SECTION 4

# Debt Management

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## Overview

During the pandemic, most governments globally have deployed stimulus packages to provide support to the economy, resulting in soaring sovereign debts to a record high for two consecutive years in 2020 and 2021. Nevertheless, the transition to endemic phase in 2022 with the reopening of country's border and resumption of economic activities has initially accelerated the global economic recovery. However, the world is facing new uncertainties particularly surrounding the Russia – Ukraine conflict that caused significant increase in commodity prices, exacerbated disruptions in supply-chain and heightened inflationary pressures. Reactions by central banks to increase policy rates have subsequently spurred rise in borrowing cost, thus hampering the growth expectation.

On the domestic front, Malaysia has entered transition towards endemic phase with strong economic performance during the first half of the year. The Government also focuses on implementation of the Twelfth Malaysia Plan, 2021 – 2025 (12MP) which act as the catalyst towards achieving a prosperous, inclusive and sustainable nation. However, as a small and open economy, Malaysia is not fully insulated from the current global developments, particularly higher commodity and food prices. Thus, the Government provides additional fiscal support to mitigate the impact of the rising prices on the rakyat. Consequently, the borrowing requirements for the year is projected to be slightly higher than budgeted as the additional revenue collection is insufficient to absorb the increase in expenditure.

Effective debt management strategies have been put in place to ensure the Government's ability to meet its financing needs, among others to raise the borrowings domestically, lengthen the tenure of issuances and introduce a new sustainability instrument. The tightening of monetary policy has not significantly impacted the Government's borrowing cost as the Overnight Policy Rate (OPR) is still below pre-pandemic level. Overall, prudent debt management will minimise the borrowing cost over the medium term while reducing risk exposure to ensure debt sustainability and affordability.

## Financing

The Federal Government's borrowing programme is guided by requirements to refinance maturing debts and finance budgeted fiscal deficit. In 2022, the total gross borrowings are projected to reach RM232 billion or 13.5% of GDP and financed entirely from domestic market. Of the total proceeds, RM132.3 billion will be utilised for principal repayments while the remaining RM99.5 billion for deficit financing. The principal repayments comprised maturing Malaysian Government Securities (MGS) of RM29.04 billion, Malaysian Government Investment Issues (MGII) (RM37 billion), treasury bills (RM57 billion), Government Housing Sukuk (SPK) (RM9 billion) and offshore borrowings (RM0.32 billion).

The availability of ample liquidity in the domestic market enabled the Government to raise its borrowings and manage the cash flow requirements via its ringgit-denominated instruments. The issuance of MGS is expected to record RM86.5 billion or 37.3% of total gross borrowings, while MGII at RM85 billion or 36.6%. The Government has also issued the inaugural Sustainability MGII on 30 September 2022 to attract new investors with specific mandates and establish a benchmark for sustainable issuance in the domestic market, signifying Malaysia's efforts in embracing climate action. In addition, the issuances of treasury bills are projected to be higher at RM60.5 billion, mainly for the purpose of cash flow management.

**TABLE 4.1.** *Federal Government Financing 2021 – 2022*

| | RM MILLION | | SHARE (%) | |
|---|---|---|---|---|
| | **2021** | **2022[3]** | **2021** | **2022[3]** |
| **Gross borrowings** | **210,140** | **232,000** | ***100.0*** | ***100.0*** |
| **Domestic** | **204,863** | **232,000** | ***97.5*** | ***100.0*** |
| MGS | 83,000 | 86,500 | *39.5* | *37.3* |
| MGII | 77,000 | 85,000 | *36.6* | *36.6* |
| Treasury bills | 44,863 | 60,500 | *21.4* | *26.1* |
| **Offshore** | **5,277** | - | ***2.5*** | ***0.0*** |
| Market loans[1] | 5,277 | - | *2.5* | *0.0* |
| Project loans | - | - | *0.0* | *0.0* |
| **Repayments** | **109,822** | **132,326** | ***100.0*** | ***100.0*** |
| Domestic | 106,279 | 132,006 | *96.8* | *99.8* |
| Offshore | 3,543 | 320 | *3.2* | *0.2* |
| **Net borrowings** | **100,318** | **99,674** | - | - |
| Domestic | 98,584 | 99,994 | - | - |
| Offshore | 1,734 | -320 | - | - |
| **Change in assets[2]** | **-1,576** | **-191** | - | - |
| **Total deficit financing** | **98,742** | **99,483** | - | - |

[1] Amount includes Sustainability Sukuk of USD800 million
[2] (+) indicates a drawdown of assets; (-) indicates accumulation of assets
[3] Estimate
Source: Ministry of Finance, Malaysia

Public auctions remain as the Government primary method of issuance constituting 86.2% of total gross borrowings, given the domestic market ability to absorb the higher supply. In 2022, the Government reopens 83.3% from 36 issuances as compared to 94.6% of 37 issuances in 2021.

The Government issues a wide range of instruments with maturities ranging from 3- to 30-year to facilitate the development of the yield curve and meet investor's demand. Short-term papers (less than a year) are estimated to account for 26.1% of total gross borrowings, while medium-term instruments (3 to 7 years) at 31.5%. The long-term issuances (10 years and above) are projected to be higher at 42.4% to match investor's risk appetite amid a positive economic growth outlook. This is also in line with the debt management objective to reduce rollover risks by lengthening the issuance tenure to establish a well-spread maturity profile.

The recovery of global economic activities has been hampered by geopolitical conflicts, which increased crude oil and commodity prices and led to inflationary pressures. The US Federal Reserve (Fed) raised its federal funds rate by 300 basis points (bps) cumulatively as at end-September 2022 in a continuous effort to curb rising inflation. The spillover of Fed rate hike towards the US Treasury yields has also influenced the dynamics of MGS yields. The total net foreign outflows of Federal Government instruments recorded RM5.2 billion during January to July 2022, while RM5.5 billion of foreign inflows were recorded in August 2022. Hence, the total net foreign inflows of RM0.3 billion were recorded for the period of January to August 2022, reflecting restored investors' confidence in Malaysia's economic performance and outlook for 2022.

Several measures were implemented by Bank Negara Malaysia (BNM) to ensure the domestic financial market remains resilient and orderly amid challenging global environment. As at end-September 2022, the Monetary Policy Committee increased the OPR by 75 bps cumulatively from 1.75% to 2.50%. As at end-August 2022, the indicative coupon rate for MGS 3-year has increased to 3.325%, the 5- and 10-year to 3.721% and 3.987%, respectively. Overall, the Government's weighted average cost of borrowing increased from 3.696% as at end-August 2021 to 4.150% in corresponding period of 2022, partly due to a higher interest rate environment as monetary policy tightens. Meanwhile, to ensure sufficient liquidity in supporting financial intermediation activity, the relaxation of Statutory Reserve Requirement (SRR) will be applicable until 31 December 2022.

During the first eight months of 2022, the Government received a total bid of RM218.3 billion for MGS and MGII market issuances of RM93 billion, representing a bid-to-cover (BTC) ratio of 2.35 times, higher than the corresponding period in 2021 at 2.14 times. In addition, the BTC for reopen papers was higher at 2.37 times compared to the new issuances' ratio at 2.25 times. The BTC ratio for medium-term papers also registered 2.31 times while long-term papers recorded 2.38 times, indicating improved investors' sentiment and confidence in Malaysia's buoyant economy.

Malaysia remains as the leader in Islamic finance with the largest sukuk market with 41.6% share of outstanding global sukuk as at end-June 2022.[1]

The issuance of MGII for 2022 is expected to register 36.6% of total Federal Government gross borrowings, while Malaysian Islamic Treasury Bills (MITB) at 21.3%. The demand for Shariah-compliant papers provides an opportunity for the Government to widen investors' base in raising fund. As at end-August 2022, spreads between the MGS and MGII yields remain unchanged particularly the 3- and 10-year at 9 bps and 2 bps, respectively. Furthermore, MGII recorded a significantly higher BTC ratio at 2.52 times compared to MGS at 2.18 times. The MGII was well-received due to attractive yield supported by enabling domestic environment amid uncertainty in the global market.

INFORMATION BOX

## 2022 Sustainability Malaysian Government Investment Issues (MGII)

### Introduction

In line with global developments, Malaysia is committed towards advancing sustainable and responsible investments, which adopts environmental, social and governance (ESG) practices and emphasises sustainability-themed issuances. Building on last year's successful issuance of sovereign USD-denominated global sustainability sukuk, the Government of Malaysia has proceeded to issue a ringgit-denominated sustainability domestic issuance in 2022.

The domestic capital market in Malaysia continues to grow significantly over the years, in particular the issuance of the Malaysian Government Investment Issues (MGII). The MGII is a Shariah-compliant debt instrument with maturities ranging from 3- to 30-year regulated under the Government Funding Act 1983. The objectives of the MGII issuance are to expand the domestic sukuk market as well as strengthen Malaysia's position as a leader in global Islamic financial hub.

As at end-2021, the share of accumulated MGII issuances to total Federal Government debt has increased to 43% from 26% in 2011, reflecting a strong growing demand for Islamic-based financial instruments. In addition, MGII accounted for 39.5% of Malaysia's sukuk market, contributing significantly to Malaysia's position as the largest sukuk market in the world with 42.4% of outstanding global sukuk and further strengthening the MGII presence in Malaysia's capital market.

### 2022 Sustainability MGII

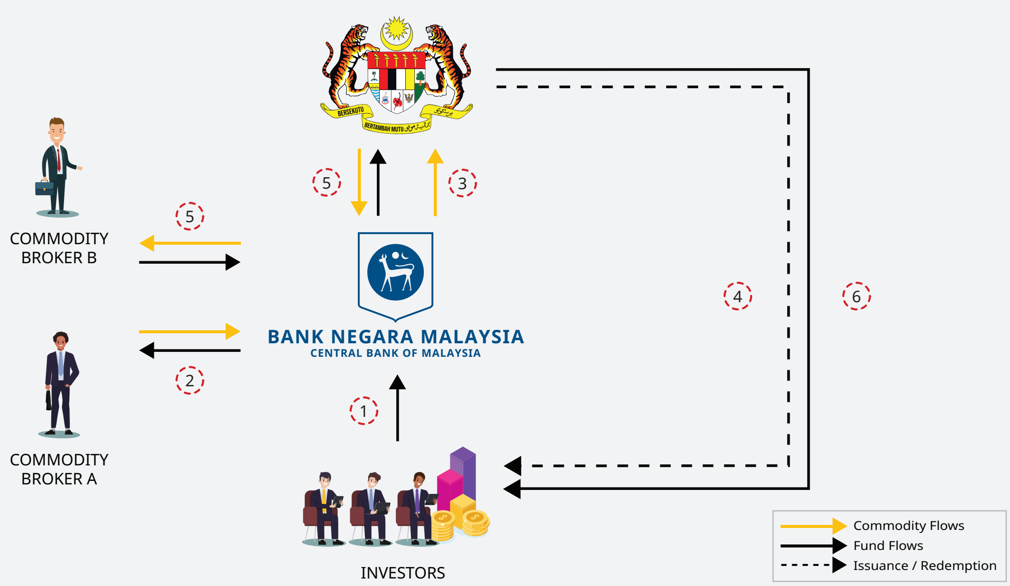
In 2021, the Government successfully tapped the global market with USD1.3 billion sukuk, of which USD800 million was the world's first sovereign USD-denominated sustainability sukuk (2021 Global Sukuk). The issuance was oversubscribed by 6.4 times following the immense response from investors. Proceeds from the issuance were fully utilised and directed towards financing the Shariah-compliant general purposes, including eligible social and green expenditures as defined in

[1] Bank Negara Malaysia

the Government of Malaysia SDG Sukuk Framework (Framework) such as building clinics, hospitals, schools and universities, providing access to rural water and electricity supply, conservation of habitat and biodiversity and developing clean public transportation system.

Upon the successful issuance of 2021 Global Sukuk, the Government continued to further strengthen Malaysia's commitment towards the 2030 Agenda for Sustainable Development by issuing, for the first time, a ringgit-denominated sustainability instrument in the domestic market. Subsequently, on 30 September 2022, the Government issued a RM4.5 billion Sustainability MGII, with a maturity period of 15.5 years. The Sustainability MGII was structured based on the Shariah principle of Commodity *Murabahah*, a cost-plus financing based on the purchase and sale of Shariah-compliant commodities. The structure and transaction flows are as shown in Figure 1.

**FIGURE 1.** *Sustainability MGII Structure and Transaction Flow*




| Step | Description |
|---|---|
| 1 | Investors will subscribe to MGII and appoint Bank Negara Malaysia (BNM) as their agent to buy the Shariah-compliant commodity. |
| 2 | BNM will purchase the Shariah-compliant commodity from the Commodity Broker A at cost price. |
| 3 | Upon completion of purchase, BNM will sell the commodity to Government at marked-up price on a deferred payment basis. Profit from sale will be paid semi-annually to investors, representing the profit rate on MGII. |
| 4 | The Government will issue MGII to investors as evidence of the indebtedness from the deferred payments. |
| 5 | Upon maturity, the Government will appoint BNM as their agent to immediately sell the commodities purchased to Commodity Broker B at cost price to raise the required funding which will then be remitted to the Government. |
| 6 | The Government will make payments for the principal and final profit to the investors when the MGII is redeemed. |

Source: Bank Negara Malaysia

The Sustainability MGII was issued based on the guidelines of the Framework, similar to the 2021 Global Sukuk. Proceeds will be used to finance or refinance eligible social expenditures such as programmes and projects related to healthcare, education and training, basic infrastructure as well as support the development of small and medium enterprises (SMEs).

Additionally, the proceeds will also be used to finance or refinance eligible green expenditures such as clean transportation, sustainable management of natural resources, renewable energy and green building projects. In this regard, more focus will be given towards providing wider coverage and a better broadband quality to support home-based learning, assist SMEs and business-to-business to recover and diversify, and improve connectivity in the country. The use of proceeds will be tracked in the SDG Sukuk Register and reported yearly after the issuance date.

Islamic and conventional investors of domestic and foreign origin may subscribe to the Sustainability MGII through Principal Dealers (PDs), Islamic PDs, other licensed onshore banks and appointed overseas offices. Primary investors to the Sustainability MGII issuance include banking institutions, the Employees Provident Fund (EPF), insurance companies and other institutions.

**Conclusion**

Leveraging the growing demand for sustainable financing and the successful landmark issuance of the USD-denominated sustainability global sukuk in 2021, the Government has successfully tapped the domestic market with an inaugural Sustainability MGII. This issuance is expected to ramp up Malaysia's effort to meet its commitments towards advancing sustainable financing and supporting the national sustainable development agenda. Furthermore, the issuance has strengthened and further affirmed Malaysia's leadership in Islamic financial hub and in pioneering new sustainability instruments. The Sustainability MGII reiterates the Government's relentless pursuit to continuously deliver new innovative products.

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## Federal Government Debt

The COVID-19 pandemic has caused governments across the globe to implement stimulus measures which led to the rise in public debt levels. The average global public debt-to-GDP ratio is estimated at 98.8% in 2021 compared to the pre-pandemic level of 83.7% in 2019.[2]

The urgency to provide unprecedented fiscal support had led countries to activate the escape clauses, while those without the escape clauses would resort to temporarily suspend, amend or introduce new fiscal rules to address the impact of the pandemic.[3]

The Federal Government enacted the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830] in 2020, which temporarily allows the Government

[2] IMF Public Debt and Real GDP: Revisiting the Impact (April, 2022).
[3] IMF Fiscal Rules and Fiscal Councils - Recent Trends and Performance during the COVID-19 Pandemic (January, 2022).

to utilise of borrowing proceeds for programmes and projects under the COVID-19 Fund. The Act which expires on 31 December 2022 also increased the statutory debt limit from 55% to 65% of GDP.[4] Consequently, the higher debt limit has accommodated additional borrowings space to finance fiscal stimulus measures, resulted in the Federal Government statutory debt to rise to 59.7% of GDP in 2021 compared to 48.6% in 2019. The outstanding debt of other instruments, namely Malaysian Treasury Bills (MTB) and offshore borrowings remained within the current stipulated limits under their respective Acts during the pandemic period.

**TABLE 4.2.** *Debt Legislative Guidelines*

| ACT | STATUTORY LIMIT | END-JUNE 2022 |
|---|---|---|
| **Loan (Local) Act 1959 [Act 637]**<br>**Government Funding Act 1983 [Act 275]**<br>**Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) (Amendment) Act 2021 [Act A1635]** | Outstanding MGS, MGII and MITB not exceeding 65% of GDP | **57.8% of GDP (RM989 billion)** |
| **External Loans Act 1963 [Act 403]** | Offshore borrowings not exceeding RM35 billion | **RM29.4 billion** |
| **Treasury Bills (Local) Act 1946 [Act 188]** | MTB not exceeding RM10 billion | **RM8.5 billion** |

Source: Ministry of Finance, Malaysia

As at end-June 2022, the Federal Government debt registered RM1,045 billion or 61.0% of GDP. All debt instruments remained within the stipulated statutory debt limit of which accumulated MGS, MGII and MITB stood at 57.8% of GDP, below the 65% threshold as governed under the amended Act 830 while the outstanding MTB reached RM8.5 billion, slightly below the RM10 billion ceiling specified under the Act 188. Correspondingly, offshore borrowings stood at RM29.4 billion, below the limit of RM35 billion under the Act 403.

The Federal Government debt is largely denominated in ringgit constituting 97.2% of the total, while the remaining 2.8% is in foreign currencies. Domestic debt stood at RM1,015.6 billion, mainly comprising medium- and long-term securities, namely MGS and MGII with maturities ranging between 3- to 30-year. These two instruments hold the largest share at 51% and 43.8% of the total domestic debt, respectively. In addition, treasury bills, namely MTB and MITB are short-dated instruments with maturities of 3-, 6-, 9- or 12-months, which amount to RM34.5 billion or 3.4% of the total domestic debt. Other domestic debt is SPK (RM18.1 billion or 1.8%) which was issued before the establishment of the Public Sector Home Financing Board (LPPSA) in 2016 to finance the civil servants housing loan and will gradually mature by 2024.

[4] The Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) (Amendment) Act 2021 [Act A1635] revised the statutory debt limit under Act 830 from 60% to 65% of GDP.

Offshore borrowings which consists of market and project loans amounting to RM29.4 billion are denominated in US dollar (64.6%), yen (35.1%) and other currencies (0.3%). Market loans with a total of RM25.4 billion comprise of global sukuk and Samurai bond, while the remaining are outstanding project loans from bilateral and multilateral agreements to finance existing programmes and projects for universities, sewerage plants and water transfer infrastructure.

**TABLE 4.3.** *Federal Government Debt by Instrument 2021 – 2022*

| COMPONENT | RM MILLLION | | SHARE (%) | | SHARE OF GDP (%) | |
|---|---|---|---|---|---|---|
| | 2021 | 2022[2] | 2021 | 2022[2] | 2021 | 2022[2] |
| **Domestic debt** | **950,084** | **1,015,605** | ***97.0*** | ***97.2*** | ***61.5*** | ***59.3*** |
| MGS | 480,718 | 518,039 | *49.1* | *49.6* | *31.1* | *30.2* |
| MGII[1] | 423,266 | 444,966 | *43.2* | *42.6* | *27.4* | *26.0* |
| SPK | 18,100 | 18,100 | *1.8* | *1.7* | *1.2* | *1.1* |
| Treasury bills | 28,000 | 34,500 | *2.9* | *3.3* | *1.8* | *2.0* |
| **Offshore borrowings** | **29,730** | **29,355** | ***3.0*** | ***2.8*** | ***1.9*** | ***1.7*** |
| Market loans | 25,147 | 25,383 | *2.5* | *2.4* | *1.6* | *1.5* |
| Project loans | 4,583 | 3,972 | *0.5* | *0.4* | *0.3* | *0.2* |
| **Total** | **979,814** | **1,044,960** | ***100.0*** | ***100.0*** | ***63.4*** | ***61.0*** |
| *Memorandum item:* Non-resident holdings of ringgit-denominated debt securities | 241,846 | 239,942 | *25.5* | *23.6* | *15.6* | *14.0* |

[1] Including Sukuk Prihatin
[2] End-June 2022
Source: Ministry of Finance, Malaysia

The debt service charges (DSC) for 2022 is estimated at RM43.1 billion or 15.1% of revenue, slightly lower compared to 2021 (16.3%). The DSC-to-revenue ratio is expected to improve due to higher revenue collection, particularly from taxes and commodity-related revenue. The financing cost for domestic issuances is estimated at RM42.3 billion while the remaining RM0.8 billion is for offshore borrowings. Despite the strengthening of US dollar, the impact to the external financing cost is minimal given the low composition of foreign currency debt. The weighted average yield for outstanding domestic debt as at end-June 2022 remained stable at 3.968% (2021: 3.960%), despite the higher global interest rate environment.

The composition of long-term instruments with remaining maturity above 10 years has slightly increased to 32.6% of the total debt as at end-June 2022 (2021: 31.2%). This is in line with the debt management strategy to minimise refinancing risk by spreading the maturity profile. Consequently, the debt maturity profile for the year is expected to remain favourable with the weighted average time to maturity is projected to stretch to 9.1 years (2021: 8.7 years).

As at end-June 2022, the share of resident and non-resident holdings registered at 74.7% and 25.3% of total Federal Government debt, respectively. Resident investors increased their holdings amounted to RM780.2 billion, mainly consisting of large and long-term institutions, particularly Employees Provident Fund (24.1%), insurance companies (4.6%) and Retirement Fund (Incorporated) (2.9%). Meanwhile, banking institutions' holdings grew to 35.1% attributable to BNM's efforts in providing temporary flexibility for banking institutions to take into account MGS and MGII as part of SRR compliance. Other resident holders also include development financial institutions with holdings of 2.1% and others at 5.9%.

Meanwhile, non-resident holdings slightly reduced to RM264.8 billion (2021: RM267.3 billion). Long term institutions, such as pension funds, insurance companies as well as central bank and sovereigns, cumulatively held a sizeable share at 12.5% of the total Federal Government debt, while fund managers accounted for 8.8%. The balance was held by banking institutions with 3.4% holdings and other non-residents at 0.6%. Accordingly, non-resident holdings in MGS and MGII also reduced to 45.7% of the total outstanding of these instruments (2021: 49.9%), reflecting net foreign outflows during the period due to the aggressive pace on the normalisation of the global interest rates.

**TABLE 4.4.** *Federal Government Debt by Holder 2021 – 2022*

| COMPONENT | RM MILLION | | SHARE (%) | | SHARE OF GDP (%) | |
|---|---|---|---|---|---|---|
| | 2021 | 2022[3] | 2021 | 2022[3] | 2021 | 2022[3] |
| **Resident** | **712,506** | **780,177** | ***72.7*** | ***74.7*** | ***46.1*** | ***45.5*** |
| Employees Provident Fund | 235,712 | 252,197 | *24.1* | *24.1* | *15.3* | *14.7* |
| Retirement Fund (Incorporated) | 29,436 | 30,424 | *3.0* | *2.9* | *1.9* | *1.8* |
| Insurance companies | 46,020 | 48,274 | *4.7* | *4.6* | *3.0* | *2.8* |
| Banking institutions | 328,457 | 366,588 | *33.5* | *35.1* | *21.2* | *21.4* |
| Development financial institutions | 18,235 | 21,585 | *1.9* | *2.1* | *1.2* | *1.2* |
| Others[1] | 54,646 | 61,109 | *5.5* | *5.9* | *3.5* | *3.6* |
| **Non-resident** | **267,308** | **264,783** | ***27.3*** | ***25.3*** | ***17.3*** | ***15.5*** |
| Fund manager | 94,972 | 91,989 | *9.7* | *8.8* | *6.1* | *5.4* |
| Central bank and sovereigns | 78,880 | 75,363 | *8.0* | *7.2* | *5.1* | *4.4* |
| Banking institutions | 33,376 | 35,727 | *3.4* | *3.4* | *2.2* | *2.1* |
| Pension funds | 44,657 | 47,225 | *4.6* | *4.5* | *2.9* | *2.7* |
| Insurance companies | 7,957 | 8,109 | *0.8* | *0.8* | *0.5* | *0.5* |
| Others[2] | 7,466 | 6,370 | *0.8* | *0.6* | *0.5* | *0.4* |
| **Total** | **979,814** | **1,044,960** | ***100.0*** | ***100.0*** | ***63.4*** | ***61.0*** |

[1] Include 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 2022
Source: Ministry of Finance, Malaysia

FEATURE ARTICLE

# Sovereign Debt Rules: Country Comparison

## Introduction

Fiscal policy plays a significant role generally in promoting robust economic growth as well as alleviating the impact of economic crises and the latest COVID-19 pandemic. Governments use fiscal policy through spending and taxing authority to achieve macroeconomic stability and sound public finances in the short, medium and long term. Recently, global economy has been severely affected by the pandemic which hampered the households, businesses and healthcare services. Therefore, fiscal policy has played its role imperatively in supporting the economy through expansionary fiscal measures, via increased government spending and tax cut to cushion the impact of the crisis.

Given limited fiscal space due to lower-than-anticipated annual revenue collection, the COVID-19 pandemic has prompted most governments in the world to increase their annual borrowing. As the debt level elevates, some countries have relaxed their debt rules to provide room and flexibility to accommodate the higher spending. As a result, global debt surged to 99% of GDP in 2020 and 97% of GDP in 2021 compared to pre-pandemic level of 84%.[1]

Amid projected economic recovery phase in 2022, the world was shocked by global high inflation due to rising commodity price following the Russia – Ukraine conflict that hampered the growth of the global economy. World Economic Outlook July 2022 by International Monetary Fund (IMF) forecasts the global growth to slow sharply from 6.1% in 2021 to 3.2% in 2022. Consequently, governments again face the challenging task in maintaining the economic recovery momentum and ensuring the well-being and livelihood of the people remain protected, despite the increase in debt level.

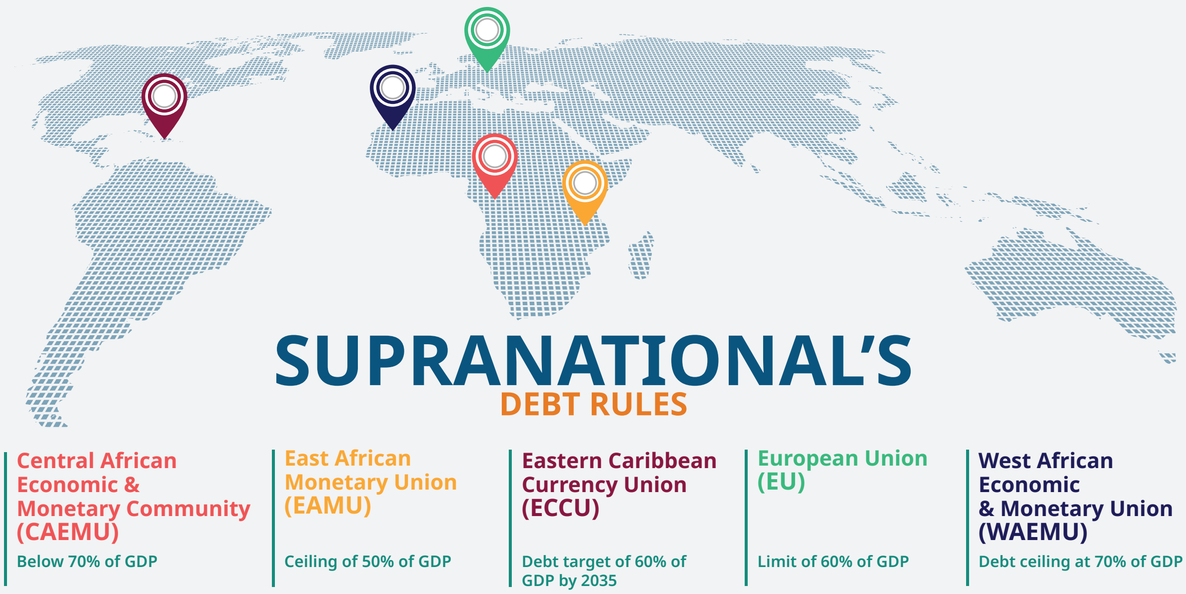
## Sovereign Debt Rules

Fiscal rule is a curtailment on fiscal policy through numerical limits on budgetary aggregates which aims at rationalising tax incentives and controlling overspending pressures, particularly in good economic situation, to ensure fiscal responsibility and debt sustainability.[2] Debt rule is part of fiscal rules which set a limit or target in order to avoid excessive debt level to ensure debt affordability and sustainability in the long run.

In general, sovereigns set a numerical limit on their debt level whether in nominal outstanding amount or at a certain percentage of GDP. There are countries which prescribe a target to reduce their debt to a determined percentage of GDP within a certain period of time. Additionally, supranational unions stipulate specific debt rules to be complied by their members as shown in Figure 1. In the absence of debt rule, other types of fiscal rules such as budget balance, expenditure or revenue is applied to ensure adherence to fiscal discipline.

[1] IMF April 2022 Fiscal Monitor
[2] IMF Fiscal Rules Dataset 1985-2021

**FIGURE 1.** *Supranational's Debt Rules*




Source: Fiscal Rules at a Glance, IMF (2022)

Advanced Economies are spearheading the adoption of fiscal rules post-Great Depression[3], followed by emerging and developing economies since the late 2000s. Apart from having their own national fiscal rules, Germany, France and Italy also adhered to the EU's debt rules under the Maastricht Treaty signed in 1992 which established debt ceiling at 60% of GDP. EU has temporarily suspended these ceiling until end of 2023 to allow member states to cope with pandemic impacts and economic fallout from Russian – Ukraine conflict. Meanwhile, Canada and the UK are committed to contain its debt by imposing a debt reduction target. The US sets a debt limit at nominal outstanding amount of USD31.4 trillion.

To ensure compliance to the debt rules, the debt limits or debt reduction targets are legally bound under country's respective acts or agreed by a coalition agreement or political commitment. Some countries have also established an independent body to monitor the implementation of their debt rules such as Canada, UK and Iceland.

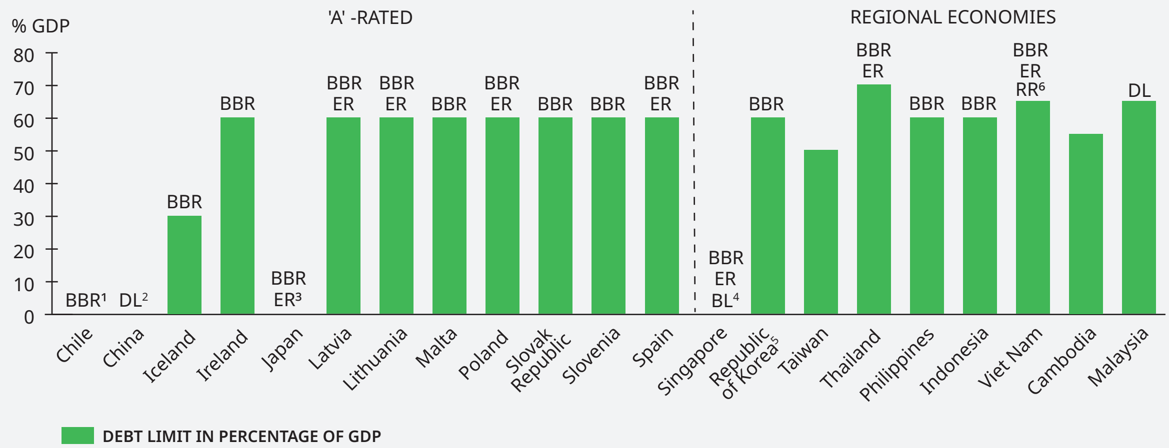
**Country Comparison: 'A'-rated and Regional Economies**

i. Debt Rules

Among the A-rated peers, eight EU members namely Ireland, Latvia, Lithuania, Malta, Poland, Slovak Republic, Slovenia and Spain, have adopted the Maastricht Treaty debt rules. Iceland, on the other hand, sets a net debt ceiling of 30% of GDP. Meanwhile, China controls national debt by imposing a nominal outstanding amount limit in its local currency. For Japan and Chile, other types of fiscal rules are in place to manage their debts. Japan through Basic Policy on Economic and Fiscal Management and Reform (2018) aims for the primary balance surplus target by 2025 while Chile generally practices the budget balance rule.

[3] The Great Depression refers to the world economic recession around 1929 – 1939

**FIGURE 2.** *Sovereign Debt Rules*




Notes:
[1]Budget balance rule (BBR)
[2]Debt limit in oustanding amount (DL)
[3]Expenditure rule (ER)
[4]Borrowing limit (BL)
[5]Republic of Korea: proposed fiscal rule
[6]Revenue rule (RR)

Source: IMF Fiscal Rules at a Glance (2022)

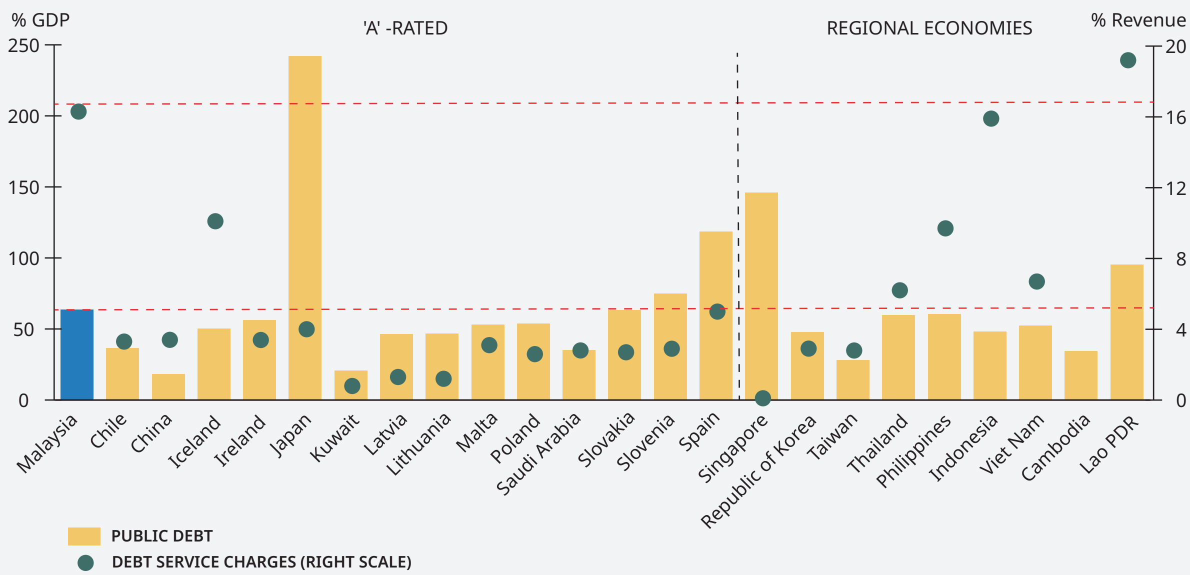
For regional economies, most countries adopted debt ceiling in percentage of GDP as their debt rule. Thailand has imposed the highest ceiling as compared to others by capping debt at 70% of GDP, followed by Viet Nam (65%), Republic of Korea (60%), the Philippines (60%) and Indonesia (60%). Distinctively for Taiwan, the debt ceiling of 50% of GDP is divided into central government (40.6%), special municipalities (7.65%), counties (1.63%) and townships (0.12%) while Cambodia's debt ceiling of 55% of GDP is separated into domestic and external debt with 15% and 40% share, respectively. However, Singapore is the only country within the region that has a borrowing limit instead of a debt ceiling in percentage of GDP.

For Malaysia, the debt rules are embedded legislatively in various national acts. The Government limits the outstanding debt specific for each debt instrument whether in percentage of GDP or in nominal amount. Malaysia also imposes an administrative rule of which debt service charges (DSC)-to-revenue ratio should not exceed 15% excluding principal repayments.

ii. Debt indicators

In comparison to selected A-rated peers and regional economies, Malaysia's debt-to-GDP ratio at 63.4%, ranked sixth highest in 2021 after Japan (242%), Singapore (145.9%), Spain (118.4%), Lao PDR (95.2%) and Slovenia (74.7%). In terms of DSC-to-revenue ratio, Lao PDR recorded the highest ratio at 19.2% followed by Malaysia (16.3%), while other countries' ratio stood less than 10% including Japan (4%) and Singapore (0.1%).

**FIGURE 3.** *Sovereign Public Debt & Debt Service Charges*

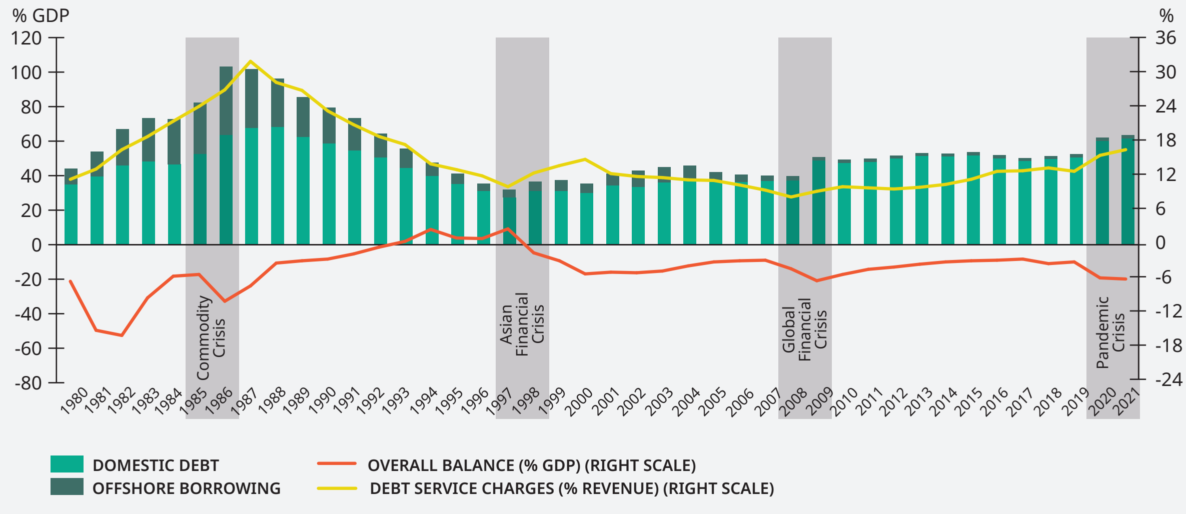



Source: Economist Intelligence Unit & Fitch Rating

The high gross debt level of Singapore reflects it's zero net debt of which all their borrowing proceeds are utilised for investments. Furthermore, the returns from these investments are sufficient to cover the debt servicing cost. The availability of large external assets also supports in mitigating debt-associated risk. Meanwhile, Japan mountainous debt is compensated by its huge holdings of net external assets and domestic savings base, ultra-low interest rate environment as well as favorable debt profile with no foreign currency debt.

Nevertheless, Malaysia's debt level remains manageable despite higher DSC-to-revenue ratio compared to Japan and Singapore. The Government continues to reduce debt-related risks exposure by prioritising issuance in the sufficiently liquid domestic market, maintaining a low composition of foreign currency debt and adhering jurisdictive requirement in fulfilling the DSC obligations via revenue. Even though several revisions have been made to the debt ceiling to provide additional fiscal space, Malaysia has resiliently endured the headwinds to steadily serve maturing debts and interest payments. Figure 4 illustrates the Federal Government debt position for the period 1980 – 2021 through series of crises.

**FIGURE 4.** *Federal Government Debt, Overall Balance & Debt Service Charges 1980 – 2021*



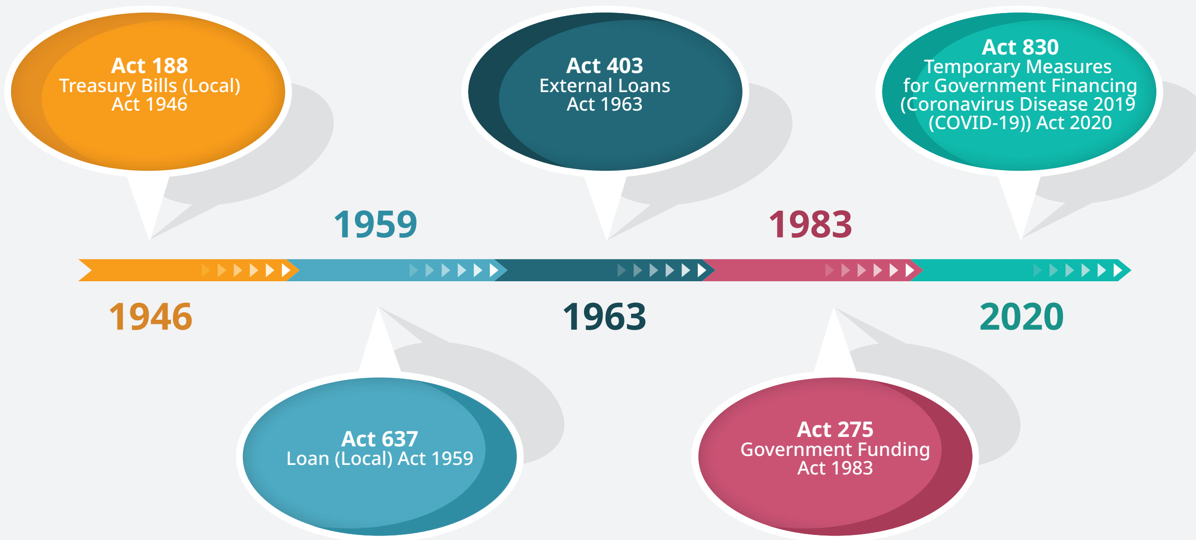

Source: Ministry of Finance, Malaysia

Generally, given a robust fiscal and economic position in terms of revenue, international reserves and market liquidity, a high debt level is not detrimental to the A-rated countries. As such, there is no specific ideal debt limit and it is subject to the respective country's financial position and economic situation in determining their debt rules.

### Overview of Malaysia's Sovereign Debt Rules

In Malaysia's context, debt rules are stipulated in various acts according to type of instrument. The first debt-related legislation is the Treasury Bills (Local) Act 1946 [Act 188], followed by the Loan (Local) Act 1959 [Act 637] which allows the Government to issue Malaysian Treasury Bills (MTB) and Malaysian Government Securities (MGS), respectively. The External Loans Act 1963 [Act 403] allows the Government to borrow in foreign currency while the Government Funding Act 1983 [Act 275] authorises Government's issuance of Shariah-compliant instruments namely Malaysian Islamic Treasury Bills (MITB) and Malaysian Government Investment Issues (MGII). While each instrument has its specific debt threshold, they share a common purpose in which gross borrowing proceeds are to be channeled into development expenditure and repayment of maturing debts only.

**FIGURE 5.** *Federal Government Debt-Related Acts*



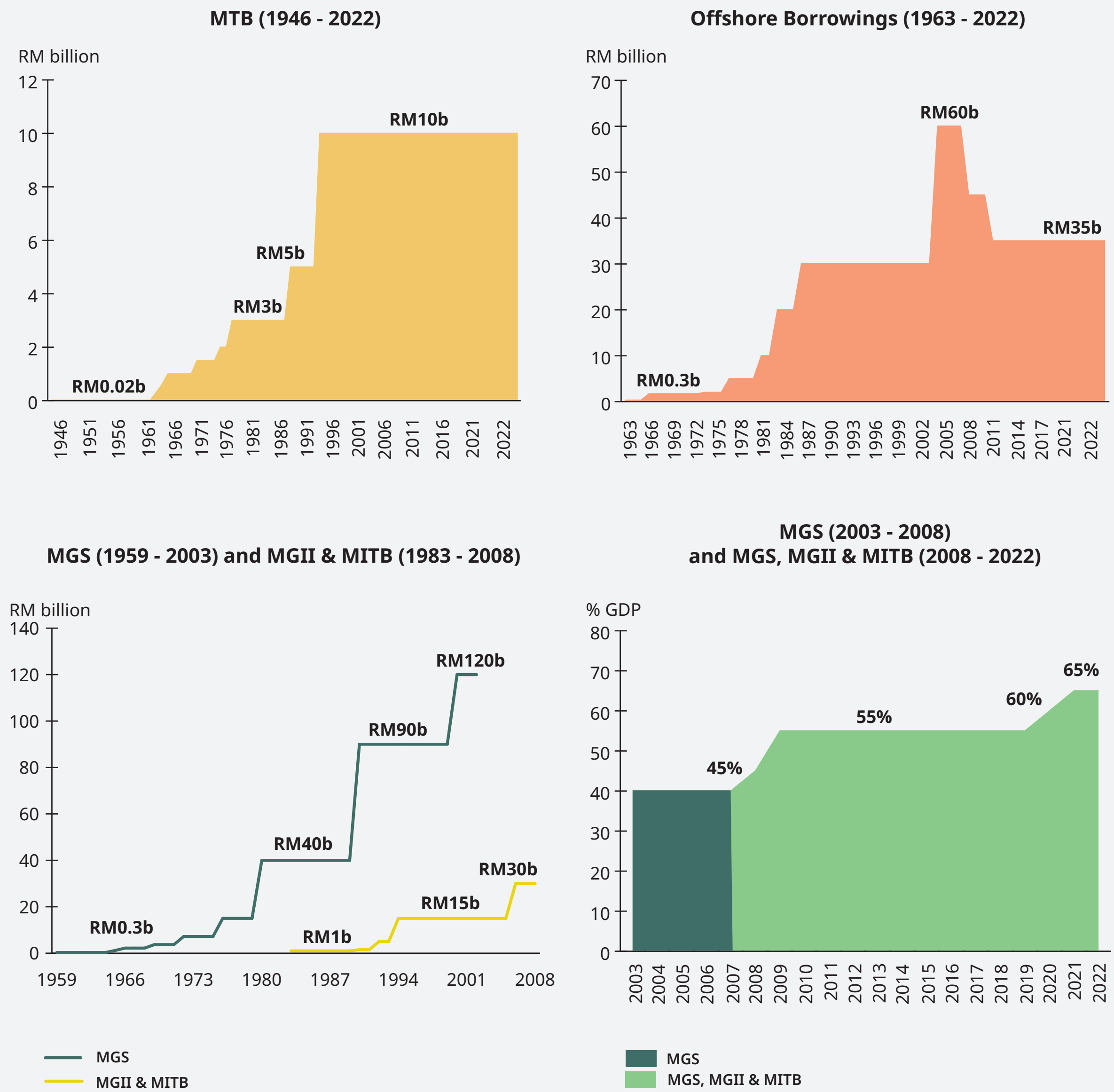

Source: Ministry of Finance, Malaysia

Under the Act 188, the outstanding MTB was initially capped at RM20 million. This ceiling was last revised in 1992 with the current effective ceiling standing at RM10 billion. Meanwhile, Act 637 which initially capped outstanding MGS at RM300 million, has been revised to RM120 billion in 2000. The accumulated MGS issuances was capped at nominal value in ringgit until end-March 2003. Subsequently, the ceiling was capped in percentage of GDP at 40% until 2008 to allow the Government to manage borrowings in line with GDP growth. Act 275 stipulated the outstanding MGII and MITB should not exceed RM1 billion which was revised in 2006 to RM30 billion. Meanwhile, Act 403 originally limits offshore borrowing at RM300 million whereby the last amendment in 2009 revised the ceiling to the current RM35 billion.

The Government again revised the statutory debt ceiling under Act 637 and Act 275 in June 2008 by combining the outstanding MGS, MGII and MITB to 45% of GDP to provide flexibility to the Government in managing the issuances of Islamic and conventional papers. Due to the Global Financial Crisis, this statutory debt ceiling was later increased to 55% of GDP in 2009 to cater to the additional borrowings to finance fiscal stimulus measures.

Similarly, the imposition of Movement Control Order to curb the spread of COVID-19 virus have caused the Government to provide a series of stimulus and economic recovery packages. Therefore, the Parliament on September 2020 has approved the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830] to temporarily allows the Government to utilise the borrowing proceeds for programmes under the COVID-19 Fund and increase the statutory debt limit from 55% to 60% of GDP. The debt ceiling under this Act was further revised up to 65% in November 2021 and the Act will expire on 31 December 2022.

**FIGURE 6.** *Evolution of Federal Government Statutory Debt Ceiling*




Source: Ministry of Finance and Attorney General Chambers, Malaysia

The limit imposed on each debt instrument was revised through the amendments to the acts and statutory borrowing ceiling order. These revisions have provided additional fiscal space for economic growth and expansionary fiscal requirements during crisis. Furthermore, maintaining a low offshore borrowing threshold reduces exposure to foreign exchange risk while facilitating the development of deep and liquid domestic market. These revisions were thoroughly scrutinised, presented and justified to the Parliament reflecting the Government's transparency and good governance in managing debt.

### Way Forward

The Federal Government debt level trajectory is forecasted to remain within the statutory debt limit in the medium term due to the scarring effect of the additional borrowing during COVID-19 pandemic and the funding requirements for the implementation of the Twelfth Malaysia Plan. Therefore, the current debt limit will be maintained to provide fiscal space in executing the nation's development agenda, strengthening the economy and ensuring a sustainable recovery. Concurrently, the Government is also exploring the feasibility of a single debt limit as one of the fiscal rules.

Moving forward, lessening the debt burden is crucial in improving the Government debt affordability in the long term. The Government aims to gradually reduce the Federal Government's debt-to-GDP ratio to provide the country with fiscal headroom to manage potential crises in the future. The lowering of the debt burden can be realised through fiscal reforms accompanied by improved revenue collection post-crisis and expenditure rationalisation. The pace of economic momentum remains positive which is expected to grow between 6.5% and 7.0% in 2022 which will expedite the debt level trajectory towards downward path.

### Conclusion

Fiscal rules adopted globally encompass a range of budget balance obligations, expenditure limits, revenue measures as well as debt ceilings. Adherence to the fiscal rules entails Government's full commitment to ensure the fiscal objectives, which aim for fiscal and debt sustainability, can be achieved. Formalising the debt rules through legal provisions has facilitated the Government in containing its debt at a manageable level especially during crisis. While borrowing by the Government is inevitable, it is imperative to maintain debt affordability and sustainability in ensuring the resilience of the economy in the medium- and long-term.

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# External Debt

The nation's external debt constitutes the public and private sector offshore borrowings, non-resident holdings of ringgit-denominated debt securities, non-resident deposits as well as other external debt. As at end-June 2022, the external debt increased to RM1,128.3 billion or 65.9% of GDP, mainly contributed by higher interbank borrowings and the foreign currency exchange rate valuation effects following the depreciation of ringgit especially against the US dollar.

The largest component of external debt which is offshore borrowings amounted RM620.5 billion or 55% of the total external debt, which largely attributed to the net foreign currency-denominated issuances by the non-financial corporations. Meanwhile, the share of non-resident holdings of ringgit-denominated debt securities has slightly reduced to 22.4% (2021: 23.6%). The reduction was due to non-resident investors liquidating their holdings in domestic papers in repositioning their investment portfolio. Furthermore, these liabilities were not affected by the volatility of ringgit against other currencies.

Overall, the country's external debt remained manageable given its favourable maturity profile, with medium- and long-term debt constituting a higher share at 60% than short-term debt (40%). Sufficient coverage through foreign currency reserves mitigates the refinancing risk of the short-term external liabilities.

**TABLE 4.5.** *External Debt*
*2021 – 2022*

| COMPONENT | RM MILLION | | SHARE (%) | | SHARE OF GDP (%) | |
|---|---|---|---|---|---|---|
| | 2021 | 2022[3] | 2021 | 2022[3] | 2021 | 2022[3] |
| **Offshore borrowings** | **591,958** | **620,454** | ***54.7*** | ***55.0*** | ***38.3*** | ***36.2*** |
| Medium- and long-term debt | 391,393 | 393,513 | *36.2* | *34.9* | *25.3* | *23.0* |
| Public sector | 162,829 | 154,297 | *15.1* | *13.7* | *10.5* | *9.0* |
| Federal Government | 25,461 | 24,841 | *2.4* | *2.2* | *1.6* | *1.4* |
| Public corporations | 137,368 | 129,456 | *12.7* | *11.5* | *8.9* | *7.6* |
| Private sector | 228,563 | 239,216 | *21.1* | *21.2* | *14.8* | *14.0* |
| Short-term debt | 200,565 | 226,942 | *18.5* | *20.1* | *13.0* | *13.2* |
| **Non-resident holdings of ringgit-denominated debt securities** | **255,056** | **252,721** | ***23.6*** | ***22.4*** | ***16.5*** | ***14.8*** |
| Medium- and long-term debt | 246,098 | 241,637 | *22.8* | *21.4* | *15.9* | *14.1* |
| Federal Government | 232,510 | 229,244 | *21.5* | *20.3* | *15.0* | *13.4* |
| Others[1] | 13,588 | 12,393 | *1.3* | *1.1* | *0.9* | *0.7* |
| Short-term debt | 8,958 | 11,084 | *0.8* | *1.0* | *0.6* | *0.7* |
| **Non-resident deposits** | **99,902** | **106,914** | ***9.2*** | ***9.5*** | ***6.5*** | ***6.2*** |
| **Others[2]** | **135,146** | **148,176** | ***12.5*** | ***13.1*** | ***8.7*** | ***8.7*** |
| **Total** | **1,082,061** | **1,128,266** | ***100.0*** | ***100.0*** | ***70.0*** | ***65.9*** |

[1] Include private sector and public corporations
[2] Comprise trade credits, IMF allocation of SDRs and miscellaneous
[3] End-June 2022
Note: Total may not add up due to rounding
Source: Bank Negara Malaysia

## Public Sector Debt

Public sector debt includes 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 2022, the public sector debt increased to RM1,442 billion or 84.2% of GDP. Federal Government debt remained the largest component with its share increasing from 70.6% to 72.4% of the total, contributing to the overall increase in public sector debt.

Meanwhile, statutory bodies guaranteed debt declined to RM89.2 billion, partly contributed by the principal repayment by Johor Corporation, LPPSA and Perbadanan Tabung Pendidikan Tinggi Nasional. The NFPCs' debt also decreased to RM307.9 billion, mainly attributed to the principal repayments of maturing offshore debts. Overall, the public sector debt remains manageable as the debt is significantly denominated in ringgit, thus limiting foreign exchange risk.

**TABLE 4.6.** *Public Sector Debt*
*2021 – 2022*

| COMPONENT | RM MILLION | | SHARE (%) | | SHARE OF GDP (%) | |
|---|---|---|---|---|---|---|
| | 2021 | 2022[1] | 2021 | 2022[1] | 2021 | 2022[1] |
| **Federal Government** | **979,814** | **1,044,960** | ***70.6*** | ***72.4*** | ***63.4*** | ***61.0*** |
| Domestic | 950,084 | 1,015,605 | *68.5* | *70.4* | *61.5* | *59.3* |
| Offshore | 29,730 | 29,355 | *2.1* | *2.0* | *1.9* | *1.7* |
| **Statutory bodies** | **91,300** | **89,168** | ***6.6*** | ***6.2*** | ***5.9*** | ***5.2*** |
| Domestic | 91,300 | 89,168 | *6.6* | *6.2* | *5.9* | *5.2* |
| *of which:* Guaranteed | 91,300 | 89,168 | *6.6* | *6.2* | *5.9* | *5.2* |
| Offshore | - | - | - | - | - | - |
| **Non-financial public corporations** | **316,752** | **307,902** | ***22.8*** | ***21.4*** | ***20.5*** | ***18.0*** |
| Domestic | 185,309 | 184,342 | *13.3* | *12.8* | *12.0* | *10.8* |
| *of which:* Guaranteed | 185,309 | 184,342 | *13.3* | *12.8* | *12.0* | *10.8* |
| Offshore | 131,443 | 123,560 | *9.5* | *8.6* | *8.5* | *7.2* |
| *of which:* Guaranteed | 27,778 | 28,274 | *2.0* | *2.0* | *1.8* | *1.7* |
| **Total** | **1,387,866** | **1,442,030** | ***100.0*** | ***100.0*** | ***89.8*** | ***84.2*** |

[1] End-June 2022
Source: Ministry of Finance, Malaysia

## Outlook for 2023

Amid global economic uncertainties, Budget 2023 continues to prioritise well-being of the rakyat, economic reforms and inclusivity with the focus on ensuring fiscal sustainability. Therefore, the Federal Government's gross borrowing needs are projected to reach 14% of GDP. Despite the withdrawal of the assistance packages due to the closure of COVID-19 Fund, the borrowings are still substantial due to higher allocation for development expenditure, in line with continuation of the programmes and projects in the Third Rolling Plan, 12MP. In addition, the substantial borrowings were also attributed to high principal repayments obligation, which includes redemption of 1MDB's maturing bond. Given the sufficient liquidity in the market, the

Government's borrowing strategy will continue to prioritise domestic issuance. Furthermore, issuance of the sustainable instrument denominated in ringgit will be continued in line with the Government's aspiration in achieving the 2030 Agenda for Sustainable Development.

There is a noticeable increase in the Federal Government's debt level during the pandemic, mainly associated with the expansionary fiscal measures through the additional borrowing for COVID-19 Fund, which will drag the debt consolidation trajectory to a slower pace in the medium-term. Consequently, the overall debt is projected to be around 65% of GDP, while statutory debt at 63% by end-2023. Therefore, considering the COVID-19 debt-scarring effect and to ensure smooth implementation of 12MP, the Government may extend the statutory debt limit of 65% of GDP in the medium-term after the expiry of the Act 830 on 31 December 2022.

The increased debt level will heighten the borrowing cost and refinancing risk. Therefore, the Government is fully committed to gradually reduce the debt level while balancing the fiscal needs in ensuring growth momentum in the medium-term and mitigating the impact from inflation. The prudent fiscal and debt management will ensure the Government's fiscal position is sufficient to face future crises as well as improve the debt affordability.

## Conclusion

The Federal Government borrowing strategy continues to prioritise low financing cost at a reasonable risk. The Government also upholds the principle of transparency and accountability as well as enhancement in governance to ensure prudent debt management. Furthermore, the Government also strives to rebuild fiscal headroom through widening of the revenue base, rationalising subsidies and undertaking structural reforms. Subsequently, persistent fiscal consolidation will lessen the Government's indebtedness and ensuring debt sustainability in the long-term.

**FIGURE 4.1.** *Issuance by Maturity*

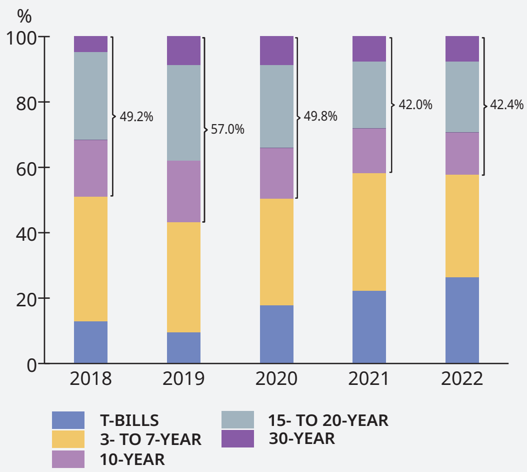



**FIGURE 4.2.** *BTC Ratios of MGS and MGII*

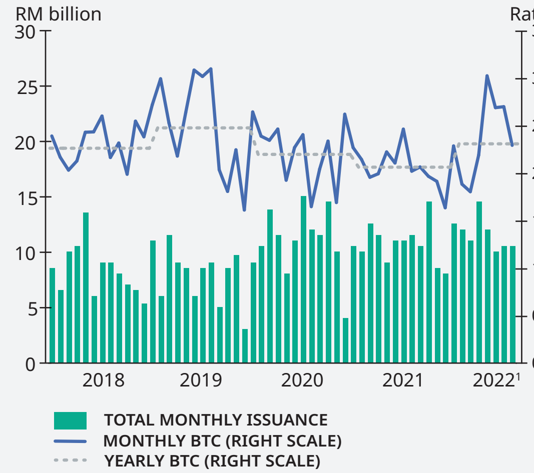



**FIGURE 4.3.** *MGS Benchmark Yield Curve*

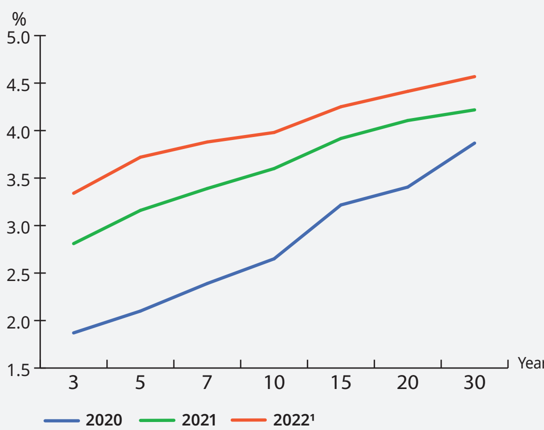
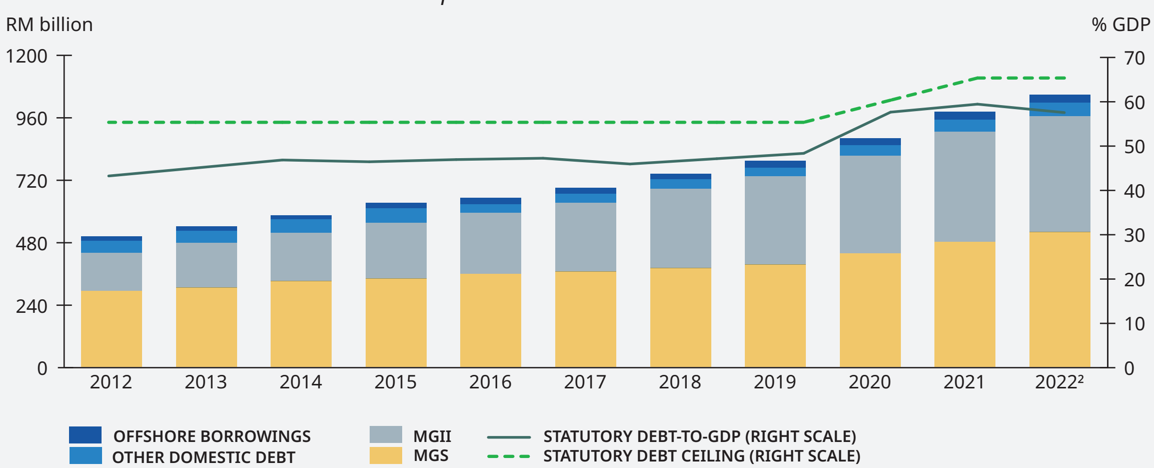



**FIGURE 4.4.** *MGS Indicative Yields*


**FIGURE 4.5.** *Federal Government Debt Composition*




[1]End-August 2022
[2]End-June 2022
Source: Ministry of Finance, Malaysia, Bank Negara Malaysia and Bloomberg

**FIGURE 4.6.** *Federal Government Debt by Holder*

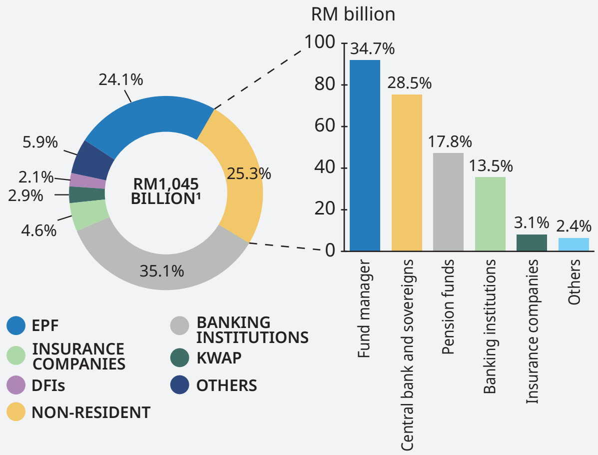



**FIGURE 4.7.** *Non-Resident Holdings of Ringgit-Denominated Debt Securities*

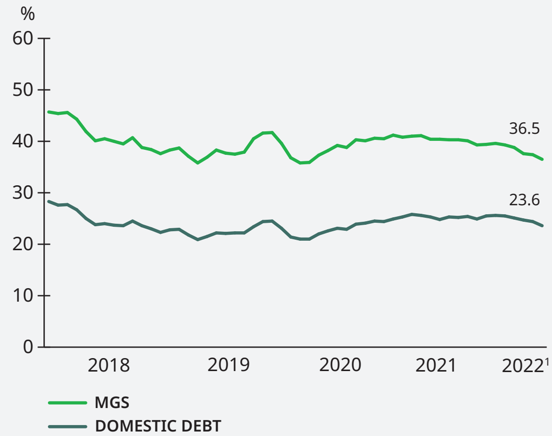



**FIGURE 4.8.** *Federal Government Debt by Remaining Maturity*

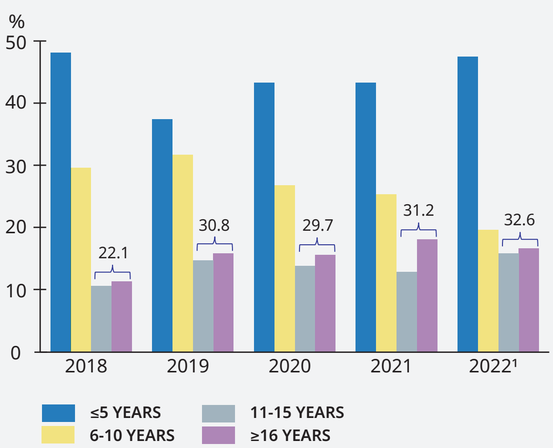



**FIGURE 4.9.** *Debt Service Charges*

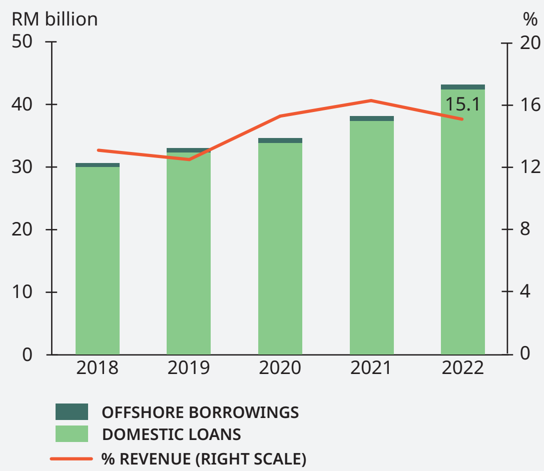
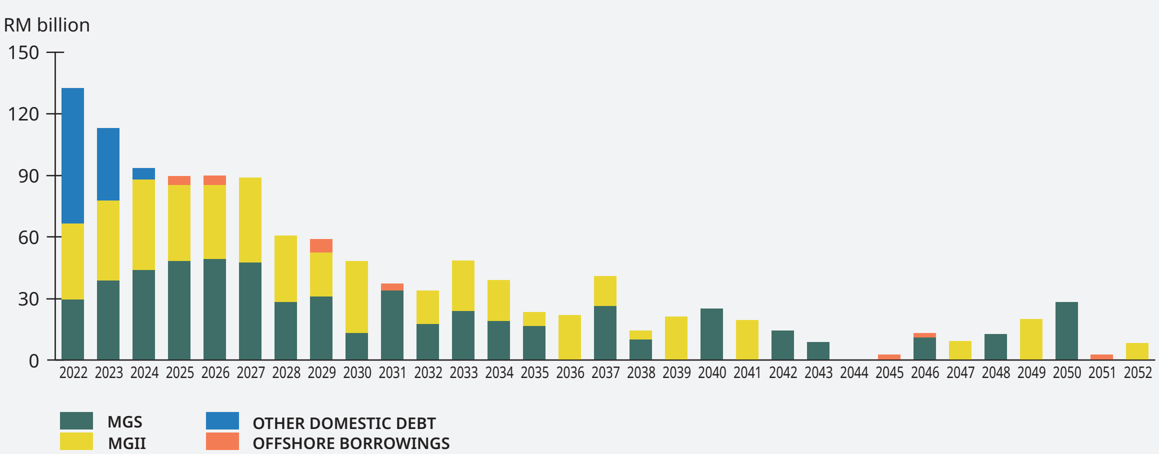



**FIGURE 4.10.** *Debt Maturity Profile*




[1]End-June 2022
Source: Ministry of Finance, Malaysia