AFFIN HWANG CAPITAL Asset Management

FUNDAMENTAL FLASH

Newsflash | Views on Budget 2022

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With a focus on recovery, the recently tabled Budget 2022 is touted as the largest one to-date with an allocation of RM332.1 billion.

The expansionary budget will see it being financed by new tax measures such as the Cukai Makmur (one-off prosperity tax) to plug any revenue gaps and narrow the fiscal deficit.

Gan Eng Peng, Senior Director of Equities shares his views on its potential market impact as well as other measures of Budget 2022 in our latest Fundamental Flash.

Flashpoints

- The one-off prosperity tax potentially mutes the growth outlook for the local market with already modest earnings growth in 2022.
- It also introduces future policy uncertainty for corporate Malaysia in terms of new tax measures meant to socialise profits.
- Markets could see a kneejerk correction in the near-term with the absence of any catalysts.
- Depending on the magnitude of the selldown, we plan to gradually raise the cash levels of our local portfolios.

<u>Questions</u>

1. How would a one-off prosperity tax impact the local market?

The newly announced Cukai Makmur will raise the corporate tax for companies earning above RM100million in pre-tax profit from 24% to 33%.

This only applies to Malaysia sourced income and is applicable for the year of assessment 2022.

The government has projected that the prosperity tax would raise up to RM4.9 billion.

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In our view, we believe the wealth destruction via the capital markets could be greater than the potential income raised. This 37% spike in tax rate effectively wipes out most of the already modest 5%-10% earnings growth of 2022.

Markets are priced-off future growth, the lack of which leads to potential derating as well as immediate kneejerk selldown to account for this impact. We think the broader market might correct 1%-3% in the near-term, potentially wiping off RM20-50 billion in value.

This prosperity tax also potentially mutes the growth outlook for 2022, leading to a flat market if there is no derating. We think investors won't look into 2023 prospects yet. It also introduces future policy risk for corporate Malaysia, i.e. that it is okay to socialise profits in times of need. Corporates might also be incentivised to report lower profits in 2022 to minimise the tax burden.

2. Any other measures contained in Budget 2022 that could impact markets?

Other significant announcements in Budget 2022 include the removal of the stamp duty cap on share transaction of RM200 and an increase of stamp duty from 10 bps to 15 bps. This makes large share transactions less efficient and could result in reduced velocity of trading.

The lack of any further property pump priming measures will also disappoint the recent strong rally in shares of property developers.

3. Which sectors are the most and least affected?

The hardest hit sectors will be the banks, telcos, utilities, large oil & gas players, gloves and plantation companies. A point to note is that the prosperity tax does not apply for offshore income as well as those companies that have special tax incentives like pioneer status.

The tax is also imposed at the individual subsidiary level, so entities with multiple subsidiary profit centres will have a lesser tax impact.

The least affected sectors are small-caps and the technology sector. However, the secondary effect of a large-cap selldown might affect all constituents.

4. How are we positioning our Malaysian equity portfolios?

Our local portfolios were heavily weighted coming into Budget 2022 with notable exposure in the financial and telco space. Depending on the magnitude of the correction, we plan to gradually raise the cash levels across our domestic funds to a range of 5%-10% post announcement.

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