed, and by whom it is held;

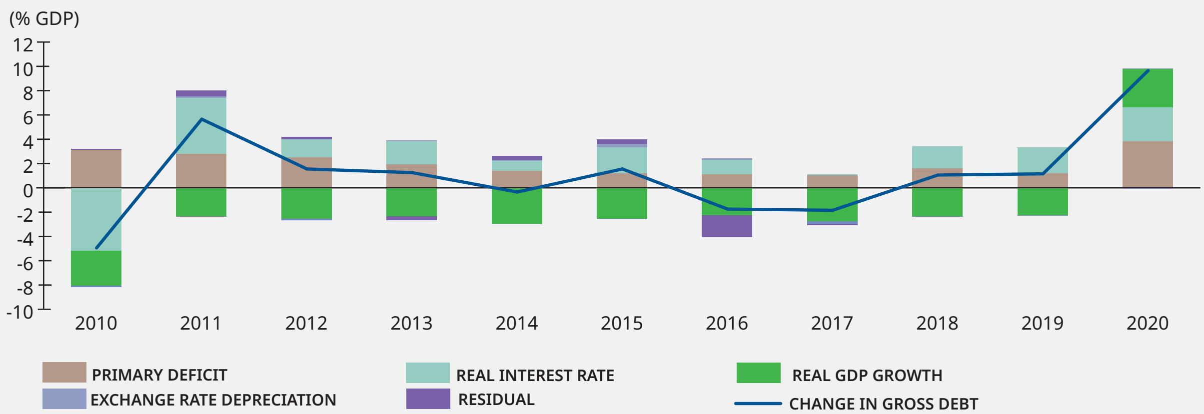
b) Identify vulnerabilities in the debt structure or the policy framework far enough in advance so that policy corrections can be introduced before payment difficulties arise; and

c) In cases where such difficulties have emerged or are about to emerge, examine the impact of alternative debt-stabilising policy paths.

Based on this framework, the debt burden threshold for emerging markets is benchmarked at a debt-to-GDP ratio of 70% and gross financing needs-to-GDP ratio of 15%.

In the last decade, the two main factors contributing to debt creation are primary deficit and real interest rate. Meanwhile, real GDP growth has led to a lower fiscal deficit and subsequently lowered the debt ratio, indicating an inverse correlation between the debt-to-GDP ratio and economic growth. In contrast, for 2020, the COVID-19 pandemic has resulted in a GDP contraction, thus disrupting the fiscal consolidation path. Hence, as illustrated in Figure 1, macro-fiscal factors namely primary deficit, real GDP growth and real interest rate, contributed to the surge of debt-to-GDP ratio in 2020.

FIGURE 1. *Debt-Creating Flows*



Source: Ministry of Finance, Malaysia and IMF

Scenario Analyses

In the baseline scenario, the gross financing needs are estimated at 13.8% to GDP in 2021 and are expected to reduce to 7.1% by 2026. Consequently, the overall debt-to-GDP ratio[1] is estimated at around 65% in 2021 and projected to stabilise to around 64% by 2026. These projections are still below the DSA's debt and gross financing needs benchmark of 70% and 15% to GDP, respectively. This scenario is based on the following macro-fiscal assumptions:

[1] For the purpose of this DSA, debt coverage only refers to Federal Government debt

MACRO-FISCAL VARIABLES	AVERAGE (2021-2026)
Real GDP growth (% per annum)	5.1%
Inflation (% per annum)	2.1%
Primary Balance (% to GDP)	-2.1%
Effective Interest Rate (%)	4.3%

In addition to the baseline scenario, the DSA also simulates alternative scenarios to estimate debt ratio and gross financing requirements on the following assumptions:

i. Constant Primary Balance Scenario

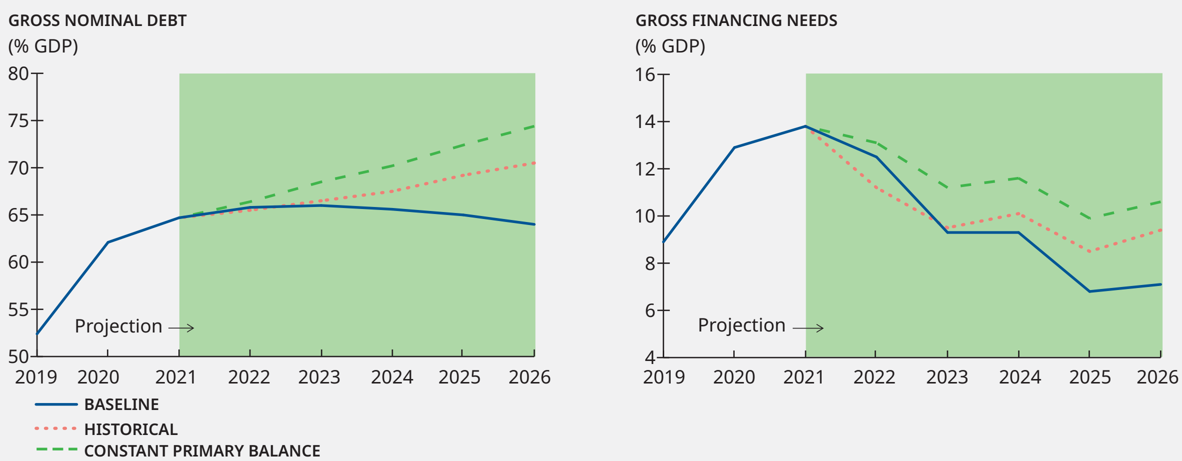
This scenario assumes the primary balance remains constant with no fiscal consolidation over the medium term. With this assumption, the debt level is projected to reach 74.4% to GDP by 2026, exceeding the DSA's debt benchmark of 70%. The gross financing requirements will also increase to 13.8% to GDP in 2021 and estimated to reduce to 10.6% by 2026.

ii. Historical Scenario

Under this scenario, it is assumed that the historical trend of the macro-fiscal variables will be maintained over the projection years. The debt-to-GDP ratio is forecasted to slightly exceed the DSA's debt benchmark at 70.7% by 2026, while gross financing needs are projected to decline to around 9% to GDP by 2026. This indicates that assuming the previous fiscal consolidation effort is replicated, the Government may require a longer time frame to reduce its debt-to-GDP ratio.

All the scenarios are featured graphically, as shown in Figure 2 below:

FIGURE 2. *Baseline and Alternative Scenarios*



Source: Ministry of Finance, Malaysia and IMF

Sensitivity Analyses

Stress tests are conducted to simulate the impact of macro-fiscal shocks on Malaysia's debt sustainability. Furthermore, additional stress tests are applied by simulating combined macro-fiscal shock as well as contingent liabilities shock. The outcome of the analysis highlights the Government's level of indebtedness in the event of any shocks, thus guiding the formulation of mitigation measures before such shocks arise.

i. Primary Balance Shock Scenario

Assuming the primary deficit is higher at 3.6% and 2.7% to GDP in 2022 and 2023, the debt-to-GDP ratio is projected to peak at 66.7% in 2023 and gradually reduce to 65.6% by 2026. Gross financing needs will decline to 7.4% by 2026. Both indicators remain below the DSA benchmark.

ii. Real GDP Growth Shock Scenario

Assuming real GDP growth slows down to 2.5% and 1.9% in 2022 and 2023, the debt level is estimated to peak at 73.6% to GDP by 2023 and will remain elevated at 71.1% in 2026, exceeding the DSA's debt benchmark of 70%. Gross financing needs will reach 13.6% to GDP in 2022 and gradually decline to 7.8% by 2026.

iii. Real Interest Rate Shock Scenario

Assuming effective interest rate increases by an average of 110 basis points annually from 2023 until 2026, the debt-to-GDP ratio will exceed the DSA benchmark by 2025 at 70.2%. Moreover, the gross financing needs are higher than other shock scenarios in 2024 to 2026, ranging between 9% and 11% to GDP.

iv. Exchange Rate Shock Scenario

Assuming the exchange rate spiked by 30% from the baseline assumption in 2022, the debt ratio is projected to average at 61.7% to GDP throughout the projection years. Gross financing requirements will continue to decline from 11.8% to GDP in 2022 to 6.8% by 2026. The shock scenario has the least impact on the debt parameter compared to other shock scenarios due to the low composition of foreign-denominated instruments.

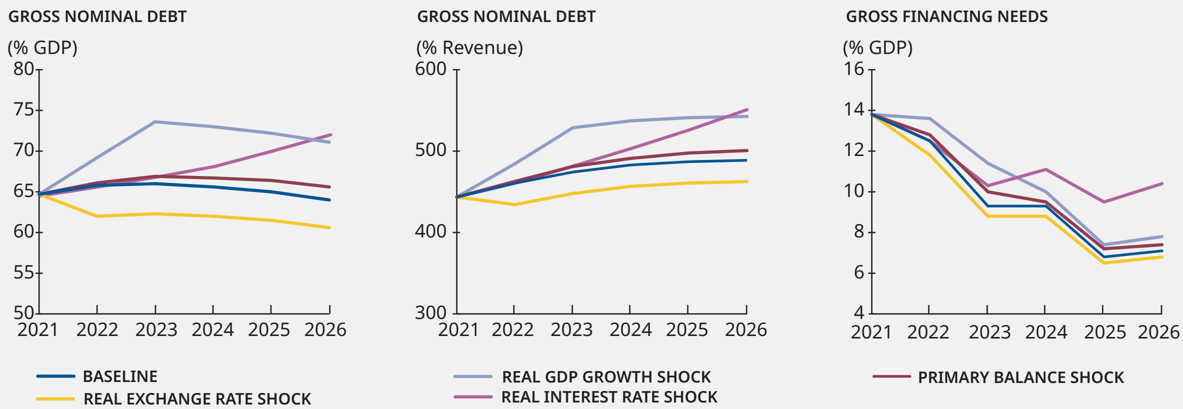
v. Combined Macro-Fiscal Shock Scenario

Assuming all the macro-fiscal shocks occur simultaneously in 2022, the debt is projected to increase to 75.3% to GDP in 2023 and subsequently surge to 81.5% by 2026, significantly surpassing the DSA benchmark. Gross financing needs are expected to remain high at around 12% to GDP throughout the projection period.

vi. Contingent Liability Shock Scenario

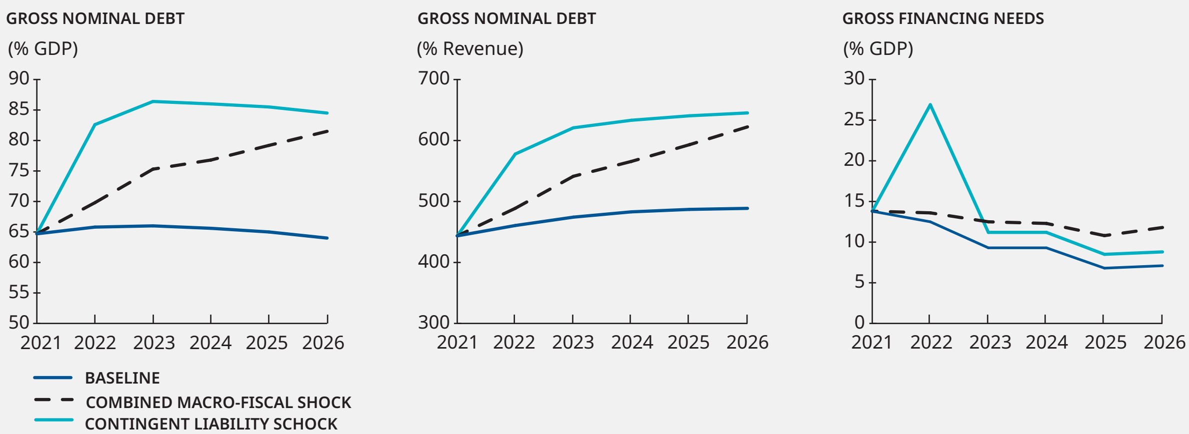
Assuming the Federal Government is obliged to provide an additional allocation of around 13% to GDP in 2022 due to the materialisation of contingent liability, the debt ratio will immediately accelerate to 82.6% to GDP with gross financing requirement also escalating to 26.9% to GDP during the same year. The debt level remain elevated during the projection period, far exceeding the DSA benchmark, representing the worst case of all shock scenarios.

FIGURE 3. *Macro-Fiscal Stress Tests*



Source: Ministry of Finance, Malaysia and IMF

FIGURE 4. *Additional Stress Tests*



Source: Minisrty of Finance, Malaysia and IMF

Risk Assessment

A heat map provides signals on the impact of external shocks to debt burden indicators under the baseline and shock-imputed scenarios. In addition, it also summarises the outcome of DSA on debt and gross financing requirements, as well as risk assessment on the debt profile. The risk assessment thresholds for each indicator are as follows:

FIGURE 5. *Heat Map*

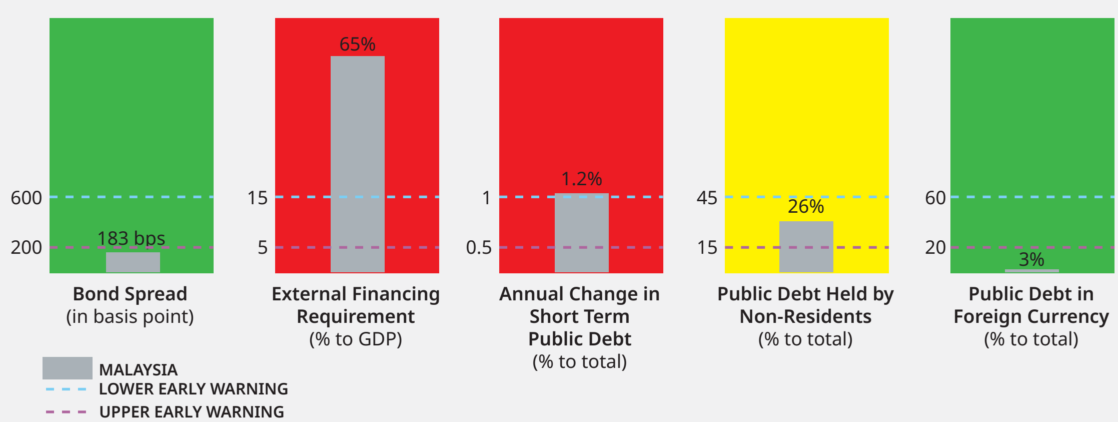
Debt level	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Real Exchange Rate Shock	Contingent Liability Shock
Gross financing needs	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Real Exchange Rate Shock	Contingent Liability Shock
Debt profile	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

HEAT MAP	DEBT LEVEL	GROSS FINANCING NEEDS	DEBT PROFILE
Low Risk	If the debt level does not exceed 70% to GDP under baseline or specific shock scenarios	If the gross financing needs do not exceed 15% to GDP under baseline or specific shock scenarios	If the country's parameter value is less than the lower risk-assessment benchmarks
Moderate Risk	If the debt level exceeds 70% to GDP under the specific shock scenario but not baseline	If the gross financing needs exceed 15% to GDP under the specific shock scenario but not baseline	If the country's parameter value is in between the lower and upper risk-assessment benchmarks
High Risk	If the debt level exceeds 70% to GDP under the baseline scenario	If the gross financing needs exceed 15% to GDP under the baseline scenario	If the country's parameter value exceeds the upper risk-assessment benchmarks

Source: Ministry of Finance, Malaysia and IMF

As illustrated in the heat map, primary balance and real exchange rate shocks pose low-risk exposure to Federal Government debt and gross financing needs. However, real GDP growth and real interest rate shocks result in moderate risk exposure to the debt level, while contingent liability shock presents a moderate risk to debt level and gross financing needs. In terms of debt profile vulnerabilities, it is based on lower and upper risk-assessment benchmarks for each debt profile parameter, as demonstrated in Figure 6.

FIGURE 6. *Debt Profile Vulnerabilities*



Source: Ministry of Finance, Malaysia and IMF

Based on the assessment, the annual change in short-term debt is susceptible to high risk due to the increased proportion of short-term debt in 2020 compared to the historical average. Similarly, the external financing requirement also carries a high-risk exposure to Malaysia's debt profile. Nevertheless, the availability of ample external assets which can be utilised to meet these obligations will mitigate this risk.

In terms of market perception, Malaysia is assessed as low risk due to its lower-than-benchmarked average long-term bond spread over US bonds, indicating sustained investor confidence in Malaysia's debt instrument. In addition, its debt in foreign currency also poses a low risk given its minimal composition of foreign-denominated debt, at about 3% to GDP. Nevertheless, the debt held by non-residents imposes a moderate risk, albeit mitigated by the presence of a deep and liquid domestic debt market.

Overall, the DSA simulation demonstrates increased debt vulnerabilities to the Government in the event of any shocks, thus limiting the fiscal space and the ability to raise additional borrowing for counter-cyclical responses. Furthermore, the higher debt level will lead to higher debt service charges, thus restraining the Government's capacity to allocate for other expenditures. In this regard, the Government remains committed to fiscal consolidation in the medium term as outline in the 12th Malaysia Plan with a deficit target of 3.5% to GDP by 2025.

Conclusion

The DSA assessment has taken into account the impact of the COVID-19 crisis in the macro-fiscal parameters for 2020. The outcome of this simulation highlights the increased risk exposure of the Government's indebtedness in the medium term in the event of materialisation of external shocks. Nevertheless, the Government's immediate priority is to return the nation to its potential growth trajectory while allowing society and businesses to adapt to new norms and invest for future growth to provide new job opportunities. The continuous provision of fiscal support in the medium term is projected to lead to a more gradual pace of fiscal consolidation, resulting in a moderate decline in the debt-to-GDP ratio, as illustrated in the baseline scenario. However, the planned fiscal reforms, anchored by the introduction of the Fiscal Responsibility Act, adoption of Medium-Term Revenue Strategy and expenditure reviews, will accelerate the resumption of fiscal consolidation post-crisis. These initiatives will build sufficient fiscal buffers in ensuring the country's fiscal and debt sustainability in the medium and long term.

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External Debt

External debt comprises the nation's offshore borrowing, non-resident holdings of ringgit-denominated debt securities, non-resident deposits and other external debt. As at end-June 2021, the external debt increased to RM1,021 billion or 67.4% to GDP, mainly attributed to higher offshore borrowings from the public sector as well as non-resident holdings of ringgit-denominated debt securities. Offshore borrowings remained the largest component of external debt at RM589.5 billion, with a share of 57.8%. The higher public sector offshore borrowings were due to the issuance of the global sukuk by the Federal Government and foreign currency bonds and sukuk by public corporations. Meanwhile, non-resident holdings of ringgit-denominated debt securities and deposits collectively accounted for RM338.4 billion, with a higher share of 33.2% of the total.

In terms of maturity profile, the medium- to long-term external debt stood at 62.2% of the total, reflecting low refinancing risk. Short-term external debt accounted for 37.8%, backed by an adequate level of international reserves. Furthermore, the external risk is also mitigated by sizeable external assets and export earnings.

TABLE 4.5. *External Debt*
2020 – 2021

COMPONENT	RM MILLION		SHARE (%)		SHARE TO GDP (%)	
	2020	2021[3]	2020	2021[3]	2020	2021[3]
Offshore borrowings	**559,560**	**589,479**	***58.4***	***57.8***	***39.5***	***38.9***
Medium-and long-term debt	360,997	382,627	*37.7*	*37.5*	*25.5*	*25.3*
Public sector	143,934	164,736	*15.0*	*16.2*	*10.2*	*10.9*
Federal Government	23,672	28,415	*2.5*	*2.8*	*1.7*	*1.9*
Public corporations	120,262	136,321	*12.5*	*13.4*	*8.5*	*9.0*
Private sector	217,063	217,890	*22.7*	*21.3*	*15.3*	*14.4*
Short-term debt	198,563	206,853	*20.7*	*20.3*	*14.0*	*13.6*
Non-resident holdings of ringgit-denominated debt securities	**220,103**	**244,828**	***23.0***	***24.0***	***15.5***	***16.2***
Medium-and long-term debt	210,811	233,045	*22.0*	*22.8*	*14.9*	*15.4*
Federal Government	200,060	220,612	*20.9*	*21.6*	*14.1*	*14.6*
Others[1]	10,751	12,434	*1.1*	*1.2*	*0.8*	*0.8*
Short-term debt	9,292	11,782	*1.0*	*1.2*	*0.6*	*0.8*
Non-resident deposits	**94,497**	**93,542**	***9.8***	***9.1***	***6.7***	***6.2***
Others[2]	**83,983**	**92,816**	***8.8***	***9.1***	***5.9***	***6.1***
Total	**958,144**	**1,020,665**	***100.0***	***100.0***	***67.6***	***67.4***

[1] Include private sector and public corporations
[2] Comprise trade credits, IMF allocation of Special Drawing Rights and miscellaneous
[3] End-June 2021
Note: Total may not add up due to rounding
Source: Bank Negara Malaysia

Public Sector Debt

Public sector debt comprises outstanding debt obligations of the Federal Government, state governments, non-financial public corporations (NFPCs), and sovereign-guaranteed debts of statutory bodies. As at end-June 2021, public sector debt increased to RM1,355 billion or 89.5% to GDP, mainly contributed by higher Federal Government debt resulting from borrowings to finance deficit and COVID-19 assistance and stimulus packages announced during the year. The Federal Government debt remains the largest component with a share of 70.7% of the total, followed by NFPCs (22.9%) and statutory bodies guaranteed debts (6.4%).

The net increase in NFPCs debt to RM309.9 billion was attributed to the loan drawdown for ongoing infrastructure projects as well as issuances of bonds abroad by public corporations. In addition, the statutory bodies' debt increased to RM86.7 billion due to additional guaranteed loans raised by the Federal Land Development Authority (FELDA) and LPPSA for their investment and refinancing purposes.

TABLE 4.6. *Public Sector Debt 2020 – 2021*

COMPONENT	RM MILLION		SHARE (%)		SHARE TO GDP (%)	
	2020	2021[1]	2020	2021[1]	2020	2021[1]
Federal Government	**879,560**	**958,388**	***70.1***	***70.7***	***62.1***	***63.3***
Domestic	851,284	924,784	*67.8*	*68.2*	*60.1*	*61.1*
Offshore	28,276	33,604	*2.3*	*2.5*	*2.0*	*2.2*
Statutory bodies	**80,660**	**86,735**	***6.4***	***6.4***	***5.7***	***5.7***
Domestic	80,660	86,735	*6.4*	*6.4*	*5.7*	*5.7*
of which: Guaranteed	80,660	86,735	*6.4*	*6.4*	*5.7*	*5.7*
Offshore	-	-	-	-	-	-
Non-financial public corporations	**294,875**	**309,948**	***23.5***	***22.9***	***20.8***	***20.5***
Domestic	181,809	180,440	*14.5*	*13.3*	*12.8*	*11.9*
of which: Guaranteed	181,809	180,440	*14.5*	*13.3*	*12.8*	*11.9*
Offshore	113,066	129,508	*9.0*	*9.6*	*8.0*	*8.6*
of which: Guaranteed	25,106	26,510	*2.0*	*2.0*	*1.8*	*1.8*
Total	**1,255,095**	**1,355,071**	***100.0***	***100.0***	***88.6***	***89.5***

[1] End-June 2021
Source: Ministry of Finance, Malaysia

Outlook for 2022

The Government will continue its expansionary fiscal policy in the 2022 Budget to ensure the rakyat's well-being, protecting businesses continuity and revitalising the economy. In addition, the Twelfth Malaysia Plan (12MP), 2021 – 2025, with a development expenditure ceiling of RM400 billion, is expected to increase Federal Government borrowings. As such, gross financing requirements, including additional allocation for the COVID-19 Fund, are expected to remain sizeable at around 12% to GDP.

Given the sufficient liquidity, the Government's borrowing strategy will continue to prioritise domestic market issuance to balance the financing costs with acceptable risk exposure over the medium term. The composition of conventional and Shariah-compliant instruments will be distributed over a range of maturities to ensure a well-spread maturity spectrum in view of market demand. Furthermore, the accommodative monetary policy, availability of a deep domestic market and the diversity of investor base will further support the Government's funding needs.

The COVID-19 pandemic has elevated the Federal Government's debt level due to the provision of additional assistance and stimulus packages. Thus, the Federal Government overall debt is projected to reach 66% to GDP, while its statutory debt at 63.4% by the end of 2022, lower than the new debt threshold of 65% to GDP as approved by the Parliament. In this regard, the Government remains committed to adhering to the statutory debt limit stipulated in the respective Acts. Moving forward, the degree of fiscal consolidation will be contingent on the pace of economic recovery. Subsequently, the Government aims to gradually reduce its level of indebtedness and strengthen debt affordability.

Conclusion

The Federal Government has demonstrated a credible track record in consolidating its debt level post-crisis, aided by pragmatic fiscal policy and strong execution of national development plans. As the country relies on expansionary measures to ensure a durable and sustainable recovery, it is crucial for the Government to optimise the utilisation of resources to bolster the economy while cognisant of its medium-term fiscal sustainability. Thus, the gradual reopening of economic sectors will facilitate the transition towards the new norm, which will further boost growth and ease the need for further fiscal support. Debt management policy will continue to uphold the principles of accountability and transparency while ensuring debt sustainability in the medium term.

FIGURE 4.1. *Issuance by Maturity*

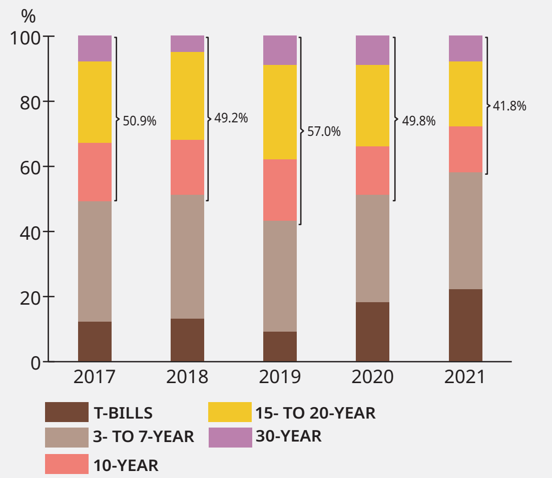


FIGURE 4.2. *BTC Ratios of MGS and MGII*

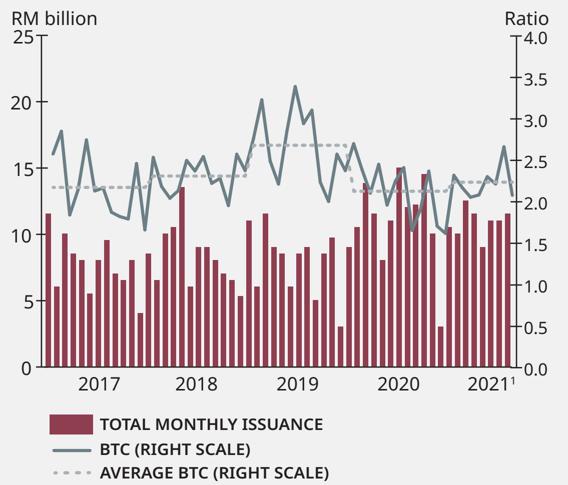


FIGURE 4.3. *MGS Benchmark Yield Curve*

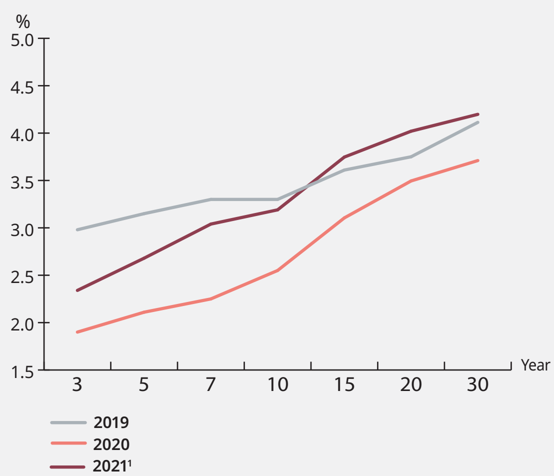
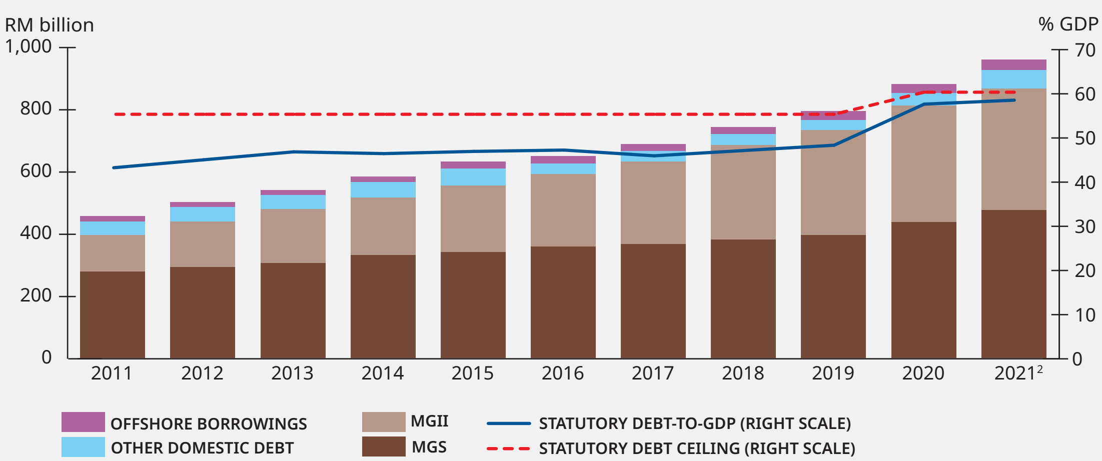


FIGURE 4.4. *MGS Indicative Yields*

FIGURE 4.5. *Federal Government Debt Composition*



[1]End-August 2021
[2]End-June 2021
Source: Ministry of Finance, Malaysia, Bank Negara Malaysia and Bloomberg

FIGURE 4.6. *Federal Government Debt by Holder*[1]

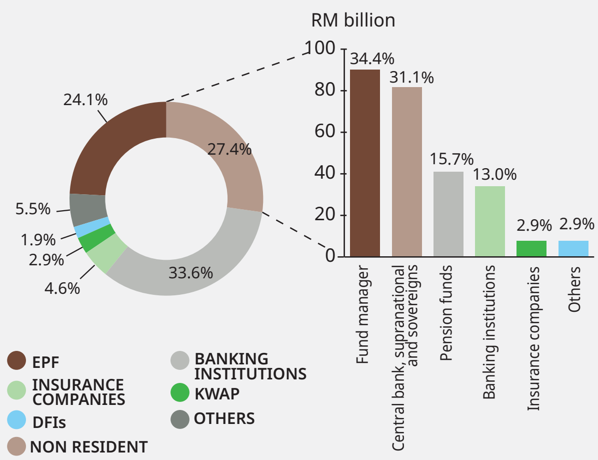


FIGURE 4.7. *Non-Resident Holdings of Ringgit-Denominated Debt Securities*

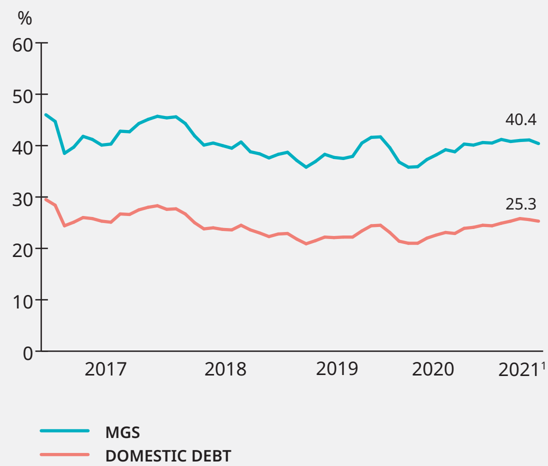


FIGURE 4.8. *Federal Government Debt by Remaining Maturity*

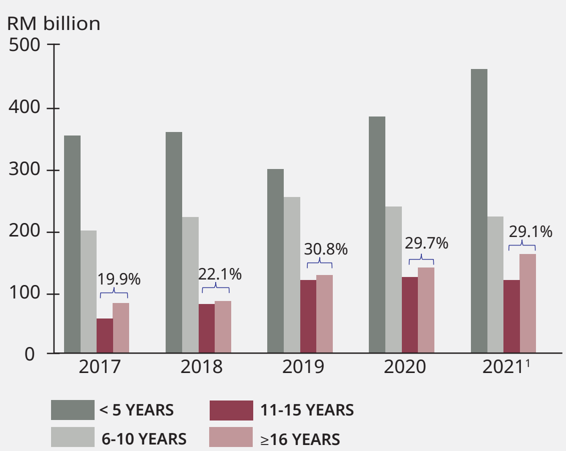


FIGURE 4.9. *Debt Service Charges*

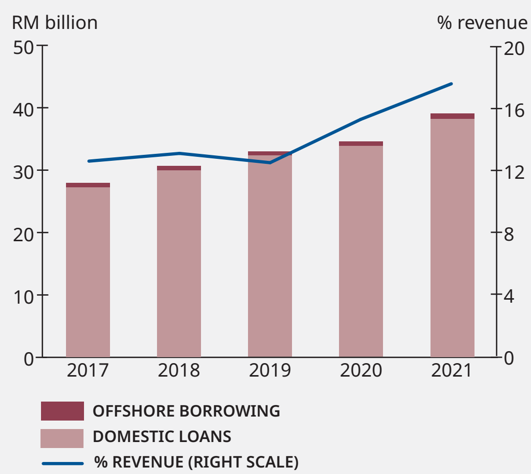
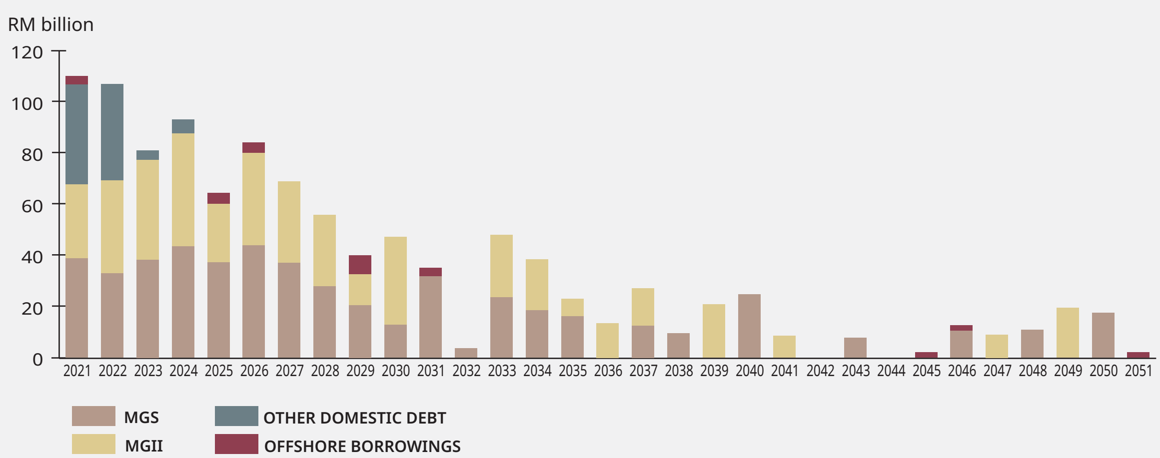


FIGURE 4.10. *Debt Maturity Profile*



[1]End-June 2021
Source: Ministry of Finance, Malaysia