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Malaysian economy picks up steam

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GLOBAL INVESTORS HAVE BEEN paying more attention to the equity markets of the three mid-sized economies in Southeast Asia in recent months. Thai and Indonesian equities have been among the best performers in both the global emerging markets scene this year and the Asia/Pacific region.

In the case of Thailand, the dual-track development strategy of Prime Minister Thaksin has delivered superior economic performance. In Indonesia, macro stability under President Megawati has significantly compressed the risk premium in place since the Asian financial crisis.

Malaysia's market, by comparison, has been a clear laggard. Equities, measured in dollar terms, have risen at low levels thus far this year, against 30-40%+ for Indonesia and Thailand. Malaysia has not exactly won favour with investors in recent years, owing to three main reasons:

* the series of measures the government took in 1998 response to the Asian financial crisis, which foreign equity investors perceived as being discriminatory against them;
* economic concerns - looking beyond cyclical weakness, equity investors were awaiting a credible new strategy to deal with the economy's structural challenges, in particular the need to shed the country's dependence on exports and fiscal pump-priming; and,
* corporate restructuring and a level playing field - equity investors were concerned that what they saw as a system of political patronage had not been dismantled effectively, and believed this would continue to stifle economic efficiency.

However, we have seen recent developments in both macro conditions and policy-making as auguring well for the Malaysian economy and equity market. This laggard could be ready for a spurt in the second half of 2003, in our view.

Second quarter's sterling performance

Malaysia's economy picked up steam in the second quarter, despite the negative impact of SARS. Exports rose 6% in June year-on-year (yoy); exports of electrical and electronic products, which account for 52% of merchandise exports, rose 5.8% in June compared with May.

Industrial production was surprisingly robust - up 16.2% yoy in May, continuing the surge of 11.8% yoy in April - indicating the manufacturing sector is adjusting for a quicker rebound in exports. In addition, Malaysia increased its non-manufacturing exports, such as liquefied natural gas (LNG) and palm oil.

Overall, second-quarter exports were better for Malaysia than for SARS-hit markets such as Hong Kong, Taiwan and Singapore. Growth in the second quarter should be higher than 4%.

For the full year, we expect GDP growth for Malaysia of 4%+, which would be likely to surpass the rates for Singapore, Indonesia and the Philippines.

An improving global economy

A clearer policy response from the US has brightened prospects for a stronger pickup in global capital expenditures.

Malaysia has large exposure to the global trade and capex cycles - exports are roughly the size of its nominal GDP - meaning it should benefit disproportionately from a pick-up in global demand.

Investors' concerns allayed

Malaysian policymakers have begun to address key investor concerns, with several positives coming through.

* Investment - in the past six months, the government has proposed several measures to stimulate foreign direct investment (FDI) as well as investment in Malaysian companies and real estate.

* Domestic demand - the government realises its economic model put too much emphasis on FDI and exports. Now, it is looking for more balanced growth. On May 21, an economic package worth US$1.9 billion (2% of GDP) was announced, with the aim of strengthening domestic demand and diversifying the sources of growth. About half of the announced expenditure (US$973 million) is to fund grassroot initiatives to boost domestic demand, which tends to have a good multiplier effect on domestic income and jobs. The announced initiatives are to support small- and medium-sized enterprises (SMEs); agriculture and rural development; and new housing for the masses.

In short, these are exactly the kind of grassroots, demand-focused activities that have been promoted with success by Thaksin in Thailand for the past two-and-a-half years. Economic benefits for Malaysia should start to flow in the second half of this year.

* Political transition - the smooth conclusion of the annual gathering several weeks ago of the ruling party, UMNO (United Malay National Organisation), set in motion what should be a smooth leadership transition when Prime Minister Dato' Seri Dr Mahathir Mohamad steps down later this year

* Corporate restructuring - the government has unofficially signalled it is prepared to broaden and deepen restructuring and consolidation beyond the top echelon of government-linked companies and the banking sector. This, I believe, would involve merging and rationalising listed and non-listed government-linked companies, to create more focused and efficient business units leveraged to the domestic economy or for the expansion of the external economy (the acquisition of foreign corporate assets). Also on the agenda would be strategic alliances between government- and private-controlled corporate sectors.

The bottom line

Among Southeast Asian markets, Malaysia has been a clear laggard in the past three years. At a time when global demand was slowing, Malaysia did not exactly win favour with investors, especially relative to Thailand and Indonesia.

In terms of its economic prospects and ability to attract investors, Malaysia has probably turned the corner. Recently, an aggressive economic package was announced to find new sources of growth - chiefly through supporting grassroot initiatives to boost domestic demand - and new measures were announced to improve the investment climate. More corporate restructuring also appears to be in the pipeline.

Meanwhile, the political backdrop has become reassuring, with a smooth leadership transition on the cards. Significantly, a recovery in global demand, propelled by a rebound in capital expenditure, would likely benefit the Malaysian economy more than it would those of Thailand and Indonesia.

Thus, we view the Malaysian market as being poised to turn from laggard to pace-setter in the second half of 2003.

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