Kenanga Investors

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Allaying investors' pessimism with brighter prospect of economic rebound

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Themed *Credible Malaysia, Dynamic Economy, Prosperous Rakyat*, Budget 2019 which also went down into history as the maiden budget under the Pakatan Harapan Government was tabled by Finance Minister Lim Guan Eng last Friday (November 2). For the fund management industry, Budget 2019 should be seen in the light of providing clarity on policy direction as well as the rolling out of reform initiatives to turnaround the Malaysian economy amid uncertainties of sorts in the external environment.

Budget 2019 should be seen in the light of providing an assurance to investors that workable solutions-cum-strategies have been put in place not only to lift the Malaysian economy out of the woods but to put the country back on the path of sustainable growth moving forward. There is an optimal mix of stimulus, incentives and safeguards to navigate what is expected to be another challenging year ahead.

Except for the various forms of financial aids extended to the lower income group (the Bottom 40% or B40) to mitigate spiraling living cost, populist measures are kept to a minimum with priority accorded to addressing the nation's excessive debt level and fostering long-term competitiveness with the ambition of reviving the Malaysian economy as an "Asian Tiger" once again.

ASSORTMENT OF NEW TAXES

Against a backdrop of the Government incurring a RM1.065 tril real debt and liability as of end-June 2018, a slew of belt-tightening measures are inevitable as the Government strives to oil the economy while fulfilling its social obligations.

Striking a balance is always a difficult exercise in the economic sense. As a trade-off for the abolishment of the indirect Goods and Services Tax (GST) – where a shortfall of RM19 billion abound (GST is projected to generate RM43 bil/year while the Sales and Services Tax [SST] is targeted to generate RM24 bil/year) – it is only sensible for the Government to pursue other means of tax-related income.

One way is to pursue collection from direct taxation (i.e. corporate and personal income tax) or revenue sources from direct taxes even though they are vulnerable to external influences and can possibly fluctuate in response to the ups and downs of the world economy.

This explains the introduction of the following taxes (among others):

- Digital tax (effective Jan 1, 2020 on software, music, and online advertising);
- Gaming tax (annual gaming license fee for casinos to be raised from RM120 mil to RM150 mil; gaming tax on casinos to be raised to 35% of gross gaming revenue);
- Real property gains tax (RPGT) (5% on local & PR and 10% for companies & foreigners from sixth year onwards);
- Excise duty or soda tax (40 sen/litre to be imposed on two categories of packaged sweet drinks from April 1, 2019), and
- Levy on outbound air travellers effective June 2019 (RM20 on travellers flying to ASEAN; RM40 on those heading to other countries).

Nevertheless, the absence of capital gain tax can be deemed as a big relief for equity market. Tobacco and brewery players, too, escaped tax hikes although their joy can be short-lived given there had been instances in the past when taxes are imposed on a later date.

LIFTING CONSTRUCTION SECTOR GLOOM

Elsewhere, austerity measures centering on cost rationalisation involving mega infrastructure projects are also welcomed although they will somehow hurt the revenue/profit projection of the listed contractors. The measures, among others, include:

- A 47% downward revision of the Light Rail Transit Line 3 (LRT3) project cost to RM16.6 bil (from the initial estimated cost of RM31.6 bil);
- Cost savings of 22.4% for the Mass Rapid Transit Line 2 (MRT2) project to RM30.5 bil (from the initial estimated cost of RM39.3 bil), and
- A re-tendering of the RM5.2 bil Klang Valley Double Tracking Project which is also expected to provide substantial cost savings.
- The Government to continue with the Pan Borneo Highway project subject to a cost-rationalisation study

That the Government reiterates its commitment to the aforementioned projects will somehow restore investors' confidence in the construction sector given the KL Construction Index which measures the performance of stocks under that sector has dipped almost 42% from 281.13 on the eve of GE14 to close at 163.34 as of Oct 30.

Aside from the MRT2 and LRT3, other mega infrastructure projects namely the East Coast Rail Link (ECRL), KL-Singapore High Speed Rail (HSR) and MRT3 will continue to be shelved pending future review.

However, the same cannot be expected of the property sector. In addition to REHDA (the Real Estate and Housing Developers' Association Malaysia) agreeing to slash house prices by up to 10% on new projects, the introduction of 5% RPGT for disposal of property in the sixth and subsequent years alongside the maximum 4% stamp duty from the previous 3% on properties worth more than RM1 mil is expected to deepen the woes of the sector.

PETRONAS CHIPPING IN

Amid higher global oil prices, the Federal Government is expected to collect revenue of RM261.8 bil comprising a special dividend of RM30 bil from Petronas (2018: estimated RM24 bil; 2017: RM16 bil).

Essentially, the RM30 bil special dividend has enabled the Government to grow revenue by 10.7% to RM261.8 bil, thus containing its fiscal deficit at 3.4% or RM52.1 bil despite operating expenditure growing by 10.7% to RM259.9 bil.

While these improvements should be viewed positively by rating agencies, the fact that revenue will see a 2% or RM4.7 bil decline in 2019 without PETRONAS' special dividend contribution could raise a red flag which ultimately become a thorn in their evaluation.

It is hoped that rating agencies in the likes of Fitch, S&P and Moody's would look beyond the special dividend factor (or even the abolishment of GST) given the Government is initiating new revenue sources (vis-à-vis the introduction of new forms of taxes) or has embarked on major move to pare down debts and other liabilities through a concerted effort to plug wastages (curbing over-staffing in the civil service or payment of fat salaries to key personnel) and leakages (combating corruption and abuses of funding).

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Moreover, rating agencies should also take cognisant of the following initiatives:

- The setting up of a national Debt Management Office to review and manage government debts and liabilities, and to monitor new debt issuance by government, statutory bodies and special purpose vehicles, and
- The Ministry of Finance (MoF) to helm a special task force to review the role and function of MoF-owned firms and statutory bodies to avoid duplication and direct competition with the private sector.

MOVING FORWARD

On the overall, Budget 2019 bodes well for the fund management industry by having primarily lifted the gloom pertaining to policy direction and the type of reform Malaysia is embarking on to re-build its economy and financial position.

In all fairness, it can be deemed as a decent budget that attempts to bridge the fiscal gap with high impact projects and targeted subsidies without negatively impacting economic growth and burdening the wider populace with new taxes.

Amid a brief rally which waned off in the later part of the afternoon as the tabling of Budget 2019 progressed, the FBM KLCI ended a commendable 6.95 points or 0.41% higher at 1,713.87, a harbinger that a relief rally should ensue in the days ahead considering that the budget was not as market-unfriendly as widely anticipated.

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