Malaysia Baru, Where Art Thou?

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It has been one year since the watershed 14th general elections (GE14), when the Pakatan Harapan (PH) government unexpectedly trumped Barisan Nasional (BN) 6 decade rule to wrest control of Putrajaya. However, market reaction has not been kind with the benchmark KLCI plunging close to 12% since May 2018 as euphoria dissipates over lack of policy clarity and sluggish growth, making us the only regional market to be in the red this year.

One year on, where is Malaysia Baru headed? Is the local market really that short of zest to be considered 'boring'? In the following interview, Gan Eng Peng, Director of Equities Strategy & Advisory, Affin Hwang Asset Management offers some perspective and if the market has bottomed out.

Questions

1 As we approach the one-year anniversary of PH government coming into power, what's your assessment of the market so far and speed of reforms?

Malaysia is the only decent size market globally to be down this year. We did not benefit from the liquidity driven risk-on rally. Even Thailand, which had an inconclusive election has fared better than Malaysia.

It is fair to point that the speed and effectiveness of reforms has been lacking. There has been a lot of own goals, flip-flops and policy risk coursing through corporate Malaysia. Wholesale changes of top corporate personalities would grind down decision making. To be clear, Malaysia is economically healthy – it's just the animal spirits that has been taken down. The velocity of money has slowed. People are not driven to invest even though there is tremendous wealth on the side-lines.

2 Are markets just too impatient or are there other external factors ailing the market?

Last year there were various external factors weighing down on markets, so we could hide behind these issues and said we were suffering together. But the performance this year has ended this debate of whether it is a global issue overhang or domestic underperformance. It is clearly domestic underperformance.

Markets are always impatient. It is a real-time measure of the performance and prospect of the country via its listed corporate.

3 We've since seen the revival of the East Coast Rail Link (ECRL) project after several rounds of negotiations. Market expectations are for the resumption of other mega infrastructure projects too like the HSR and MRT Line 3. Do you think there could be a shift in tone by the government from cost-cutting to now pump-priming the economy?

The positive lining to this doleful story is that all stakeholders are on the same page now. I would say 6-9 months ago, government policy makers are still of the belief that they could embark on heavy reforms without focusing on growth policies to balance out prospects.

After a string of by-election losses, poor market performance, weak currency and general shrinkage of wealth, we think the government is clearly in the mood to address the lack of growth policy and concerns of markets. Markets essentially price off growth, the lack of which deflates prices.

Hence, we think we are at a market trough. We think the Malaysian market will play catch up with the Asian and global rally. Maybe not as strong but it should be a positive rally at the least.

The way the government appear to be addressing these market concerns is to firstly reverse some of the projects that has been shelved. Secondly, to drive in more foreign direct investments (FDI) especially from China.

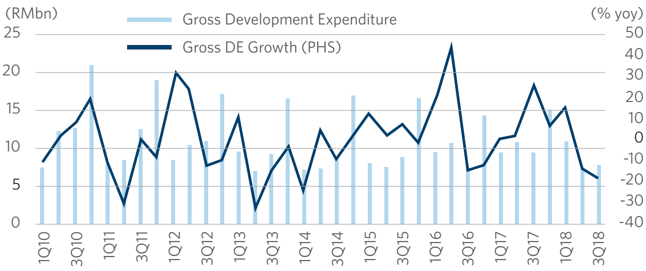
Out **think.** Out **perform.**

4 ***Many have lauded Tun Mahathir deftness in handling the East Coast Rail Link (ECRL) negotiations without upsetting our largest trading partner China. With improved bilateral relations, do you expect improved business confidence and FDI flows from China to return in a big way? Would this be a boost for markets?***

The recent revival of ECRL and now Bandar Malaysia has certainly put a spark into the construction industry. We think this is the beginning of a broader marker revival. The slowing economy is self-induced. The revival of these projects would not only jump start the construction industry, but bring back some animal spirit into the market and we think eventually the economy, which is much needed.

From a technical perspective, so many things have gone wrong for Malaysia that from an investment perspective, it is hard to see the negative streak continuing. Cumulative foreign selling of local shares has erased all inflows since 2010. The benchmark KLCI has lagged so much versus the MSCI Asia Pacific ex-Japan Index that such an event only occurred 0.3% in the last 5 years statistically.

Table 1: Malaysia Government Not Spending Enough?



Source: Ministry of Finance, 2019

Table 2: Infrastructure awards to be awarded in 2019 onwards

Project Cost	(RMdn)
East Coast Rail Link	44
Penang Transport Master Plan (PTMP)	32
Pan Borneo Highway Sabah (PBH)	13
Sarawak Coastal Highway	5
Sarawak Second Trunk Road	6
Sarawak Water Grid Phase 1	8
Klang Valley Double Tracking	4
Total	**112**

Source: Affin Hwang Capital, various Media (The Star, The Edge)

5 ***Bank Negara Malaysia (BNM) lowered its GDP forecast this year expecting growth to expand by 4.3% to 4.8% in 2019, compared with 4.7% in 2018. The central bank also maintained its dovish tilt with expectations of an OPR cut in the 2H'19. Do you expect growth to remain placid or will a rate cut help to spur consumption?***

Interest rate cuts generally makes cost of borrowing cheaper, hence it tends to spur loan growth. It also makes returns on deposits lower, encouraging depositors to seek better returns on margin, which is a form of investment inducement. We are only expecting at best a 25 basis points (bp) cut in interest rate, which is not significant. A more dire economic situation may warrant a deeper cut, but we are far from such a situation yet.

The recent planned review by index provider FTSE Russell who may drop Malaysian bonds from its global index could postpone the decision by Bank Negara Malaysia (BNM) to cut the overnight policy rate (OPR), as interest rates are also used as a tool to control flows of currency.

6 ***Are markets also concerned about a smooth political transition to Datuk Seri Anwar Ibrahim as the new PM? What other hurdles does the local market need to overcome to stem foreign outflows and bring back confidence?***

Among the many market concerns is one of continuity of leadership, hence policy. How do we know that whatever positive policies we are seeing now will be retained in 1-2 years' time when there is a promised Prime Minister transition? Will there be a wholesale Cabinet change? How does one make a 5-10-year direct investment decision when the political situation is so fluid?

These are some of the constant concerns we are hearing from foreign fund managers and corporates. Until the current administration can address such an issue, it will remain an overhang. It will be one of the many concerns, but not a death knell for the market or rally.

Malaysia Baru: Timeline of Events

2018

9 May - 11 May
Pakatan Harapan wins historic GE14. Tun Dr Mahathir Mohamad was sworn in as the Prime Minister (PM) making his second stint in office.

12 May
The Council of Eminent Persons was formed to advise the government.

16 May
Datuk Seri Anwar Ibrahim receives royal pardon and released from prison.

21 May
RM 1 trillion debt revelation by Finance Minister YB Lim Guan Eng.

5 June
Clean-up begins. A massive GLC and agency shakeup led to the removal of several heads including Bank Negara Malaysia (BNM) Permodalan Nasional Berhad (PNB), Telekom, Felda and Malaysian Anti-Corruption Commission (MACC).

3 July
Ministry of Finance (MOF) issues suspension notice on all ECRL works.

3 Aug
Datuk Shahril Ridza Ridzuan appointed as MD of sovereign wealth fund Khazanah. Datuk Shahril replaces Tan Sri Azman Mokhtar, after the entire Khazanah board resigned en-masse with 8 other directors.

17 Aug - 21 Aug
PM Tun Dr Mahathir makes first official visit to China as PM.

1 Sept
Sales and Services Tax (SST) regime makes a comeback with 10% rate for sales and 6% for services.

2 Nov
PH maiden's federal budget was tabled in Parliament. Budget 2019 was a mildly expansionary one which stuck to fiscal consolidation, whilst providing a social safety net to the vulnerable B40 group.

2019

January
Malaysia's economy swung into deflation territory for the first time since November 2009 as fuel prices dropped. Consumer prices declined 0.7% from a year ago.

11 Feb
A newly formed Economic Action Council (EAC) was set-up by the government to help stimulate economic growth and accelerate policy execution.

3 Apr
Former PM Datuk Seri Najib Razak has his first day in court. Charges including criminal breach of trust and abuse of power were laid against the former premier in relation to the RM42 million SRC International Sdn Bhd's money that was deposited into his accounts.

12 Apr
ECRL project is reinstated. Under the revised deal, the project will proceed at a reduced cost of 32.8% to RM44 billion compared to its original cost of RM65.5 billion.

19 Apr
Mahathir announces the revival of Bandar Malaysia. The development project was awarded back to the original consortium and would prioritise for the use of local content in the construction process.

25 Apr - 28 Apr
Mahathir makes his second trip to China to attend the Belt and Road Initiative (BRI) Summit. Both countries inked several MOUs including an agreement to enhance palm oil trade.

Source: Various media and news reports (Malaysiakini, Bloomberg, The Edge, etc.)