Kenanga Investors

Date: 12 November 2018

ALLAYING INVESTORS' PESSIMISM

Focus Malaysia (10 November 2018)

By Ismitz Matthew De Alwis

- **STRIKING** a balance between ensuring growth amid global uncertainties and committing to fiscal consolidation
- **THE** aftermath of Budget 2019 provides clarity on policy and market direction

Budget 2019 has been a surprise in that it turned out to be another expansionary Budget instead of a "sacrificial" Budget as was widely anticipated. For the investor fraternity, Budget 2019 should be seen in the light of providing clarity on policy direction as well as the rolling out of reform initiatives to turn around the Malaysian economy amid uncertainties of sorts in the external environment. There is an optimal mix of stimulus, incentives and safeguards to navigate what is expected to be another challenging year ahead. Against a backdrop of the nation incurring RM1.065 tril real debt and liability as of end-June 2018, understandably a slew of belt-tightening measures is inevitable to keep the economy afloat to enable the government to fulfil its social obligations.

ASSORTMENT OF TAXES

Striking a balance is always a difficult exercise in economic manoeuvring. As a trade-off for the abolition of the indirect Goods and Services Tax (GST) - where a shortfall of RM19 bil abounds from the introduction of the Sales and Service Tax (SST) - it makes valid sense for the government to pursue other means of tax-related income (the GST was projected to generate RM43 bil a year while the SST is targeted to generate only RM24 bil year). On that note, the absence of capital gain, inheritance and carbon taxes are indeed a welcome relief for investors. Likewise, there was no mention of a sin tax in the context of breweries and tobacco companies. Nevertheless, a post-budget excise duty hike cannot be ruled out in the coming months although this is very unlikely given that the government had recently increased the SST rate for alcohol and cigarettes. However, the much-talked about digital and soda taxes were introduced alongside the casino tax, stamp duty for high-end properties and real property gain tax (RPGT).

FBMKLCI Historical Performance - Pre and Post Budget								
Before				BUDGET	After			
3 Month	2 Month	1 Month	2 Weeks		2 Weeks	1 Month	2 Month	3 Month
-3.7%	-5.5%	-4.6%	-1.1%	2019 (02-Nov-18)				
-1.2%	-1.3%	-0.7%	-0.5%	2018 (27-Oct-17)	-0.2%	-1.7%	0.8%	6.2%
0.8%	-1.2%	0.0%	0.3%	2017 (21-Oct-16)	-1.3%	-2.8%	-2.1%	-0.3%
-0.6%	11.7%	6.1%	0.3%	2016 (23-Oct-15)	-1.5%	-2.9%	-4.0%	-5.0%
-3.9%	-2.2%	-3.1%	-1.7%	2015 (10-Oct-14)	0.6%	0.8%	-3.9%	-4.2%
1.7%	5.5%	2.4%	2.3%	2014 (25-Oct-13)	-0.7%	-1.3%	1.0%	-0.8%
2.3%	0.7%	-0.5%	1.4%	2013 (28-Sep-12)	1.5%	2.2%	-2.4%	2.3%
-12.2%	-6.5%	-4.7%	2.5%	2012 (07-Oct-11)	2.8%	5.5%	5.8%	8.1%
11.5%	8.7%	1.1%	1.6%	2011 (15-Oct-10)	1.1%	0.7%	1.4%	5.4%
9.6%	7.9%	4.0%	2.7%	2010 (23-Oct-09)	-0.5%	0.6%	-0.5%	2.6%
-13.8%	-7.3%	-5.1%	0.5%	2009 (29-Aug-08)	-5.1%	-7.3%	-24.4%	-21.3%
-3.5%	-5.0%	-0.2%	2.5%	2008 (07-Sep-07)	0.1%	5.2%	6.5%	10.4%
3.2%	5.0%	2.8%	2.0%	2007 (01-Sep-06)	-0.2%	0.7%	2.9%	12.5%
3.7%	-1.1%	1.5%	0.6%	2006 (30-Sep-05)	-0.2%	-2.3%	-3.1%	-2.9%
3.2%	-0.4%	3.5%	3.5%	2005 (10-Sep-04)	0.6%	1.3%	3.1%	5.3%
7.4%	2.4%	2.3%	-0.3%	2004 (12-Sep-03)	0.2%	6.7%	7.3%	7.1%
-9.5%	-7.4%	-8.0%	-3.1%	2003 (20-Sep-02)	-4.2%	-3.0%	-5.2%	-5.3%
-5.2%	-6.0%	-2.3%	1.0%	2002 (19-Oct-01)	-3.0%	3.3%	8.0%	13.6%
-1.0%	-0.7%	9.7%	5.5%	2001 (27-Oct-00)	-4.9%	-9.8%	-14.1%	-9.6%
-3.4%	-3.2%	10.0%	3.0%	2000 (29-Oct-99)	-2.9%	0.4%	7.4%	25.9%
0.3%	32.3%	8.3%	12.8%	1999 (23-Oct-98)	8.0%	10.0%	28.0%	47.4%
-20.6%	-9.7%	1.0%	-0.3%	1998 (17-Oct-97)	-16.4%	-16.0%	-31.5%	-32.1%
45.5%	36.4%	59.1%	72.7%	**Gain Frequency**	38.1%	57.1%	52.4%	57.1%
54.5%	63.6%	40.9%	27.3%	**Loss Frequency**	61.9%	42.9%	47.6%	42.9%
4.4%	9.3%	4.1%	2.6%	**Average Gain**	1.8%	3.1%	6.5%	12.2%
-6.6%	-4.1%	-3.2%	-1.2%	**Average Loss**	-3.2%	-5.2%	-9.1%	-9.1%
-1.6%	0.8%	1.1%	1.6%	**Total Average Return**	-1.3%	-0.5%	-0.9%	3.1%

Source: TA Securities

These can be construed as negative for the gaming, food and beverage (F&B) and property sectors respectively. The gaming sector is a major loser with the annual gaming licence fee for casinos to be raised from RM120 mil to RM150 mil while the gaming tax on casinos is to be raised to 35% of gross gaming revenue. This has led to Genting Malaysia Bhd and Genting Bhd being subjected to a knee-jerk reaction (both stocks dipping as much as 30% and 12% respectively on the first post-Budget 2019 trading day) while research houses aggressively trim the earnings forecasts of both casino-related counters.

Nevertheless, number forecast operators are spared from incurring the wrath of both gaming tax and betting duty except that the number of special draws will be slashed by half. In the case of the real estate sector, the additional 1% in stamp duty (to a maximum of 4% from the previous 3%) on the transfer of property valued above RMi mil is deemed milder than expected while that of RPGT imposition on properties priced above RM200,00 (from 0% to 5% for Malaysians and to 5% to 10% for companies and foreigners) from the sixth year of ownership could be a blessing in that it may encourage property owners to hold 011 to their assets to reap better appreciation value.

To lift sales and clear inventories, the government has mooted what is deemed as the first-in the-world "property crowd funding" platform as an alternative source of financing for first-time homebuyers in addition to the Real Estate and Housing Developers' Association Malaysia (REHDA) agreeing to reduce prices of houses by as much as 10% (this follows SST exemption on construction materials). Elsewhere, Malaysia will also for the first time impose a two-pronged excise tax of 40 sen/litre on sweetened beverages (i.e. containing added sugar of more than 5gm per 100ml drink) starting from April 1 next year. This is as much an effort to encourage Malaysians to lead a healthier lifestyle given that a study by the Health Ministry found that nearly one in two Malaysians are overweight or obese. Such moves may not augur well for F&B companies like Dutch Lady Milk Industries Bhd, Nestle (M) Bhd and Fraser & Neave Holdings Bhd in the long term.

LIFTING THE CONSTRUCTION SECTOR GLOOM

Elsewhere, austerity measures focusing on cost rationalisation involving mega infrastructure projects are also welcomed although they will somehow hurt the revenue/profit projections of the listed contractors. The measures, among others:

- The government's commitment to the mega infrastructure projects will somehow restore investors' confidence in the construction sector given the KL Construction Index, which measures the performance of stocks under that sector, has dipped almost 42% from 281.13 on the eve of the May 2018 general election to close at 163.34 as of Oct 30.

- Aside from the MRT2 and LRT3, other mega infrastructure projects - the East Coast Rail Link (ECRL), KL-Singapore High Speed Rail (HSR) and MRT3 - will continue to be shelved pending future review.

PETRONAS CHIPPING IN

Amid higher global oil prices, the government is expected to collect revenue of RM261.8 bil including a special dividend of RM30 bil from Petronas (2018: estimated RM24 bil; 2017: RM16 bil). Essentially, the special dividend has enabled the government to grow revenue by 10.7% to RM261.8 bil, hence containing its fiscal deficit at 3.4% or RM52.1 bil despite operating expenditure growing by 10.7% to RM259.9 bil. While these improvements should be viewed positively by rating agencies, the fact that revenue will see a 2% or RM4.7 bil decline in 2019 without Petronas' special dividend contribution could raise a red flag which will ultimately become a thorn in their evaluation.

Moreover, slower global economic growth and a rise in supply from oil majors, namely the US, Saudi Arabia, Libya and Russia, may see crude price fall below US$70/barrel in 2019, thus posing a risk for Malaysia to achieve its fiscal revenue target. It is hoped that rating agencies in the likes of Fitch. S&P and Moody's would look beyond the special dividend factor (or even the abolition of GST) given the government is initiating new revenue sources (vis-a-vis the introduction of new forms of taxes) or has embarked on a major move to pare debts and other liabilities through a concerted effort to plug wastages (curbing overstaffing in the civil service or payment of fat salaries Source: TA Securities to key personnel) and leakages (combating corruption and abuses of funding). Moreover, rating agencies should also take cognisant of the following initiatives: • The setting up of a national Debt Management Office to review and manage government debts and liabilities, and monitor new debt issuance by government, statutory bodies and special purpose vehicles, and • The Ministry of Finance (MoF) to helm a special task force to review the role and function of MoF-owned firms and statutory bodies to avoid duplication and direct competition with the private sector.

"It can be deemed as a decent budget that attempts to bridge the fiscal gap with high impact projects and targeted subsidies without negatively impacting economic growth and burdening the people with new taxes."

MOVING FORWARD

At a glance, the higher-than expected budget deficit numbers may prompt foreign investors to shy away from the local market in the short term. Likewise, there is pressure on the ringgit judging from the deficit numbers. Overall, Budget 2019 bodes well for the investor community by having primarily lifted the gloom pertaining to policy direction and the type of reform Malaysia is embarking on to rebuild its economy and financial position. In all fairness, it can be deemed as a decent budget that attempts to bridge the fiscal gap with high impact projects and targeted subsidies without negatively impacting economic growth and burdening the wider populace with new taxes.

ENDS

Ismitz Matthew De Alwis *is the executive director and CEO of Kenanga Investors Bhd and also the current president of the Financial Planning Association of Malaysia (FPAM). He is a certified financial planner and holds a Capital Market Services Representative's Licence from the Securities Commission.*

Article Source:
Focus Malaysia (10 November 2018)

Allaying investors' pessimism

- **Striking** a balance between ensuring growth amid global uncertainties and committing to fiscal consolidation
- **The** aftermath of Budget 2019 provides clarity on policy and market direction

By **Junita Matthew De Alwis**

Source: TA Securities

Assortment of taxes

Lifting the construction sector gloom

Petronas chipping in

Moving forward

> **"It can be deemed as a decent budget that attempts to bridge the fiscal gap with high impact projects and targeted subsidies without negatively impacting economic growth and burdening the people with new taxes."**