

Escaping Najib's Malaysia, investors also flee currency, stock market

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While Malaysian Prime Minister Datuk Seri Najib Razak's Cabinet reshuffle last month may have achieved the "unified team" he was seeking in the face of probes into his bank accounts, global funds have been voting with their feet.

The ringgit has slumped 6.3%, the benchmark stock index lost 9.4% and sovereign bond risk jumped to a four-year high since the Malaysian Anti-Corruption Commission on August 3 said Najib had received RM2.6 billion from donors and not state investment company 1Malaysia Development Bhd (1MDB). The conclusion failed to help 1MDB's bonds, which are trading at 81 cents on the dollar.

PineBridge Investments LLC has cut Malaysian sovereign bond holdings, while Schroder Investment Management Ltd says it's too early to buy Asia's worst-performing currency, as political uncertainty clouds the outlook for an economy rocked by plunging oil prices and an emerging-market selloff.

Najib had denied taking money for personal gain and has counter-attacked against what he described as a campaign to oust him, by reshuffling his Cabinet, suspending a leading newspaper and seeking the arrest of a newsletter's founder.

"By sacking everyone who criticises him, prime minister Najib is putting himself more in the spotlight from an international investor perspective," said Anders Faergemann, who helps manage US\$10.6 billion (RM43.25 billion) of emerging-market debt at PineBridge in London.

"We are increasingly worried about the outlook for Malaysian government bonds due to the ongoing 1MDB scandal and have recently reduced our exposure further."

'Unified team'

The UK-based Sarawak Report and the Wall Street Journal last month reported on documents that almost US\$700 million may have moved through government agencies and companies linked to 1MDB before ending up in accounts bearing Najib's name.

A warrant is out for the arrest of the Sarawak Report founder under laws relating to false statements and acts detrimental to democracy. Lawyers for Najib sent a letter criticizing the Journal report. Malaysia's Edge newspaper has been suspended from publication as the government said its coverage of the events threatened public order. Publishers of all three media outlets contested the criticism.

On July 28, Najib said he needed a "unified team" when he removed Tan Sri Muhyiddin Yassin from his Cabinet, shortly after the deputy prime minister called for "the real truth" on 1MDB.

His rural development minister also fell in the shuffle, while attorney-general Tan Sri Abdul Gani Patail, who helped to lead a 1MDB probe, was replaced for "health reasons".

Amnesty International described Malaysia as a human rights "black hole" in May after the arrest of opponents on sedition charges.

Under attack

Najib, who chairs the advisory board of 1MDB, has resisted calls from former prime minister Tun Dr Mahathir Mohamad to step down over the RM42 billion in debt amassed by the fund.

The anti-corruption commission said the money in Najib's accounts was from donors in the Middle East and not 1MDB. It said it wouldn't disclose their identities and planned to question Najib about the funds. Malaysian opposition party, PKR, announced on August 12 that it would be suing Najib, saying his coalition breached campaign spending limits during 2013 elections.

Najib said last week that while there are rules on such expenditure, there are no laws on funding. He said better legislation is needed. His office didn't respond to emailed requests for comment. 1MDB said in a statement that it had investor support for its reorganisation plans.

Malaysia, Brazil

"1MDB maintains regular contact with its bondholders, via meetings and conference calls," the statement said. "The vast majority of our bondholders are fully aware of our current strategy and the on-going execution of our rationalization plan, and we are pleased with the support they have provided."

La Francaise Des Placements, which sold almost half of its 1MDB debt in April, see similarities between the controversy and allegations involving Petroleo Brasileiro SA that has led to protests against Brazilian president Dilma Rousseff. While the fund doesn't expect a default, the current climate makes it "difficult to buy," she said.

"As emerging-market fund managers, we are more or less used to difficult stories," said Yasmine Ravai-Mans, a senior La Francaise Des Placements fund manager in Paris.

But if the money was used for other purposes than the national interest, she said, "it will not be just a regular case of corruption, it'll be a huge scandal."

The mix of politics, money trails, central bank investigations would rank it close to Petrobras in terms of how toxic it is to emerging-market investors."

'Trust deficit'

The ringgit has tumbled 22.7% in the last 12 months and slid to a 17-year low of 4.1340 per dollar on Monday. Local-currency sovereign debt handed investors a 8.4% loss in dollar terms this month, the worst performance among 16 emerging markets tracked by JPMorgan Chase & Co indexes. The cost to insure the securities for five years using credit-default swaps climbed to 180, the highest since 2011.

"There's a growing trust deficit with the current leadership," said Chua Hak Bin, a Singapore-based economist at Bank of America Merrill Lynch, which sees the currency dropping to 4.28 by the end of 2016.

"Without confidence returning on the leadership and government, investors will be reluctant to jump into the currency and the markets."

Overseas investors cut holdings of Malaysian debt by 2.4% in July to a three-year low of 206.8 billion ringgit, central bank data show. The FTSE Bursa Malaysia KLCI Index lost 10.3% this year as foreign investors pulled US\$3.3 billion.

Restoring confidence

The nation has to show "a greater tolerance towards democracy, fighting corruption and a conservative monetary and fiscal policy" to restore confidence, said Christian Wildmann, a fixed-income portfolio manager at Union Investment Privatfonds GmbH in Frankfurt.

Malaysia's 10-year sovereign yield has jumped 23 basis points this month to 4.30% and Wildmann sees its rising to 4.7% by year-end.

Moody's Investors Service is standing by its A3 rating on Malaysia with a positive outlook as Najib's administration hasn't reversed reforms despite the "increased political risk," said Christian de Guzman, a vice president in Singapore.

The ruling Barisan Nasional coalition lost the popular vote in the May 2013 general election, even as it kept a parliamentary majority. The next general election must be held by 2018.

Schroder Investment is among fund managers that view the probes as just one of the challenges for an economy that expanded at the slowest pace in almost two years in the second quarter.

"The domestic situation on the political side is uncertain," said Rajeev De Mello, who oversees about \$10 billion as head of Asian fixed income in Singapore. "But the other problems are the falling oil prices and commodity prices, which do impact Malaysia."

Merrill's Chua said politics may affect economic management. There are doubts that when central bank governor Tan Sri Zeti Akhtar Aziz finishes her term at the end of April she will be replaced by someone as "independent and credible," he said.

"Investors cannot see the end-game," he said. "Anybody who questions the prime

minister has basically been sidelined.” – Bloomberg, August 19, 2015.

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