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Invest Malaysia 2011: Ringing up the growth registers

Economic Research

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Our view

There are increasingly positive vibes about the government's overall transformation programmes which were initiated to take Malaysia to a higher plane of development in the next 10 years. At Invest Malaysia 2011, more updates on both the Government Transformation Programme (GTP) and the Economic Transformation Programme (ETP) were revealed to assure investors and the general public of the progress of the reforms.

The ETP has garnered more positive responses from investors, as evidenced by the value of total investments committed which rose to RM95 billion since October 2010. This encouraging amount of investment is envisaged to create almost 225,000 job opportunities in the next 10 years. As for 2011, total investment will likely surpass the government's target of RM83 billion, even if only 70% of the planned projects are realised. We take our hats off to the Performance Management and Delivery Unit (PEMANDU) for driving the momentum of investment so far.

We are also comforted by the amount of foreign direct investment (FDI) that soared by more than 400 percent from USD1.7 billion in 2009 to USD7 billion last year. However, we are of the view that the jump in last year's FDI was primarily because of the extremely low base during the recession in 2009. Going forward, the amount of FDIs will likely normalise as more direct investments are channeled to giant economies such as China and India.

Against such a backdrop, the onus is on direct domestic investments which, if properly planned and executed as envisioned by the ETP, will reinvigorate private investments in the Malaysian economy in the medium term. This is, of course, based on the assumption that the global economy will not experience any heart-stopping volatility as it did in the past two years.

MIDA's effort to address the RM1.4 trillion question should be applauded as this has become the key concern among investors and the general public. The strategies are clear cut with emphasis on investment generation, facilitation, image enhancement and policy advocacy. Needless to say, there is another issue that investors are needing an answer from the authority, and that is the appropriate body that they can seek help from should there be any discrepancies in the guidelines between the state and federal government with regards to investment matters.

There are understandably other pockets of concern about the ETP, despite the overall upbeat momentum portrayed by the results achieved in the past one year. First and foremost, the exogenous variable is the state of the relatively fragile global economy, notwithstanding its upward swing in 2010. Despite more enthusiastic investors searching voraciously for opportunities globally, the risk-aversion genie is not totally back in the bottle. Geopolitical risks, escalating oil prices and lingering concerns over developed nations' government finances and debt levels will continue to spook investors if negative developments unfold. And do not forget that the amount of liquidity sloshing around in emerging economies – in both direct and portfolio investments – is causing investors to be wary as speculations abound of what could happen should the liquidity start to leak out.

It is true that should risk aversion rise, portfolio investments will likely take the brunt more than direct investments. However, investors' sentiment will also be ruled by greed and fear, making them more prone to changing their minds with regards to investment decisions, despite commitments that may have been given in particular areas. But again, this is out of our control.

When talking to people in the street, we sense that they are becoming more aware of the opportunities provided by the government through the ETP. Plus, there is increased enthusiasm about the possible changes that could be seen in the Malaysian economic landscape in the next 10 years. Nevertheless, some issues were repeatedly raised by a minority group. These include:

Income disparity – Although the issue of hardcore poverty has been addressed, there is growing belief that income disparity has room for further improvement. In other words, there should be greater emphasis on narrowing income distribution in the country.

Relative poverty – There is an issue of the urban population living in big cities strgulling with rising living costs despite incomes being above the poverty line.

Benefits to the man in the street and small businesses – The ETP is viewed by some groups as benefiting merely the big businesses, with less attention being given to small businesses or the man in the street.

What if there is an increase in risk aversion? – Should risk aversion resurface and private investors reduce their commitment in some of the projects outlined earlier, will the government step in to support investment as they did before? This is a critical question as investors are increasingly wary about global economic uncertainties in the medium term.

There is a sense of urgency to address the problem of brain drain, judging by the 15% flat tax rate offered for five years to Malaysians who return to work in Malaysia. While we concur with the idea of bringing back the talents needed to help develop the Malaysian economy, such an incentive may actually catalyse the emigration of Malaysian professionals who subsequently return after several years to take advantage of such privileges. A notion of inequality has emerged, especially when one considers that many talented Malaysians have chosen to remain in the country to contribute to the development of the economy in the past years. In relation to this, we have argued in our yearly pre-Budget discussions that widening the personal income tax bands is one of the first measures that the government can introduce to discourage migrating, as the prevailing narrow tax bands cause professionals to progress quickly to higher tax brackets, resulting in significant reductions to their disposable incomes.

It is heartening to see that government-linked companies (GLCs) continued to chart favourable earnings, as reflected by the total shareholders' return of 16.4% between 2004 and 2010. It is hopeful that this will translate into more divestment exercises by the government to promote further expansion of private investment.

Overall, should this momentum continue, Malaysia's private investment could potentially be the growth driver in the future – a positive outcome, as over-reliance on private consumption can be unsustainable in the long term. Bear in mind that between 2000 and 2010, private consumption's contribution to gross domestic product (GDP) has averaged circa 3.9 percentage points (out of 4.9% average annual growth). Such dynamics may not be sustainable if macro imbalances, such as high household debt, continue to plague the economy.

In regard to the Capital Market Masterplan 2 (CMP2), we recognise the challenges in implementing policies that will encourage further growth of the capital market while containing unnecessary risks to the economy. A focus on growth alone will undoubtedly cause under-pricing of risks which, if not properly controlled, can lead to the emergence of systemic risks and have adverse repercussions on the general economy. This can be seen from the experience in the US where the absence of proper regulatory measures resulted in the emergence of sophisticated financial products that eventually became one of the major causes of the collapse of the financial market, marking the onset of the global financial crisis in 2009.

The issue of the illiquid secondary market was addressed in the recently announced CMP2, and we opine that this is a good step towards further improvement in the domestic bond market as, needless to say, a vibrant bond market with healthy investor appetite across the various rating bands is essential to ensure that the Malaysian business sector in the various industries, asset classes and rating bands will be able to raise adequate funds to meet their funding needs.

On specific measures that may contribute to an improvement in secondary market liquidity of the bond market, we believe that a fund management unit focusing on investing in investment grade corporate bonds should be set up in order to stimulate a secondary market for such bonds. The fund management unit can be housed in, or monitored by, government institutions with proven track records in financial markets. Alternatively, such funds could also be placed with existing asset management companies with specified investment objectives to encourage more active trading in higher yielding papers which are typically offered by relatively lower-rated bonds.

Invest Malaysia 2011: A quick note

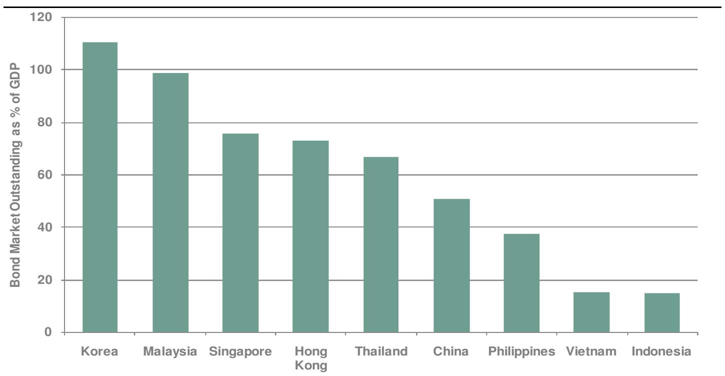
Using the slogan "Powering Global Excellence," Invest Malaysia 2011 provided details on Malaysia's transformation initiatives through the GTP and the ETP. Based on the positive results that were achieved in the past one year, the government is confident that the process of transformation will enable Malaysia to realise its goal of becoming a high-income nation by 2020.

In addition, the CMP2, unveiled by the Securities Commission (SC) will facilitate the process of mobilising the country's huge savings in undertaking necessary investments that are needed to spearhead the country in the long term as envisioned by the ETP. The theme of the CMP2 – "Growth with Governance" – reflects the delicate balancing act of expanding the capital market's role in mobilising funds to invigorate investments and economic growth while addressing concerns about risks associated with the market's efficacy in the aftermath of the global financial crisis.

The local bond market developed tremendously following the 1997 Asian Financial Crisis, with The Asian Development Bank (ADB) data showing that the size of the domestic bond market grew at a Compound Annual Growth Rate (CAGR) of 13.6% between 2000 and 2010, bringing the outstanding size to USD245 billion as at end-2010. Additionally, the significance of the bond market as a financing vehicle in the economy is further evidenced by its huge pie of the domestic GDP. The outstanding bond market as a percentage of GDP stands at 98.6% as at end-2010, and by this measure, the bond market in this country is the second largest among developing East Asian countries after South Korea.

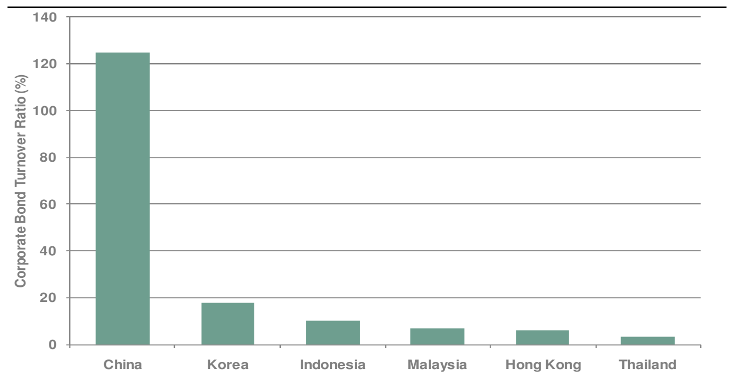
However, rapid developments in the primary market are not replicated in the secondary market, with corporate bonds remaining illiquid in the secondary market, particularly for non-AAA issuers. Based on the data compiled by ADB, the turnover ratio for Malaysia's corporate bond market stands at 7.0% as at end-2010, the fourth highest and trailing Indonesia by three percentage points.

Chart 1: Local Currency Bond Market as a % of GDP



Source: Asian Development Bank

Chart 2: Corporate Bond Turnover Ratio Comparison



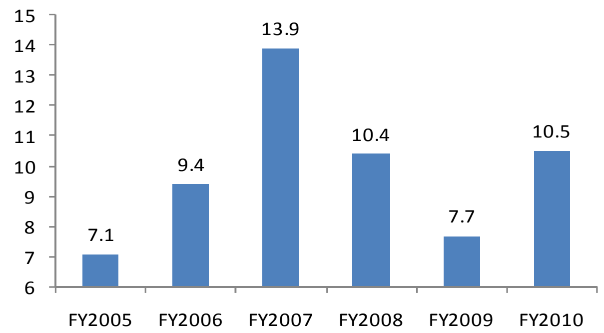
Source: Asian Development Bank

Key takeaways from the Prime Minister's keynote address

- ***GLCs continued to register strong performance in 2010.***
- ***The government will continue to reduce its role in the economy by further divesting its assets while promoting private investments.***
- ***The government will continue to promote investments in high-growth companies.***

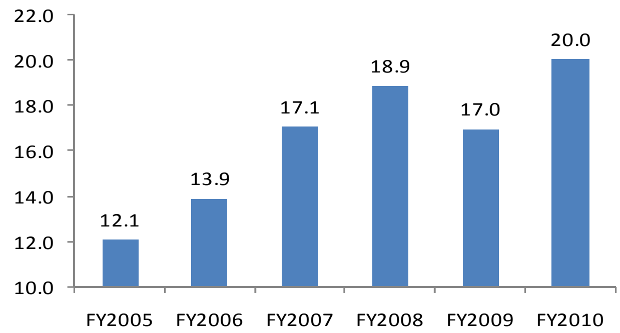
GLCs: The country's 20 largest GLCs posted strong performance in 2010 with aggregate earnings of RM17.3 billion, a growth of almost 50% compared with 2009. These top-performing 20 companies also registered an annual total shareholder return of 16.4% over the period of the GLC Transformation Programme from 2004 to 2010, significantly outpacing Bursa Malaysia's average.

Chart 3: G20 Return on Equity (%)



Source: Khazanah Nasional

Chart 4: G20 Historical capital expenditure (RM billion)



Source: Khazanah Nasional

Disposal of non-core assets: Khazanah Nasional Berhad and other government-linked investment companies (GLICs) are gradually divesting their non-core holdings and non-competitive assets, including 26 parcels of government land. At least 10 companies earmarked for divestment are expected to complete the process by the end of this year. In addition, four lots of government land are being sold, with estimated proceeds in excess of RM1 billion.

Listing of Felda Sugar: Felda Global Ventures Holdings is undertaking a listing exercise of its sugar business, the first ever within the Felda Group. The listing of Felda Sugar on Bursa Malaysia is expected to take place in July this year.

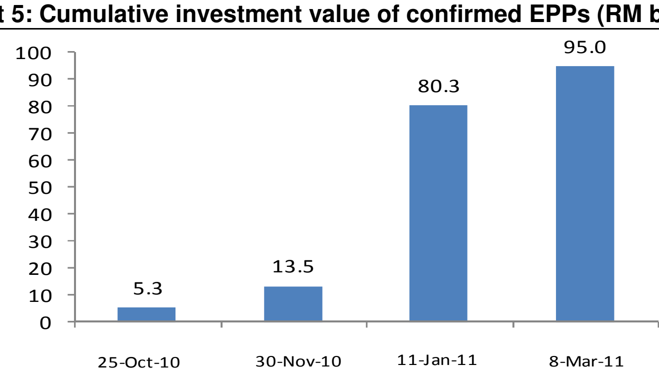
Pos Malaysia: The disposal of Pos Malaysia is now in its final stage. Evaluations have been completed and recommendations will be made to the Khazanah board.

Ekuinas: Invested RM483 million in four growth companies, facilitating a total capital deployment of more than RM600 million into the Malaysian economy. It is also planning to invest up to RM600 million, enabling a total economic capital deployment of up to RM1 billion in 2011 into the Malaysian economy.

Updates on the ETP & GTP

- The total investment commitment so far stands at RM95 billion, which will create almost 225,000 jobs over the next 10 years.

Chart 5: Cumulative investment value of confirmed EPPs (RM billion)



Source: PEMANDU

- FDI rose by more than 400 percent from USD1.7 billion in 2009 to USD7 billion last year.

- Khazanah last week announced a RM3.3 billion investment by Mitsui and Co. for a 30 percent stake in Integrated Healthcare Holdings Sdn Bhd.

- The MyPROCUREMENT website gives details of successful bidders for 3,500 government contracts, making it easier to identify and prevent corruption.

- The Kelana Jaya light rail transit (LRT) line, which runs through the heart of Kuala Lumpur, has had its capacity greatly increased, with almost 2.5 million more passengers traveling on the line last year. More than two million Malaysians living in rural areas now have access to roads, water and electricity – many for the first time ever.

Talent Corp

- The introduction of the Residence Pass aims to attract and retain top foreign talents, and has been open for applications since the beginning of April. The Residence Pass is an enhancement of the Employment Pass, providing expatriates with a longer tenure of 10 years to reside and work in Malaysia. In addition, the Ministry of Home Affairs is implementing a number of improvements to the terms of the Employment Pass, including allowing for a tenure of up to five years to reside and work in Malaysia.

- The parameters and qualifying criteria of the Returning Experts Programme (REP) have been revised to better meet the needs of the ETP.

- The existing fiscal incentive under the REP of tax-free import of two cars will now be limited to locally assembled cars. A new transitional income-tax incentive will also be introduced, under which returning Malaysian professionals will be eligible for a low flat rate of 15 percent income tax for five years.

- The pressing issue of brain drain that the country is presently faced with is indeed one which the government is working tirelessly to address, judging by its extension of the 15% flat tax rate for five years to Malaysians who return to work in Malaysia. While the effort to draw back the talents needed to help develop the Malaysian economy is a noble one, this incentive could, on the contrary, also serve to speed up the emigration of Malaysian professionals who intend to return after several years to take advantage of such privileges. A sense of inequality has, unsurprisingly, emerged among the group of talented Malaysians who have chosen to stay in the country and contribute to its development hitherto: they perceive such measures by the government to be inherently unfair and not in good spirit as these Malaysians had been instrumental in driving the economy through their productive capacities as well as tax payments. In this regard, we have argued in our yearly pre-Budget discussions that widening the personal income tax bands is one of the first measures that the government can implement to dampen migratory activity, as the prevailing narrow tax bands cause professionals to progress quickly to higher tax brackets, bringing about significant reductions to their disposable incomes.

The Capital Market Masterplan 2

- ***There is a need to ensure that the capital market is efficient in utilising the country's savings for capital formation so as to create opportunities and jobs and to finance investments needed to spearhead economic growth. However, there are greater risks associated with pursuing such an objective. A delicate balancing act is thus required to ensure that growth of the capital market will not lead to excessive risk-taking activities. This is needed to protect the rights and interests of stakeholders.***

Growth strategies

- **Promoting capital formation**: Create an intermediation environment conducive for seeding emergent companies and industries, nurturing the growth of small- and mid-cap companies, financing large and high-risk ventures, and promoting investments in socially responsible projects.

- **Increasing intermediation efficiency and liquidity:** Address structural constraints to increase the efficiency of savings intermediation and foster an innovative and diverse intermediation environment to expand the supply of assets to meet the needs of investors.

- **Deepen liquidity and risk intermediation:** Broaden the diversity of investment strategies and strengthen market connectivity through risk-intermediation products and widening the range of participants.

- **Facilitate internationalisation:** Expand growth boundaries by tapping global opportunities to facilitate an expansion in scale and to capitalise on hub opportunities in areas of comparative advantage.

- **Build capacity and strengthen information infrastructure:** Strengthen the knowledge base through talent development and acquisition to support the expansion of the capital market into high value-add areas, and build a strong information infrastructure to address information asymmetries and promote service innovation and efficiency in a highly electronic environment.

Governance strategies

- **Enhance product regulation to manage risks:** Foster a more conducive environment for product innovation and diversity while ensuring that active fund-raising and financial innovation benefit investors.

- **Expand accountabilities as intermediation scope widens:** Create an enabling environment for participants to broaden intermediation activities and strengthen industry capabilities and standards.

- **Robust regulatory framework for a changing market landscape:** Ensure a consistent regulatory approach to a changing market environment and focus on enhancing the quality of markets.

- **Effective oversight of risks.** Expand regulatory coverage, capacity and tools to ensure effective supervisory reach and strengthen oversight of risks to market stability.

- **Strengthen corporate governance:** Strengthen the effectiveness of corporate governance through broad-based approaches to promote greater stewardship, more active shareholder participation and strengthen gate-keeping accountabilities.

- **Broaden participation in governance:** Promote active participation of stakeholders in shaping intermediation and corporate behaviour and to promote a culture of integrity and increased emphasis on socially responsible goals.

In her speech, SC chairman Tan Sri Zarinah Anwar also stated that one of the growth areas in the financial market is the unit trust industry, which is expected to register a higher penetration rate of 34% in 2020, almost double the 18% rate recorded in 2010. Another interesting issue mentioned in her speech was the new private pension fund framework which is needed for setting up private retirement schemes approved by the Commission. This will be in place by the end of the year.

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