

# Business battens down in the aftermath of Malaysian poll

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ON ASIA

"What is good for democracy can be bad for the markets" was the reaction this week when Malaysia's tough-minded National Front government was handed its biggest election setback in 50 years of rule.

The Kuala Lumpur stock exchange took its biggest one-day dive in 10 years on the first trading day after the weekend polls. The election outcome produced what the markets hate most: uncertainty. Share prices have recovered only modestly since then.

But the election result also offers the hope of an end to the crony capitalism that has plagued Malaysia for decades.

That system has been fostered by the government's long-standing policy of giving preferential treatment to the ethnic Malay majority, including the award of state contracts.

Foreign investors have seen the programme as hobbling economic efficiency when Malaysia must compete with the likes of China, India and Vietnam.

The country's ethnic Chinese and Indian minorities have complained that the policy places them at an economic disadvantage and that was one reason why they voted in large numbers for the opposition.

But the uncomfortable fact remains that many of Malaysia's leading businessmen, of all races, have grown dependent on government contracts for infrastructure projects.

The three-party opposition alliance campaigned on a programme of ending the race-based policy and replacing it with one focused on merit.

But whether it can push the reform agenda successfully is still unclear. In spite of making unprecedented gains, it still holds only a third of parliament and five of Malaysia's 13 states.

One advantage the opposition alliance possesses is that it is multi-ethnic in character and has been able to tap resentments among lower and middle-class voters across all race groups, who believe government spending mainly enriches an elite group of politicians and businessmen.

But in the short-term, Malaysia appears headed for a rather messy period that is likely to prove testing for investors.

Many of the blue-chip companies depend for earnings on a state largesse that is now under threat. This is particularly true for infrastructure companies.

The states that have fallen into opposition hands, which include some of Malaysia's biggest and richest, could veto future projects they view as graft-ridden, since they

control local land and water resources.

This could put at risk planned transport projects and "economic growth corridors" promoted by Abdullah Badawi, the prime minister.

If the opposition decides to block such deals, it will have a knock-on effect on Malaysia's economy, which is already vulnerable to a slowdown as exports to the US, the biggest overseas market, fall.

Growth has stayed buoyant because of the infrastructure projects and pump-priming measures to boost consumer spending ahead of the election. Surging prices for palm oil, of which Malaysia is the world's second-largest producer, have helped. But there are fears they may be peaking.

Also at risk is what many believe has been the one solid economic achievement of the Abdullah administration: the restructuring of state companies controlled by Khazanah Nasional, the government's investment agency. State companies

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make up a third of the market capitalisation of the Kuala Lumpur exchange.

The prime minister's appointment of a professional team in 2004 to manage Khazanah has paid dividends in terms of rising share prices for Telekom Malaysia, the Tenaga Nasional power group and Malaysian Airlines among others.

But the clout enjoyed by the Khazanah management has largely rested on the authority of Mr Abdullah, who is in danger of losing his post because of the election setback.

There are worries that the Khazanah reforms could be blunted under a new government leader.

The election heralds a shift away from race politics towards one that could favour left-leaning income redistribution policies to help narrow a widening gap between rich and poor.

Efforts to introduce market-oriented measures already look likely to be put on hold. An increase in electricity tariff rates at Tenaga favoured by investors is expected to be delayed, while a proposed cut in fuel subsidies to reduce the government's large budget deficit may be abandoned.

Investors may cheer the election results as the start of a long-desired march to a more competitive economy, but the road is still littered with daunting obstacles.

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