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Glad tidings from the South

LATELY, SOME 'FEEL GOOD' SENTIMENTS have been making their way from across the causeway at the southern tip of the Malaysian peninsula. The good news were flowing out from international financial agencies based in the neighbouring island state of Singapore, with rating agency Standard & Poor's (S&P) Rating Services being the latest.

On Marc 4, S&P announced an upgrade on Malaysia's credit rating outlook from 'stable' to 'positive', an action that may be a prelude to the country jumping up one notch in the sovereign foreign and local credit ratings. In a nutshell, such a move would enable Malaysia to raise funds through debt markets at a cheaper rate and fare better in the eyes of the international investors.

While Malaysian hockey fans watched the national team encountering a dead end at the World Cup that was going on in Kuala Lumpur, folks at S&P were busy giving final touches to the press release on the upgrade. There was already market talk anticipating the upgrade after months of attention-grabbing events in the local corporate scene. Then came the news: S&P revised the outlook on its long-term ratings on Malaysia to positive from stable, and affirmed all ratings on the sovereign, including its triple-'B'/'A-3' foreign currency and a single-'A'/'A-1' local currency sovereign credit ratings.

This has been some time in the making. The last action Malaysia saw on this score was on April 4 2001 when the rating agency downgraded the country's outlook to stable from positive. In other words, 11 months down the road, the agency deemed it fit to reverse the position. Some economists agree the move was not unexpected.

'You look at the bigger picture', says Dr Yeah Kim Leng, an economist at Rating Agency Malaysia (RAM), the country's first local rating agency. 'It reflects improving expectations with recovery in world economy and Malaysia's growth prospects. They are looking at the country's good economic fundamentals.'

The outlook revision, according to S&P, reflects the expectation that the government fiscal position will improve ad global economic recovery takes hold, which in turn will ease pressure on the country's fixed-rate foreign exchange regime. The revision of the outlook to positive also reflects the progress made in restructuring the corporate sector and in strengthening the country's external position.

'Now that economic conditions are improving, Standard and Poor's expects the general government accounts to return to balance by 2004, ensuring the general government net debt position remains at less than 25% of GDP, thereby safeguarding the government's fiscal flexibility - a key strength of the credit,' says the agency's sovereign analyst, Chih Wai Liew.

Deciphering the ratings

S&P's country risk considerations are a standard part of its analysis for credit ratings on any issuer or issue. Currency of repayment is a key factor in the analysis. These sovereign risks considerations are incorporated in the debt ratings assigned to specific issues. Foreign currency issuer ratings are also distinguished from local currency issuer ratings to identify those instances where sovereign risks make them different for the same issuer. The positive outlook designated for Malaysia means that a rating may be raised.

At the moment, the country's long-term foreign currency remains at

triple B, which is the second lowest investment grade at S&P. The rating agency has retained that rating for Malaysia since November 1999 when the country began coming out of the Asian financial crisis. The highest rating has been an 'A plus' for the period December 1994 to September 1997.

In line with the latest outlook revision on the sovereign, the agency also revised on the outlook on the triple-'B' long-term foreign currency rating on three major Malaysian corporates to positive from stable. The companies benefitting from the move are Petroliam Nasional Bhd (Petronas), Malaysian International Shipping Corp Bhd, and Telekom Malaysia Bhd. At the same time, the outlook on the single-'A' local currency rating on Petronas was similarly revised to positive from stable.

Corporate restructuring

One issue that must have figured prominently in the run-up to upgrade was corporate restructuring. There is no denying that something of a transformation has been taking place in the local arena since Prime Minister Datuk Seri Dr Mahathir Mohamed took over the position of Finance Minister after the departure of Tun Daim Zainuddin.

Soon after Daim quit in June 2001, the government took over Renong Bhd which saw the exiting of its executive director Tan Sri Halim Saad.

S&P seems to have noticed these developments. This is from an agency that has long been critical of what has been perceived as Malaysia's slow progress in corporate reform and perceived government bail out of debt-laden but well-connected companies.

In its latest action, the agency noted a picking up of corporate restructuring pace in the second half of last year. It says the strengthened Corporate Debt Restructuring Committee (CDRC) accelerated the resolution of outstanding cases, helping to reduce the drag on the economy from non-productive companies.

'At the same time, a number of large and previously politically well-connected corporations were re-nationalized to replace existing management-owners, to quicken debt restructuring, and to dispose of non-core assets. The renewed commitment of the government to push through difficult corporate restructuring is a positive for the economy,' it says.

It was different story a couple of months ago. In an analysis released on May 15 2001, the agency noted that Malaysia's corporate restructuring was only half-complete. It said many restructuring efforts have been in the form of debt rescheduling, although others entailed ambitious new equity issuance.

'The benign corporate-restructuring atmosphere, including support from public funds, has transferred private-sector credit risk to the public sector,' the report added. 'Furthermore, regulatory improvements made to tighten corporate governance have not let to sufficient market-oriented transfers of ownership and changes in corporate management. The government's nationalistic rhetoric could also discouraged foreign participation in sectors that most often require an infusion of market expertise and professional management.'

The agency looked askance at the economy. There was much concern over the government's commitment to the currency peg and the falling of international reserves. On April 5 2001, the agency revised the country's foreign currency ratings outlook, citing, among other factors, a year-to-year fall of \$2 billion in international reserves at end of February 2001, despite a \$10 billion surplus of current account and net FDI inflows.

In the latest report, the one concern expressed has to do with the government's rescuing of private companies. The agency voiced its reservation on this matter, noting that it is 'still unclear whether the government is becoming less willing to assist key private sector companies, a tendency that has raised moral hazard in the past and damaged

the government's financial position. A less interventionist approach would strengthen the credit standing of Malaysia.'

Addressing these very issues, the Prime Minister's economic adviser, tan Sri Nor Mohamed Yakcop, recently made some pertinent observations. In a speech entitled 'The Remaking Of Malaysia Inc', he said the government had found that 'among the weaknesses of the previous model was an over-reliance on a number of owner-entrepreneurs. While we often gained from their risk-taking dynamism, there was also often a shortage of controls, good governance and risk management and asset-liability management.'

The former adviser of Bank Negara said the country is now at the stage of remaking and recovery of its corporate sector. At present, the preference is for institutionalising ownership and professionalising management with a view to bringing about greater controls, checks and balance and to improve risk management.

"Within these aims, initiatives to improve corporate governance, transparency of decisions, diversification of sources of financing and better regulation on the part of the government, are all part of the overall package to raise the performance of our corporate sector, he said.

The ideas coming out from such a senior government official are some of the measures S&P and other international investors have been talking about. How they pan out over the next couple of months would make the Malaysian corporate sector an interesting scene to watch.

Understanding S&P's Rating

LOCAL CURRENCY AND FOREIGN CURRENCY RISKS

Country risk considerations are a standard part of Standard and Poor's analysis for credit ratings on any issuer or issue. Currency of repayment is likely a key factor in this analysis. BBB- and above are considered investment grades. BB+ and below are termed as speculative grades.

RATING OUTLOOK DEFINITIONS

A Standard & Poor's Rating Outlook assesses the potential direction of a long-term credit rating over the intermediate to longer term.

- * Positive means that a rating may be raised.
- * Negative means that a rating may be lowered.
- * Stable means that a rating is not likely to change.

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