

NEM: Prepare for disappointment
Malaysiakini.com
Mar 29, 2010
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Malaysian Prime Minister Najib Razak will unveil initial details of a new economic model tomorrow to boost growth and win back foreign investment in this Southeast Asian country.

najib announce gdp 240210 01The NEM aims to lift the country from a middle income economy that is heavily dependent on trade and commodities to developed nation status in 2020 through economic liberalisation and a greater focus on services.

After Tuesday's announcement there will be a period of public consultation before it is set in stone as the 10th Malaysia Plan in June.

Why does Malaysia need a new model?

Malaysia has fallen behind in the race for global investment and domestic investment rates are among the lowest in Asia, relative to the size of the economy.

construction workers 250209 02Half of the foreign direct investment money that flowed into three countries, Malaysia, Indonesia and Thailand from 1990-2000 went to Malaysia. Now that figure is under a third, according to UN data.

Investment by Malaysia's private sector stands at around 10 percent of GDP, according to the World Bank.

Malaysia's education system churns out tens of thousands of graduates who are ill-equipped for high knowledge jobs.

A report from investment bank Morgan Stanley said its gross tertiary enrolment ratio and gross tertiary completion ratio are 7 percent and 6 percent lower than the average of economies with its level of GDP per capita.

Will the reform be clear and unambiguous?

Despite expectations among some fund managers and economists this is unlikely to be a radical proposal with great detail. PM Najib has shown he is an incremental rather than radical reformer since he took office in April 2009.

According to a draft of the plans seen by Reuters, there are no firm measures to be announced, just a raft of ambitions for growth and to re-orient the Malaysian economy to high-value services and to boost domestic investment and consumption.

NONThe draft sees economic growth at 6.5 percent to 2020, after Malaysia's export dependent economy shrank 1.7 percent in 2009 and is expected by the central bank to expand 4.5-5.5 percent this year.

The draft also stresses the need to cut the budget deficit which hit a 22-year high of 7.4 percent of gross domestic product in 2009, although it does not specify how. There are plans to cut subsidies and to introduce a goods and services tax. Both of these measures were recently delayed by the government.

Malaysia's subsidy bill accounted for 24.5 billion ringgit in 2009 out of 160.2 billion in federal government operating spending.

Why will the measure disappoint?

In part at least because expectations among many fund managers and investment banks have been set too high. Many lauded Najib's earlier services and financial sector liberalisation, despite the fact that they were already contained in the country's "Financial Sector Master Plan"

Najib himself has promoted the NEM as a completely "new model" although many of the proposals such as shifting to an income based view of poverty from a race-based one have been around for years and were in the 9th Malaysia Plan.

Expectations that Najib will deliver a raft of privatisations that could cut the budget deficit are also likely wide off the mark.

Government funds that own around half the market capitalisation of Bursa Malaysia are separate entities from the federal government, so money raised from stake sales will not go to the finance ministry.

Is Najib too weak politically to deliver radical reform?

Although Najib has steadied the Barisan Nasional coalition since he took office a year ago in the wake of national and state elections in 2008 where the coalition that has ruled Malaysia for 52 years fell to its worst ever losses, his coalition is weak.

Any plans to dismantle the extensive system of privileges for Malays and other indigenous peoples that account for 65 percent of the 28 million population may trigger popular discontent.

perkasa first agm 270310 kerisaA radical group called Perkasa (left) has been formed to "defend" Malays and Islam. A rising tide of Islam has seen Malaysia cane women under sharia law for the first time, seen a caning sentence for a woman who drank alcohol and a row over whether Christians can use the word "Allah" for god.

Some political analysts say that Najib will only be able to implement meaningful reforms after winning a new electoral mandate, although that is a risky process and Najib does not appear to be a risk-taker.

Although new polls do not need to be held until 2013 at the latest, they could come as early as next year. The later elections come, the later will be any reforms, allowing Malaysia's rivals in the battle for foreign investment more time to surge ahead.

If Najib called snap polls and the BN was returned with a two-thirds majority in parliament, then he could probably reform as much as he liked. But with the BN's ethnic Chinese and Indian parties still in tatters, two-thirds looks like a tall target.

What will be the market impact?

world stock market forex 141008 03More of a whimper than a bang.

The ringgit currency has outperformed other Asian currencies this year, gaining 3.46

percent on the back of a Bank Negara Malaysia rate hike in March after underperforming most of emerging Asia in 2008 and 2009. Flows have recently returned to the domestic bond market, which is one of emerging Asia's largest and most liquid.

If radical plans are unveiled all these assets could rally further, but if there is another round of promises but no firm time-frame for implementation, then any market rally could lose steam.

Due to high levels of ownership by state funds in both equities and debt as well as by local banks, there is unlikely to be a big selloff if the measures do disappoint.

- Reuters

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Source : <http://www.malaysiakini.com/news/127815>