

# Malaysia investors get a break

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**W**hen pressed by his supporters, Mahathir Mohamad refused to reveal what he would say at the November meeting of the United Malays National Organization, the dominant party in the ruling Malaysian coalition.

Now, we may never know.

In a weekend ballot, the party denied Mahathir a chance to address its annual assembly, handing a humiliating defeat to the 80-year-old former leader who retired in 2003 after leading the party and the nation for more than two decades.

Investors ought to breathe a sigh of relief.

In recent months, Mahathir's relentless verbal attacks against his chosen successor, Prime Minister Abdullah Ahmad Badawi, had distracted the government and kept it from investing as boldly as it should have.

Although Mahathir insisted that his "end game" was merely to make the administration more transparent, many in the party were concerned that he would use the November meeting to foment discontent, if not a straight rift, among the rank and file.

The impasse had reached a point where the power struggle had begun to weigh on Malaysia's economic prospects.

Standard & Poor's said last week that Abdullah's position "remains tenable." With its decisive action, the dominant party has made it more secure. By placing Mahathir ninth among 15 aspirants in a contest that selected seven, the party gave a strong signal that it favored a quick return to business as usual.

Now it's up to Abdullah to move full steam ahead on spending proposals, which will put more money in people's pockets. And he must do it before Mahathir discovers a new line of attack, for no one can be sure that the older leader has given up the fight.

V. Anantha Nageswaran, head of research for Asia and the Middle East at Julius Bär Holding in Singapore, said he was waiting to see if Mahathir's defeat, a "big relief" for the incumbent administration, will lead to "policy dynamism and coherence."

The biggest concern is that the Malaysian government isn't spending enough.

The federal government's revenue in the first six months of 2006 grew 20 percent from a year earlier. Even then, it spent 1 percent less than last year. The overall fiscal surplus in the oil-producing nation was 4.3 percent of gross domestic product in the first half, compared with a 3.8 percent deficit last year.

Since landing the top job in October 2003, Abdullah has scrapped or postponed many of his predecessor's projects, including a bridge to neighboring Singapore.

Mahathir has hit back by accusing Abdullah of favoring his family with government contracts, a charge the prime minister rejected in a televised interview last month.

Mahathir has also criticized the government's liberal auto import policy, saying it hurt state-owned Proton Holdings, which he had set up in 1982. The unprofitable carmaker is somewhere between the hospital and the mortuary.

After refusing to renew the contract of the company's chief executive, Mahaleel Ariff, last year and selling, for €1, or \$1.27, a debt-ridden Italian motorcycle maker acquired under Mahaleel's leadership, Abdullah's government is now looking for a strategy to revive the company.

Mahathir questioned the asset sale and said Mahaleel had done a good job and should have been paid more.

As Mahathir went on the offensive, government ministries slowed in disbursing funds for public works.

In a more conducive political setting, the government would have been able to open its own purse strings more liberally to support a consumption boom that's looking jaded. Auto sales have posted six straight months of decline.

The emerging slowdown in consumption is surprising for several reasons. For one, real interest rates are still negative. A one-year bank deposit in Malaysia earns 3.7 percent, less than the current inflation rate of 4.1 percent. There isn't much incentive for households to save their growing incomes.

And incomes are growing, especially for the 490,000 small palm and rubber planters, according to Lee Heng Guie, an economist at CIMB Securities.

Lee estimated that rubber planters will earn 52 percent more this year than in 2005. Meanwhile, local gasoline prices are about 18 percent cheaper than they would have been without a government subsidy, he said.

Even as consumption falters, second-quarter statistics show a large part of the growth coming from an inventory pile-up. Slowing global growth could force Malaysian companies to cut back production and liquidate stock, leading to a slowdown in gross domestic product.

"Government development spending needs to kick in," said Sanjay Mathur, a UBS economist in Singapore.

The key lies in hastening the implementation of the Ninth Malaysia Plan, an ambitious 200 billion ringgit, or \$54 billion, spending drive spread over five years. The 2007 budget for 9MP, as the plan is known, is 44.5 billion ringgit, a quarter more than this year.

The government this month announced a 2 percentage-point cut in the corporate tax rate, which is currently 28 percent. The reduction, which will be implemented over two years starting in 2007, aims to narrow the gap with Singapore's 20 percent levy.

Improving Malaysian competitiveness is a medium-term agenda. Less corruption and better integration of the minority Chinese and Indian communities into the mainstream are long-term hopes.

For now, investors and analysts would be happy just to see the money start flowing again.

"The government has been unable to boost private consumption and investment," Anantha Nageswaran, of Julius Bär, explained. "Until there are signs of that happening, we remain neutral to slightly negative on Malaysian assets, in general."

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Bazuki Muhammad/Reuters

The attacks of former Malaysian prime minister Mahathir Mohamad on his chosen successor have dampened government spending, though Malaysia needs it to grow.