FUND MANAGERS

by Ernest Chan | 9 hours ago

Market Views: How will Malaysia treat global investors?

After last week's stunning election upset in Malaysia, we asked five experts on what the new government's policy priorities are likely to be and whether it will stay foreign-investor-friendly.

On May 9, Malaysian voters handed the United Malays National Organisation (UMNO) and the ruling Barisan Nasional (BN) coalition their first electoral defeat since Malaysia's independence in 1957.

Led by 92-year old Mahathir Mohamad, the opposition Pakatan Harapan coalition (PH) and its allies took 121 seats of the 222-seat Malaysian parliament, ousting embattled prime minister and UMNO president Najib Razak.

In the aftermath of the historic election result, market observers are looking to PH's campaign platform to gauge the expected impact of the change in government. The ruling coalition's promises include reviewing all big projects awarded to foreign firms, abolishing the country's goods and services tax, and reintroducing fuel subsidies within the first 100 days of office.

PH has also promised to implement a Royal Commission of Inquiry, a major formal public inquiry, to investigate 1Malaysia Development Berhad (1MDB). The state development fund has been plagued by scandal. Razak, who is also the chairman of 1MDB, has been accused of funnelling hundreds of millions of dollars into his personal accounts, prompting our sister publication *FinanceAsia* to name him Asia's worst finance minister of 2016.

We asked chief investment officers at two wealth management companies, a fund house CIO, an emerging markets and Asia equities specialist, and an economist whether PH's election victory is a positive for foreign investors and about its likely impact on corporate governance and local markets.

The following transcripts have been edited for clarity and brevity.

Markus Mueller, global head of CIO office

Deutsche Bank Wealth Management

It is important that the new government take a policy direction that is prudent by supporting economic development and inclusive growth, as well as the openness of the country for foreign investors, and improving the business climate.

The new government's attitude to Chinese investments will be important: there is a possibility that the new government could slow down fixed investment project approvals in the near term.

China's foreign direct investment inflows to Malaysia were significant in recent years and a lot of them are related to mega-construction projects. The new government will possibly review these projects again and this would slow down the fixed investment growth in Malaysia, leading to slower economic growth.

It's still unclear what the key government policies are in the business sectors. However, if the new government is willing to promote more openness to foreign investors, corporate governance in Malaysia could improve with increased competition from foreign companies.

In the medium-to-long-term … this election could be positive to Malaysia's economy. It could provide a good chance for Malaysia to solve some institutional problems in government. The new government may be able to address some of the corruption problems in the old government and achieve higher efficiency in policy implementation. This will be positive to the economy in the long term.

The financial market has been relatively calm this week after the initial volatility. Therefore, there is less need for Malaysia's central bank, Bank Negara, to react to the election results.

However, the Bank Negara's monetary policies in the second half of this year would matter to investors in an environment of likely higher financial market volatility caused by government policy uncertainty, possibly slower economic growth and higher inflation.

Virginie Maisonneuve, chief investment officer

Eastspring Investments

One of the headwinds the new government will face is how to maintain economic growth, especially if the oil price, which is currently providing a boost, dips. Foreign investment is one way to counter this. However, Pakatan Harapan has been clear in its intentions to review major foreign investments in public projects, especially those involving China-linked infrastructure projects.

On the one hand, this means it is unlikely the three Kuala Lumpur rail projects currently under construction, the pan-Borneo Highway, or even the Singapore to Kuala Lumpur high speed rail line will come under serious scrutiny. But the East Coast Rail Link, the Kuantan Industrial Park, and the Proton-Geely joint venture, as well as a handful of others, probably will.

The new government says it wants to review these projects to assess the costs and benefits to the domestic economy, including debt markets.

China's foreign direct investment (FDI) inflow into Malaysia totalled almost RM9 billion ($2.3 billion) in 2016 and more than RM10 billion in 2017. These are dramatic numbers and an important increase from prior years, but Chinese FDI remains at only 7% of the total arriving into Malaysia, so in a worst-case scenario, yes, there may be a dip in investment. But that gap is 'pluggable'.

South Korea, Singapore, Japan, and the European Union, among others, have all increased their investment in Malaysia since 2008, according to Bank Negara, and should the new government choose to do so, it can encourage more.

It also means showing outside investors it is willing to strengthen governance, which, from our perspective as a UN PRI signatory, will be beneficial to the country. Malaysia lies 62nd in Transparency International's respected Corruption Perception Index for 2017, alongside Cuba. If it wants to improve this ranking and increase its attractiveness as an investment hub, constructive changes will have to be made to both the law and to business culture.

A start has been made in reopening the investigation into 1MDB, as well as promising police increased pay, pledging more transparency in government procurement plans, and many more positive-sounding anti-graft measures.

It is clear that in order for Malaysia to improve its attractiveness as an FDI destination, including plugging the gap left if China FDI is scaled back, delivering on these promises is key. Until then, businesses are still likely to adopt a wait-and-see stance.

Will Ballard, head of emerging markets and Asia Pacific equities

Aviva Investors

It remains unclear whether Mahathir's government will be explicitly, positively disposed towards foreign investors. We do not, however, believe that this is the most important issue. As long-term investors, the perception of corruption, censorship and the rule of law are all much more significant and relevant factors that determine allocation of capital to, or away from, a country.

If Mahathir's government can improve transparency and reduce the perception of corruption, then it can be nothing but positive for foreign investor confidence and their desire to invest in the Malaysian economy.

The critics point to the populist agenda of the winners' election manifesto – among their 60 pledges is the potential rolling back of the much-maligned goods and services tax and the re-introduction of some fuel subsidies – and the fact that Mahathir is part of the old establishment, with the emphasis on both "old" and "establishment".

In our view, what is quite clearly missed is the cathartic benefit the country will gain from this change in regime. Over the years, Malaysia has seen a steady clampdown on the press and political freedom and a creeping rise in corruption, culminating in Najib's alleged misappropriation of assets from 1MDB and the sentencing of political opponent Anwar Ibrahim on questionable charges.

It is a great credit to Najib and Barisian National that this transition appears to be proceeding peacefully. Should Mahathir stay true to his word and relinquish his seat to Anwar on his release from jail, this will, in our view, be a strong signal that Malaysia is moving in the direction of a fully-functioning democracy backed by the rule of law.

Jamus Lim, economist

Thirdrock Group

If you look at the data, you'll find that Malaysia's existing level of corporate governance isn't actually too poor. Depending on the specific measure, it is comparable, if not better, than many other upper-middle income countries, and even higher than some industrialised economies such as South Korea, which struggles with chaebol-related corporate governance challenges, and Turkey, which faces governance challenges due to excessive firm concentration.

That said, there is a close relationship between corporate governance and the overall quality of governance in the economy. Much of this is bidirectional: a more corrupt government, for example, is more likely to overlook or tolerate corporate shenanigans, while poor corporate governance can undermine exchange relationships and give rise to a more corrupt mindset.

Does this matter for investors? Yes, but only at the margin. In general, more traditional factors – firm profitability, current valuations, and management quality – are likely to matter more. Corporate governance will come into play only after all these factors are accounted for.

There could be short-run costs if the government goes ahead with implementing some of its election promises. For example, if the new government does decide to re-evaluate or renegotiate terms on pipeline large-scale infrastructure projects, this will likely be detrimental to the earnings of construction-sector corporates that were previously in the running for said projects, and in turn their equity prices.

By a similar token, a rollback on tax reform will mean a deterioration in future fiscal and debt positions, forcing up yields on government bonds and potentially spilling over into wider corporate bond yield spreads for companies with weaker balance sheets.

If inflation rises as a result of a sustained ringgit depreciation, as it has in the runup to and since the election, then Bank Negara will face the uncomfortable prospect of having to raise interest rates to support the currency just when the economy could use a short-term boost from a relaxation in monetary policy.

The caveat to all this is that credible, sustainable structural reforms in the longer run have the potential to offset some of these shorter-run costs. For instance, if the new administration adopts serious steps toward improved governance and institutions, this can bolster growth prospects, which can more than make up for the negative short-run shock on the fiscal side.

Kelvin Tay, regional chief investment officer

UBS Global Wealth Management

In the short term, this change in government after such a vicious election campaign is likely to usher in a period of uncertainty.

We expect the equity market to react negatively to the election result, as the consensus was for a slim Barisan Nasional majority. Foreign ownership of Malaysian equities, which is at its highest level since the last election in May 2013, is likely to decline.

We expect government-linked stocks, large-cap stocks, construction plays and stocks with high foreign ownership, which have held up well this year, to succumb to profit-taking. These include sectors such as banks and utilities. Investors might wish to consider staying on the sidelines until the dust settles, in our view. Given our expectations of a weaker ringgit, we believe exporters might be more attractive on a relative basis.

Private consumption should remain elevated, boosted by election related spending and handouts. Pakatan Harapan's promise to abolish the goods and services tax and reinstate fuel subsidies should also boost real income.

Inflation is likely to remain flattish this year, with stable consumer prices. Fuel prices have been unchanged so far despite Brent oil prices breaching $75 per barrel, a logical strategy in an election year. The incoming government is unlikely to raise prices any time soon either, and therefore we expect both headline and core inflation to remain fairly stable.

We raise our US dollar to Malaysian ringgit forecasts to $4.10 in three months, previously it was $3.80, and [to] $4.00 in six months from a previously forecast $3.80. Based on the election manifesto of the incoming government, we believe the ringgit is exposed to downside risk toward $4.10 versus the US dollar.

Market sentiment on the ringgit could deteriorate for two reasons. First, in its election manifesto, the party committed to several populist measures, including abolishing the goods and services tax, which has helped offset the decline in oil-related revenue. Second, the outlook for Chinese FDI in Malaysia could become hazier, given Mahathir's recent comments that he will look more critically at it.

Want to know what's next for Malaysia?

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