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Onward with growth

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BUDGET 2001 has received mixed response. While various quarters have hailed it as forward-looking, some feel not enough 'goodies' were dished out by Finance Minister Tun Daim Zainuddin.

In any case, the stock market reacted negatively while stocks such as tobacco and alcohol took a beating. Were expectations too high from the business community?

For one, there were the pre-budget hopes of personal and corporate tax cuts, incentives for foreign direct investment (FDI) and complete removal of the exit levy on share gains. There were no tax cuts - instead, duties on tobacco and alcohol were raised. There was, however, plenty of cheer for public-sector employees, and gains for the infrastructure and information and communications technology (ICT) sectors.

'The budget was in line with our expectations,' says Johan Tazrin Ngo, executive director and senior fund manager at Kenanga Investment Management Sdn Bhd, the investment adviser to Kenanga Unit Trust.

The 2001 Budget will see the government continue to adopt an expansionary fiscal policy that will run a deficit of RM16.1 billion or 4.9 per cent of Gross National Product (GNP). The budget deficit for year 2000 was revised upward to 6 per cent of GNP or RM18 billion. This is the fourth straight year the budget is in deficit as the government sees the need to provide stimulus to sustain economic expansion.

Nizam Idris, regional economist at IDEAGlobal, an economic consultancy firm based in Singapore, says, 'The deficit reflects the country's reliance on public investment and the government's awareness that the current economic strength remains largely cyclical in nature.' The size of the deficit came as a surprise as the government was expected to go for a surplus or a small deficit, based on signals from Prime Minister Datuk Seri Dr Mahathir Mohamad in the local media.

Nizam adds, 'These huge deficits would make it harder for the government to balance the budget in the near future due to higher debt servicing and amortisation and are likely lead to higher inflation and interest rates in the long run.'

Another surprise was the review of economic growth for year 2000 to 7.5 per cent from 5.8 per cent, and 7 per cent for year 2001. Nizam believes the 7 per cent growth target for 2001 is a 'tad too optimistic' if compared with the market's mean forecast of 6.6 per cent. He expects the economy to grow by 6.5 per cent in 2001.

Kenanga's Johan says, 'The government's forecast may be on the high side given current trends in economic data. Our growth expectations are at the mid range of consensus forecasts, and hence we expect growth of between 5-6 per cent in FY2001.'

The current year economic expansion is expected to be in the region of 8.4 per cent, according to Nizam, while Johan expects a growth of 8 per cent.

In the first half of 2000, the economy expanded by an average of 10.3 per cent. Based on the budget figures and from the official point of view, the second half should expand by an average of 4.7 per cent.

The Malaysian Institute of Economic Research (Mier) expects the economy to grow by 8.4 per cent for 2000 and slow down to 6.3 per cent in 2001 due to a weaker US economy and softening in demand for personal computers, compounded by an expected tighter monetary environment to keep price

pressures in check, and uncertainty over foreign direct investment inflows.

Mier in its 'Malaysian Economic Outlook' report notes that its business condition index (BCI) in the third quarter fell by 5 points to 59.4 from the second quarter and by 2.8 points against the same quarter in 1999. The economic growth is expected to be driven by a relative strong performance from the electronics sector, growth in consumption and expansionary spending by the government while the external economic environment gives mixed signals of possible problems and opportunities for continued sustainable growth.

The government has allocated RM4.7 billion for infrastructure development such as bridges, ports and roads for 2001 aimed at improving the welfare of society and to contribute to real economic growth.

Inflation is expected to be subdued in 2000 but Kenanga expects it to rise in 2001 to 2.3 per cent due to cost-push pressures. 'Inflation next year should be well behaved, which gives positive indication on interest rates. Although, demand-pull inflationary pressure is weak, the CPI would initially be affected by adjustments in controlled items, which constitutes a heavy weight on the CPI. Hence, we may see a 25 basis point rise in short-term rates to compensate for higher CPI numbers,' says Johan.

Nizam believes the government will continue implementing a loose monetary policy. He expects the government to tap foreign capital markets to maintain the high liquidity situation in the country.

'With supply-side pressures building due to higher oil prices and government pump-priming, the interest rate outlook is likely to be on the high side, with the Kuala Lumpur Interbank Offered Rates (Klibor) more likely to inch up a full percentage point in 2001 with inflation rising to 3.2 per cent in 2001 and 3.3-3.5 per cent in 2002.

Johan says the central bank's intervention rate will likely remain at the current 5.5 per cent level as he expects it to keep monetary policy accommodative of promoting growth at the expense of banks operating with slightly lower margins.

Many wanted to see the abolishment of the 10 per cent repatriation tax or exit levy for portfolio investment. What they got was an exemption of the levy for funds remaining in the country for more than 12 months.

Johan says, 'We felt that the exit levy should have been removed to make the local market more attractive and competitive for foreign liquidity. Competition for portfolio flows is as competitive as ever, and although we did not expect a flood of short-term money into Malaysia in the short term, the removal of the exit levy would have put Malaysia in a better position to attract portfolio flows in the medium to longer term. In order for Malaysian corporates to complete their restructuring exercises successfully, a healthy stock market is essential.'

The budget imposed a maximum RM200 stamp duty on all share transactions, which Nizam says is nothing new to foreign investors. He believes it will not lead to new investments in the KLSE. He adds that fund managers seem to be keeping Malaysia at arm's length due to the manner the country handled the 1997/98 crisis, rather than the exit levy issue.

The problem is further compounded by the fact that fund managers are awaiting the result of the Morgan Stanley Capital International (MSCI) proposed weighting changes, expected to be made public by the end of the year.

Taking into consideration the above and prospects for the economy for the coming year, IDEAGlobal does not see the KLSE CI rising significantly above the 900-point level by the end of 2001.

Kenanga's Johan expects earnings per share (EPS) growth of 15-20 per

cent in FY2001, and with a current market price earnings multiple of 15 times, this should translate to a fair value CI target of approximately 920 points if EPS growth comes in at the higher end of expectations.

Probably the most important point of the 2001 Budget was the acknowledgement by the policy-makers that FDIs and an open market are and will remain the cornerstone of the country's economic well-being.

The government has over the last few months begun to adopt a more receptive attitude towards equity and management participation of foreign interest in industries that were considered 'infant' or 'of national interest', such as transportation and automotive.

Acquisition of a stake by Maersk-Sealand in the Port of Tanjung Pelepas in Johor and by Hutchison Ports Holdings in Westport, as well as talk of foreign participation in Malaysia Airlines and Proton have helped improve the image of the country as an investment destination.

Johan says, 'We were very pleased to hear that the government was keen to have more foreign investments in some of our national assets such as MAS and Proton. Should this materialise, we are confident that such events would be taken positively by foreign and local investors.'

A United Nations study shows that since the crisis, net flows of FDIs into Asean in 1999 was worth US\$16 billion or 17 per cent of the total US\$96 billion that went into developing economies in Asia. China attracted US\$40 billion or 42 per cent of this total and effectively replaced Asean as the most attractive place for investment. In the early 1990s, Asean economies attracted 61 per cent of all investments into Asia, and China only 18 per cent.

The report also adds that investors are beginning to look towards India and Latin America as well.

Noticing this trend, Tun Daim says the economy needs to become much more competitive and receptive to the global economic environment. The 2001 Budget has decided to face up to the New World Order by developing the ICT sector and the K-economy.

The government has set up a venture-capital fund worth RM500 million for investments in ICT-related firms and will outsource expertise to manage it. The government has offered incentives to Malaysians abroad to return home and apply their knowledge here.

As the budget states, the country aims to attract foreign talent 'from Bangalore to California' to achieve this purpose. This probably is the most important message any developing economy could send out to the world on its desire to have its place under the sun amidst the creeping shadows of global giant corporations.

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