**Date:** 22 June 2018

# A CLARION CALL THAT BUSINESS & POLITICS DON'T MIX

*Focus Malaysia (June 9 2018)*

***By Ismitz Matthew De Alwis***

- ***Regardless** of the pain, nothing beats the aspiration to uphold policy transparency and clarity on economics and finance-related matters*
- ***Head** honchos should realise that taking a political gamble can come with a high price*

**"I CAN'T** change the direction of the wind, but I can adjust my sails to always reach my destination." This quote by renowned country music singer and sausage company founder Jimmy Dean depicts the need for Malaysian capital markets to take cognisance – and for investors to re-strategise their portfolios – amid unprecedented market conditions in the aftermath of the 14th General Election (GE14). After all, Malaysia can be deemed to be in unchartered territory given that for the first time in 61 years, the country finds itself being administered by a new (but obviously not an inexperienced) government. Having settled down with quite a commendable performance in its first week of trading post-election, the local bourse succumbed to nerve-wracking jitters triggered by a revelation that the nation's debt burden has exceeded the RM1 tril mark (the federal government's actual debt and liabilities stood at RM1.087 tril or 80.3% of the gross domestic product (GDP) as of end- December last year, according to the Finance Ministry).

Finance Minister Lim Guan Eng has re-affirmed claims by Prime Minister Tun Dr Mahathir Mohamad that the country is saddled by such a humongous debt level, no thanks to the 1Malaysia Development Bhd (1MDB) financial scandal which was further compounded by mega projects as well as the inaccessibility of certain accounting files to warrant a consolidation exercise. On May 23, the FBM KLCI nosedived 2.21% or 40.78 points as uncertainties over the government debt loom, exacerbated by weakness in regional markets. The following day, the benchmark index erased a further 1.58% or 28.59 points to 1,775.66. What the Finance Minister did can be likened to a kitchen-sinking exercise – an accounting strategy to lump all bad news/losses at one-go so a company (a country in this context) can start with a clean slate. It can be deemed as a "biting the bullet" communication technique which is commonly used by a newly-appointed head honcho of a company to lay bare a major financial mess that he has to inherit from the previous management.

The idea is to release all existing bad news without further ado – but with valid justification – thus preventing the possibility of amassing a drip-drip effect over an extended period of time. Apparently, dishing out the truth has proven to be a pill too bitter to swallow (for the markets) although most wise investors would stand their ground on the principle of short-term pain but long-term gain. In this regard, it's praiseworthy to note that the Finance Minister intends to hold firm to the CAT nobility of competency, accountability and transparency. "If by being transparent we will be punished, then there's nothing we can do about it. We will still continue to be transparent," he said, taking a swipe at an opinion expressed by a Bloomberg columnist that investors have been left with an uncertain fiscal outlook due to his "bluntness". In fact, investors must demonstrate some degree of maturity by being able to filter the right from the wrong as well as not being easily spooked by truth, or to allow their buying instinct to be boosted by market rumours, falsehood or half-truth.

## BUILDING CONFIDENCE

One would have asked, with so many blue-chip stocks getting bruised and battered – inadvertently, the recent sell down was overdone with massive dumping by foreign funds – wouldn't buying opportunities of sorts abound for local funds/institutions or even retail investors? For a fund manager, this is not as simple as considering a "top down" approach (analysing the economy, followed by the industry and then the company) or embark on a "bottom up" approach (analysing the company and move up to the industry prospects and ultimately the economic forecasts). Neither is it about which of the two approaches would yield better results in terms of ringgit and sen.

### Breakdown of government debts amounting to RM1.087 bil

| TYPE OF DEBT | AMOUNT | DESCRIPTION |
|---|---|---|
| Federal government debt | RM686.8 bil (50.8% of GDP) | |
| Government guarantees (payment for various entities which are unable to service their debts) | RM199.1 bil (14.6% of GDP) | • Danainfra Nasional Bhd (RM42.2 bil)<br>• Govco Holdings Bhd (RM8.8 bil)<br>• Prasarana Malaysia Bhd (RM26.6 bil)<br>• Malaysia Rail-link Sdn Bhd (RM14.5 bil)<br>• 1MDB (estimated RM38 bil) |
| Lease payments | RM201.4 bil | The lease payments (including rental, maintenance and other charges) cover a whole list of public private partnership projects such as the construction of schools, hostels, roads, police stations and hospitals. |

Source: Finance Ministry (as of May 24, 2018)

Realistically, there is even a pressing need to weigh the extremely fluid political/economic environment that has presented itself post-GE14. Far from doubting that the newly-elected Pakatan Harapan government is able to fulfil its rather ambitious election manifesto within 100 days in office, the trump card lies in building and sustaining market confidence. Until the so-called financial messes related to 1MDB scandal are unearthed and the wrongdoers are prosecuted, investors from retail to institutional as well as foreign funds simply have to adjust and anticipate more shocking or market-unfriendly revelations. Undoubtedly, witnessing the recent stock market bashing, the extent of the ringgit slide against the greenback or the outflow of bond funds is an unpleasant sight.

But regardless of the pain, nothing beats the aspiration to uphold policy transparency and clarity on economics and financial-related matters. Henceforth, the government's assurance of its ability to honour its debt obligations relating to 1MDB is itself a strong signal to the financial markets. In this instance, the government has reiterated that it has ample funds to fulfil the debt obligations of the debt-laden state strategic investment fund.

## WORKABLE SOLUTIONS

Aside from the debt-related issues pertinent to 1MDB, the government also needs to remain steadfast in convincing investors on the effectiveness of its “home-grown” remedy to boost the country’s ailing finances or to build a sustainable economy moving forward. One ideal example is how revenue losses from replacing the goods and services tax (GST) with sales and service tax (SST) – which have come under the scrutiny of international rating agencies – can be cushioned by the anticipated rise in oil revenue for 2018 and a cut in government expenditure (by plugging various wastages and leakages as well as by raging war against corrupt practices).

Moreover, the finance ministry has further assured that not only is the fiscal reform initiative already underway, the GST shortfall can be offset by revenue and expenditure measures that will be announced in due course. The same applies to the re-evaluation of mega projects approved by the previous administration whereby a renegotiation on the terms may be imminent (Bandar Malaysia, Tun Razak Exchange, Pan Borneo Highway and the RM55 bil East Coast Rail Link or ECRL) while some will be scrapped entirely (the RM110 bil High-Speed Rail connecting Singapore with Kuala Lumpur and the RM40 bil Klang Valley Mass Rapid Transit Line 3).

Mega projects approved by the previous administration such as Bandar Malaysia are being re-evaluated

On a similar note, the government has redefined the meaning of foreign direct investments and technology transfers from abroad while maintaining it does not oppose investments from China, the world’s second-biggest economy. Pointing specifically to the ECRL, economist Prof Jomo Kwame Sundaram who is part of the five-member Council of Eminent Persons has justified that the project was not an investment from China, but a huge loan from China’s export-import bank for 85% of projected costs on preferential terms.

One final observation is that listed companies which were badly affected in the recent selloff are those which are perceived to be cronies of the previous administration and those that are heavily dependent on government contracts. This perhaps serves as a clarion call to founders and head honchos of listed companies that business and politics don’t mix; their indulgence in political gamble can come at a high price with dire consequences to the value of their stocks.

It is indeed a great pity that politically-affliated stocks are subject to dumping in view of the changing political tide regardless of their promising business prospects. Thankfully, the sky in the days ahead is unlikely to remain gloomy. Over the medium- to long-term, as business confidence improves with adjustment to the new management style of the government of the day, there should be clearer skies for the capital markets.

**ENDS**

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***Article Source:***
*Focus Malaysia. (June 2018)*

14 mainstream FocusM | June 9-15 2018

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