29 January 2016

Budget 2016 (Recalibration)

KLCI: 1,634.53 points

Oil dependency to decline to less than 11% of revenue

2016 Year-end Target: 1,800 points

"As the old Malay saying goes, the coast changes with the tide" – PM Najib Razak. The Government is taking proactive measures in recalibrating the 2016 Budget following changes in the external economic landscape which would have a significant effect on the nation's revenue and output. This is particularly in relation to (i) the further decline in international crude oil prices which currently stands at around USD33pb, as well as (ii) the further slowdown in global economy from 3.6% to 3.4%, as per IMF estimate, in 2016.

Support growth and contain deficit. These proactive measures are imperative in order to ensure that (i) the nation's economy attains the desired growth level within the revised target range of 4.0-4.5% this year, and (ii) the government's fiscal deficit target to GDP of 3.1% is not jeopardized. Some of the key measures announced by Prime Minister Najib Razak are as follow:

KEY MEASURES

TO INCREASE DISPOSABLE INCOME OF PEOPLE

- EPF contributions by employees to be reduced by 3% from March 2016 to December 2017, contributors from employers unchanged. This is expected to increase private sector spending by RM8b.
- Tax relief of up to RM2,000 for year of assessment 2015 to those with income RM8,000 a month or lower, benefiting two million taxpayers. The Government will forego revenue of RM350 million.

TO REDUCE LIVING COST OF PEOPLE

- Liberalisation of APs for agricultural products including coffee beans and meats.
- Establishment of MyFarm Outlets that sell agricultural produce directly such as meats, vegetables and fruits at prices between 5-20% below market prices.
- Domestic Trade, Cooperatives and Consumerism Ministry ordered to identify more fair-price shops including foreign and local hypermarkets and to increase enforcement and action against unethical traders.
- MyBeras programme to be introduced whereby each hardcore poor family will be given 20kg of rice every month.
- BR1M and welfare assistance programmes will continue to be implemented and GST rate would not be raised
- All houses priced up to RM300,000 be limited to first-time house buyers only.

TO ENHANCE REVENUE OF GOVERNMENT

- Give special consideration on relaxation for penalty on taxpayers to encourage them to come forward and declare their past years' income.
- Optimise the revenue from the telecommunication spectrum through redistribution and bidding process.
- Develop several strategic areas owned by the Government through a bidding process.

TO REDUCE EXPENDITURES OF GOVERNMENT

- More prudent in spending, particularly on supplies and services; continue efforts to rationalise the provision of grants to Government Trust Funds, federal statutory bodies and GLCs.
- Development expenditure shall focus on projects and programmes that place the people first, high multiplier effect and lower import content.
- These prudent measures are expected to save RM9b in operating and development expenditures.

SECTORIAL IMPACTS

Automotive

Currently, employee EPF contribution is fixed at 11% and after March 2016, this will be temporarily reduced to 8% up till December 2017. The move will free up net income for consumers and improves borrowing capacity. As an illustration, for those earning between RM3,000–RM10,000 a month, the amount freed up is between RM90–RM300 a month.

Illustration of hypothetical improvement in purchasing power

			Variance
Interest rate	2.80%	2.80%	
Loan tenure (years)	9	9	
Car price (RM)	50,000	58,500	8,500
Loan at 90% margin of financing (RM)	45,000	52,650	
Monthly repayment (RM)	522	610	89
			Variance
Interest rate	2.80%	2.80%	
Loan tenure (years)	9	9	
Car price (RM)	50,000	79,000	29,000
Loan at 90% margin of financing (RM)	45,000	71,100	
Monthly repayment (RM)	522	824	303

Source: MIDFR

If worked backwards on an assumption of: (1) a 9-year loan tenure (2) a 2.8% interest rate (3) a 90% margin of financing; the freeing up of this amount allows for increased purchasing power of between RM8,500–RM29,000, i.e. a person who could afford a car in the RM50,000 price segment can now afford a RM58,500–RM79,000 car based on the improved borrowing capacity. In reality of course, we think the positive impact on borrowing capacity will likely be moderated given cautious consumer sentiment and the reluctance to build-up too much debt in an uncertain global economic environment.

On the second point, the net impact is not expected to be substantial. A RM2,000 annual tax relief translates into the freeing up of ~RM475 in net income. We think this is too small to have an impact on car purchasing decisions on top of it being a one-off benefit (and does not enhance borrowing capacity), though it might reduce the burden of down-payments for cars in the cheaper price segment.

Similar measures were taken during the global financial crisis, i.e. Jan 2009 - Dec 2010 where employee EPF contribution was also reduced to 8% from 11%, albeit for a slightly longer 2-year period. 2009 TIV still contracted by 2% but in 2010, recovered by some 12.7% – TIV ended 2010 at ~605K, above pre-crisis levels – though this has to be taken in context with the broader economic recovery in 2010, i.e. GDP contracted 2% in 2009 but grew 8% in 2010. If history is anything to go by then what this suggests is that spending on big-ticket, discretionary consumer goods such as cars is still very much swayed by consumer confidence and employment security, despite the freeing up of disposable income. Maintain NEUTRAL on Automotive sector.

Aviation

We are positive on the move to waive visa requirements (for tourists from China from 1/3/16-31/12/16 for visits of no longer than 15 days) following steps taken by the GOM to promote Chinese tourist arrivals in 2015 such as allowing e-visa applications and free visa applications for group tourists travelling with tour operators. We also note that Indonesia and Thailand had removed visa requirements for Chinese arrivals in 2015 to promote tourism.

At present, Chinese tourists entering Malaysia are required to apply for a visa by submitting a Visa Application Form, providing a recent photograph with a copy of passport and paying a visa fee of RMB40 (approx. RM26). In addition, a processing fee of RMB120 (RM77) is charged by travel agencies.

We believe that the move bodes well for the travel industry after a decline of Chinese arrivals into Malaysia of -1%yoy from 1.27m in 9MCY14 to 1.25m in 9MCY15 following the MH370 incident which dissuaded Chinese tourists from visiting Malaysia. We note that China is an important market as it has the largest number of outbound tourists estimated at 139m tourists in 2015 spending almost $200b on their travels according to the China National Tourism Administration.

Chinese tourists represent the third largest inbound market for Malaysia after Singapore and Indonesia. While, MAHB saw a decline in Chinese arrivals for the first-half of 2015, the second-half saw a double-digit improvement. The removal of visa requirements would help the positive trend continue into 2016. Meanwhile, the both AirAsia and AAX have a combined 61% share of Malaysia-China seat capacity having expanded capacity by +15% in 2015 (source: CAPA, OAG), thus improvements in Chinese arrivals would be beneficial to the Group.

The measure augurs well for the aviation sector thus we remain POSITIVE. All 3 companies under our coverage will benefit from increased Chinese arrivals, i.e. MAHB (BUY, TP: RM6.35), AirAsia (BUY, TP: RM1.82) and AAX (BUY, TP: RM0.26).

Construction

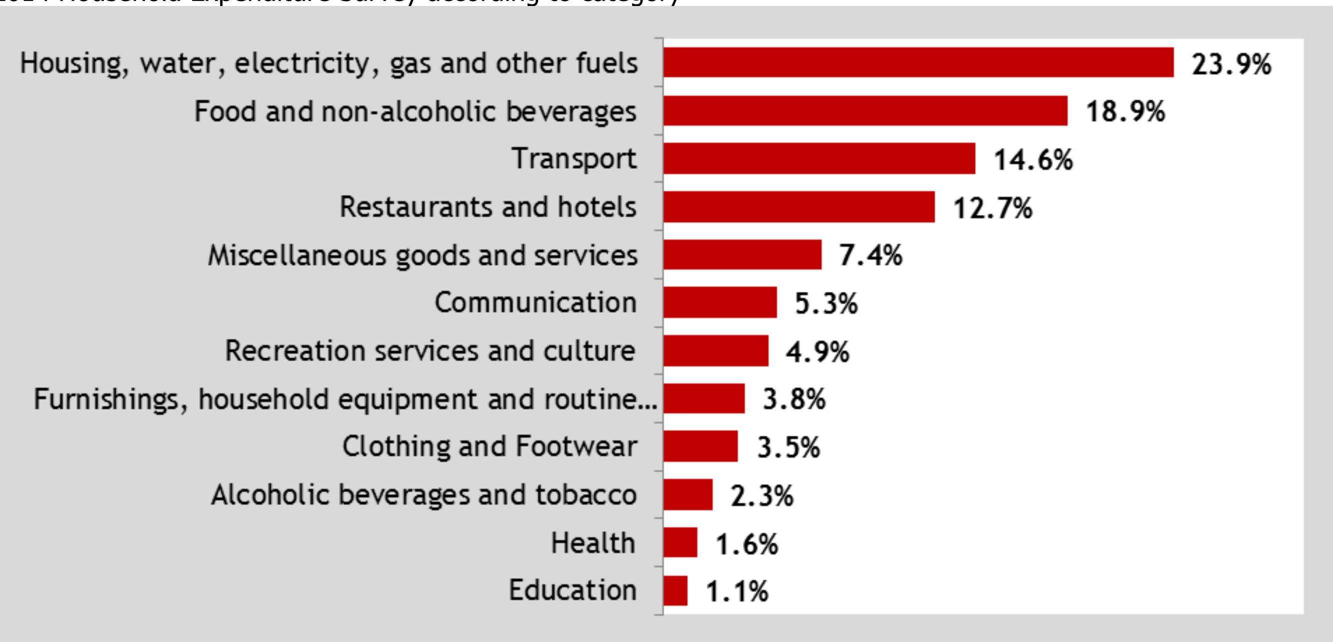
Construction and Infrastructure budget will not go off tandem with the commitment from government to proceed with projects under GTP3.0 and ETP3.0. We reiterate the estimation of budgeted development expenditure is still within our assumption of 6% of GDP in 2016. The construction of (i) affordable housing scheme such as PRIMA and PPR, (ii) hospitals, schools, (iii) roads such as West Coast Expressway and Pan Borneo Highway, and (iv) public transport system such as KVMRT2, High Speed Rail, BRT and LRT3 remain on track.

With regards to the non-physical items and the savings of RM5bn from the budget cut would involve non-infrastructure related items, we believe this reflects non infrastructure projects such as building and system upgrades for existing government facilities.

Consumer and Tobacco

A 3% reduction in EPF contribution is expected to benefit the consumer sector as readily available cash-in-hand will help to encourage consumer spending especially in the retail and food & beverage segment – this we believe is the intention of the government to sustain and to spur growth in the retail sector as the consumer sentiment index is currently at an all-time low. We believe that with higher household liquidity, consumers would be encouraged to spend more on discretionary items such as clothing, food and cigarettes. According to the 2014 Household Expenditure Survey (HES), the household expenditure for alcoholic beverages and tobacco as well as clothing and shoes increased by +0.1ppts in 2014 to 2.3% and 3.5% respectively compared to 2009.

2014 Household Expenditure Survey according to category



Source: Department of Statistics Malaysia, MIDFR

Meanwhile, staple items such as non-alcoholic food and beverages as well as transportation fell by -1.4ppts and -0.3ppts respectively. We also expect the bulk of the expenses to be centralised in Putrajaya, Kuala Lumpur and Selangor as these states consist of more shopping malls compared with the other states. In the 2014 HES, Putrajaya, Kuala Lumpur and Selangor topped the household expenditure by contributing 10.1%, 9.8% and 8.1% respectively to the national census. With these data, we expect consumer stocks such as Aeon and Parkson to benefit from the increase in consumer expenditure.

Healthcare

We expect a potential marginal positive contribution to the private hospital operators from the recalibrated Budget 2016 measures. With the increase in disposable income attributable to the reduction in Employees Provident Fund (EPF) contribution by employees to 8% (from 11% previously) as well as the tax relief of up to RM2,000 for individual taxpayers earning RM8,000 and less, we are expecting the general public to be able to flex their spending and potentially opt for quality medical treatments at private healthcare institutions instead of the government's public hospitals. We think that this would especially benefit critical cases which require immediate medical attention.

On another note, we opine that the impact on the pharmaceutical players will be neutral as medicines as well as health supplements are now essential daily items to an increasingly health conscious Malaysian population. We do foresee a marginal increase in demand as purchasing power increase, especially for branded and imported medicines however, a steep increase in demand due to this is highly unlikely.

All in, we think that despite being a potential beneficiary of the recalibrated Budget 2016 measures, we do acknowledge the possibility of this increase in disposable income will be channelled more towards easing day-to-day cost of living in terms of consumer spending. Of which, we think the overall sector would only benefit marginally from these new measures.

Plantation

No measures from the revised budget are affecting plantation sector. We maintain our POSITIVE view on the sector as CPO price is expected to average at RM2500/MT in 1QCY2016. Limited supply due to El Nino which starts from May-2015 should keep CPO price supported.

Property

With immediate effect, for all new housing projects, the Government mandates that all houses priced up to RM300,000 be limited to first-time house buyers only.

However, we gather that almost of all the new housing projects for property developers under our coverage is already priced at above RM400,000. This is due to their concentration of property launches in more strategic location in Kuala Lumpur, Selangor, Penang and Johor. Hence, the housing projects by property developers under our coverage are not affected by this measure.

Nevertheless, the measure shows government seriousness to improve house ownership for the first-time house buyers. This is caused by lower competition for the same house with speculators for house priced below RM300,000.

We reiterate our Neutral calls on property developers under our coverage.

REIT

Slightly positive to REITs with retail exposure as increased disposable income from (i) reduced EPF contributions, and (ii) tax relief, would translate into higher retail spending. This would partly offsetting the negative impact from muted retail sales growth on rental reversions.

Beneficiaries include IGB REIT (BUY, TP: RM1.60), Pavilion REIT (NEUTRAL, TP: RM1.63), CMMT (BUY, TP: RM1.66), KLCCP Stapled Group (NEUTRAL, TP: RM6.94), and Sunway REIT (NEUTRAL, TP: RM1.58).

Telecommunication

The Government will optimise the revenue from the telecommunication spectrum through redistribution and bidding process which will be implemented soon.

This will involve the reallocation of the lower spectrum band among the telecommunication companies. At present, the 900MHz bandwidth is being allocated to Maxis, Celcom (Axiata) and Digi. With the spectrum reallocation, Maxis and Celcom could be negatively impacted due to the potential loss of spectrum portion.

On the contrary, Digi, Umobile and/or Altel are potential beneficiaries should they be awarded with the spectrum. We could also see more intense bidding process as telecommunication companies would try to attach higher bidding prices in the hopes of retaining or gaining more spectrum band.

MARKET OUTLOOK

The Budget recalibration clearly restate the key budget assumptions and parameters with regard to (i) crude oil prices with average Dated Brent of USD30-35 per barrel (from USD48pb), (ii) GDP output growth range of between 4.0-4.5% (from 4.0-5.0%), and (iii) fiscal deficit target to be maintained at 3.1% of GDP for 2016. The announcements are positive as the key budget assumptions and parameters are now more realistic and attainable. Based on our estimate, it must also be highlighted that the fiscal dependency on oil-related income is expected to decline further to less than 11% of total revenue.

Some of the new budget measures particularly (i) the lowering of EPF contributions by employees by 3%, and (ii) tax relief of RM2,000 for income earner of up to RM8,000 per month, are arguably intended to help raise the aggregate disposable income of Malaysian consumers. These measures are directly positive to private consumption growth which is necessary in view of the announced cutbacks in public expenditures. Having said that, we reckon the full positive impact on consumer spending capacity may likely be moderated given cautious consumer sentiment due to an uncertain global economic environment which may explain the reduction in GDP output growth range.

On this score, it is notable that based on our estimate, the consumer discretionary sector accounts for circa 20% of the aggregate earnings of FBM KLCI constituents. However, the impact from the measures may not be sizable and targeted enough to provide a material boost to the overall earnings. Hence, the direct impact of the new budget measures on the local equity market may be rather muted or mildly positive.

Nevertheless, premised on revised key budget assumptions and macro parameters which are now more realistic and attainable, we foresee a potential market fillip from lower risk of downward earnings revisions to FBM KLCI 2016 earnings estimates pursuant to the Budget recalibration.

Another potential market fillip may emanate from the fact that, fiscally, Malaysia can no longer be considered as heavily oil dependent. As stated earlier, oil-related income is expected to decline further to less than 11% of total revenue in 2016. The market may have beginning to take cognizant of this structural shift as evident by the performance of Ringgit since the end of September last year.

Performance of Ringgit against the currencies of other 'oil dependent' countries

	30 Sep 2015	***28 Jan 2016***	***Change%***
USD/MYR	4.39	4.20	-4.3
USD/NOK (Norway)	8.51	8.62	+1.3
USD/RUB (Russia)	65.4	76.6	+17.1
Brent Crude Oil	48.4	33.9	-30.0

Source: Department of Statistics

On this score, it should also be noted that Ringgit is the best performer among major Asian currencies thus far in 2016, followed by Japanese Yen and Thai Baht. Furthermore, FBM KLCI is the fourth best performing benchmark year-to-date among major Asian indices, behind only Seoul's KOSPI, Bangkok's SET and Jakarta's JCI.

We reiterate our FBM KLCI 2016 year-end target at 1,800 points. The baseline target equates to PER16 of 16.34x and +0.67SD.

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.