Kenanga Investors

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STEERING MALAYSIA OUT OF THE ECONOMIC DOLDRUMS

Focus Malaysia (27 October 2018)

By Ismitz Matthew De Alwis

- **BUDGET** presents the chance to send signal to investors about the reform and growth opportunities available

- **GOVERNMENT** expected to stay the course of fiscal and debt consolidation while exploring new revenue streams

- **DIRE** need to address structural challenges – incomprehensive social safety nets and rising cost of living; stagnant productivity growth and low returns to labour; and insufficient highskill, high-income jobs for locals

At the rate events – both corporate and market-sensitive in nature – are unfolding, the tabling of Budget 2019 on Nov 2 is likely to be a sombre affair. To say the least, there is hardly any indication of a pre-budget market rally even with the event just around the corner. Already widely anticipated to be a prudent budget, the one million dollar question is probably the degree of belt tightening that the economy is able to endure given the nation's debt level which has surpassed the RM1 tril mark. After all, Finance Minister Lim Guan Eng who will be tabling Budget 2019 recently hinted that the budget will likely be one of "sacrifice".

In so far as the capital markets are concerned, the emphasis should be on "substance over form" – it does not matter if Budget 2019 is the first national budget prepared by the Pakatan Harapan government after emerging victorious in the 14th General Election on May 9. The crux of the matter is how the budget is able to shore up a consistent flow of funds into the local bourse even as the government strives to fine-tune fiscal reform measures that have been promised in its election manifesto. We expect the government to stay the course of fiscal and debt consolidation while exploring new revenue avenues. We continue to anticipate expenditure rationalisation by the government, hence a review of cash aid (such as BR1M or the 1Malaysia People's Aid) and fuel subsidies. Potential new tax sources may include a soda tax and digital tax or an increase in existing sin taxes (tobacco, liquor and gaming).

Speculation is also rife that the government may introduce an inheritance tax and/or capital gain tax which, in our view, may be more likely only in the medium- to longer-term as they require both in-depth studies and a comprehensive tax review prior to implementation. The government has also announced potential monetisation/ divestment of assets to pare down public debts which may include sale of shares/land, leasing of assets/buildings or even the listing of national oil corporation Petroliam Nasional Bhd (Petronas). Budget 2019 may shed more light into the assets involved and the potential timeline.

The property sector and affordable housing issue will be another focus for the upcoming budget. We believe clearer policies are likely to be laid out to assist first home ownership, unification of various affordable housing supply schemes as well as a clearer stance on property purchase by foreigners. To spur investment and growth initiatives, the government is expected to incentivise automation/modernisation and Industry 4.0 aimed at reducing dependency on foreign labour. Elsewhere, Budget 2019 will also provide better policy clarity for a wide range of issues, i.e. lowering the cost of living for the masses, potential monetisation of government assets, home ownership and the Bumiputera agenda, as well as those that span different economic sectors such as automotive, financial, manufacturing, oil & gas, property, telecommunication and tourism. As rightly pointed out by the World Bank lead economist for Malaysia, Richard Record, Budget 2019 is not only an important opportunity to set the tone for the next fiscal year but also the years beyond.

ECONOMIC OVERHAULING

"It's important how the government will try to balance between the challenges of fiscal consolidation and growth as well as debt," he told a recent media conference at the bank's East Asia and Pacific Economic Update event. "Most importantly, this is the chance to send the signal to investors and private investors about the reform and growth opportunities that Malaysia has." Undoubtedly, everybody – from mega corporations to small and medium enterprises and from high net worth individuals to retail investors and man-in the- street – harbour their very own desire as to how Budget 2019 should benefit them. Obviously, a delicate balancing exercise awaits as number crunching is never easy whenever the ultimate aim is to derive an across-the-board satisfaction. For businesses, the budget is likely to elicit smiles from some industries while others may feel that their interests have been overlooked.

On the part of the government, there is a dire need to address structural challenges in the likes of (i) incomprehensive social safety nets and rising costs of living; (ii) stagnant productivity growth and low returns to labour; (iii) insufficient high-skill, high income jobs for locals and a need for the labour force to adapt to technological disruptions, and (iv) non-inclusive and unbalanced economic development. From a fund manager's perspective, there is a pressing need to address the widening wealth gap among the T20 (Top 20%), M40 (Middle 40%) and B40 (Bottom 40%) groups before any type of reform can yield optimum results.

Narrowing the existing gap will improve financial literacy which is crucial to spur more households towards exploring innovative means to grow their wealth via investments. As attested by the Mid-Term Review of the 11th Malaysia Plan, the wealth gap issue – if left unchecked – can also be a major stumbling block for Malaysia to pursue its goal of achieving a high-income or developed nation status. Likewise, we think human capital development is the key measure to narrow the income gap in the medium- to long-term. As such, the government is expected to focus on education provision and human capital development, especially for the less urban and less affluent population. In the meantime, the government has always targeted efforts to assist B40 such as roll-out of BR1M and fuel subsidies, launch of affordable housing schemes and reduction of broadband prices. We therefore expect the government to continue similar efforts – albeit lowering the hand-outs – targeted at B40 in the near term.

CURTAILING SPENDING

In the quest to pare down meteoric public debt levels, the government has either postponed, shelved or scrapped some mega infrastructure projects, including the KL-Singapore High Speed Rail, Mass Rapid Transit Line 3 and the East Coast Rail Link. On top of that, the government has also reduced the cost of certain mega projects such as Light Rail Transit 3 from RM31.65 bil to RM16.63 bil (savings of RM15.02 bil) and MRT Line 2 above-ground works from RM22.6 bil to RM17.4 bil (savings of RM5.2 bil). While trimming of lavish spending which led to wastage and leakage is deemed healthy, this has led to many listed construction firms seeing red as evident from the plunge in their stock prices (the construction index has dropped almost 45% year-to-date). Such development inadvertently has spill over effects on market sentiment with domestic events – coupled with uncertainties on the global front – being a drag on the FBM

KLCI. Moreover, investors' sentiment may have been further dampened following the revelation that the government is contemplating to impose a wide array of taxes to create new revenue streams.

With their confidence rattled, investors on Oct 10 reacted by throwing their tantrum on the FBM KLCI with a bashing of 38.97 points or 2.2%. Despite the pessimistic scenario with year-to-date foreign fund outflow having breached RM9.8 bil, it has to be borne in mind that Malaysia still has the second lowest outflow (after the Philippines) among the four Asean markets (the others are Indonesia and Thailand) tracked by MIDF in its weekly fund flow report. In all frankness, it's unclear which direction Bursa Malaysia will drift in the immediate term. But for sure, Budget 2019 will have significant implications for the market given fiscal constraints and the nature of ideas being floated on new sources of revenue.

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Ismitz Matthew De Alwis *is the executive director and CEO of Kenanga Investors Bhd and president of the Financial Planning Association of Malaysia (FPAM).*

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Steering Malaysia out of the economic doldrums


The government is expected to review cash aid schemes such as BR1M and fuel subsidies

By **Ismitz Matthew De Alwis**

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Curtailing spending

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