

25 April 2024

**Global Economics & Market Strategy**

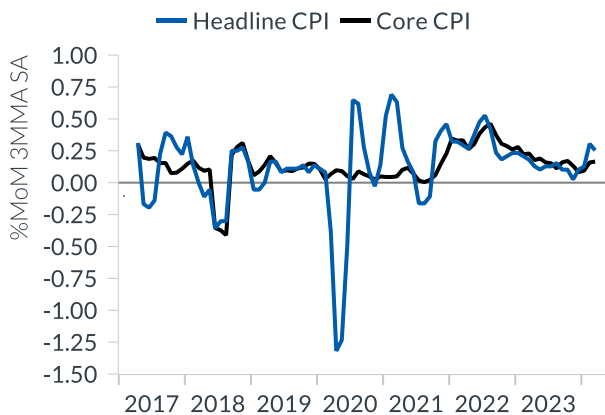
**Malaysia: Inflation Momentum to Edge Higher in Coming Months**

- ◆ We maintain our 2024 headline inflation projection at 3.3% YoY. We remain cautious on the potential upside on inflation amid fiscal consolidation measures and elevated commodities prices.
- ◆ The Overnight Policy Rate (OPR) is likely to be maintained at 3.00% for 2024. Wide official inflation range of 2.0% to 3.5% should provide sufficient room against future price movements.
- ◆ March CPI inflation sustained at 1.8% YoY compared to a similar reading in the previous month versus Bloomberg consensus estimate of 2.0% YoY and our house projection of 1.9% YoY.

Economist

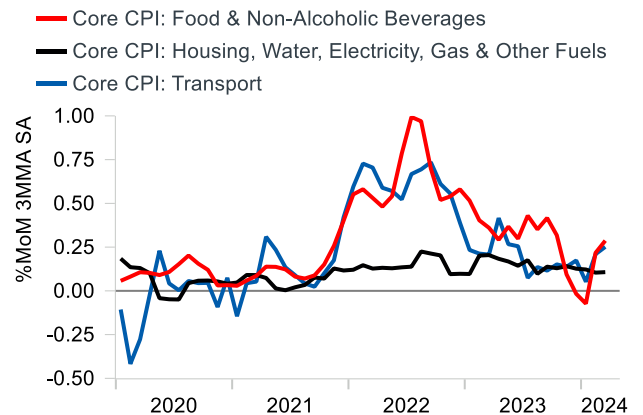
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**Figure 1: Inflation momentum has picking up...**



Source: Macrobond, RHB Economics & Market Strategy.

**Figure 2: ...on higher transport, food and utilities costs**



Source: Macrobond, RHB Economics & Market Strategy.

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## Inflation Momentum across Major Sub-Categories is Picking Up

**We maintain our 2024 headline inflation projection at 3.3% YoY.** Following the adjustments in services tax and anticipated rollout of diesel subsidy rationalisation, we expect the inflation momentum to gain pace in 2Q24. According to our estimates, the proposed fiscal consolidation measures are projected to lift the headline inflation by 0.7%-1.1% (versus 2.5% YoY in 2023). At the time of writing, we have noticed an upside to the inflation in the recent two months amid upward adjustments in the water tariffs for the domestic users in Peninsular Malaysia and the Federal Territory of Labuan. Higher water tariffs have contributed to a 0.2% increase in overall headline inflation. Based on our in-house estimation, the upside to headline CPI could range between 0.02% and 0.05% for every 5% increase in water tariff.

**The actual magnitude of the upside risks would be hinged on a few key factors: (1) the effective date of implementation for fuel subsidy rationalisation, (2) the quantum of the prices and tariffs adjustments, (3) the strength of second-round impacts on the household spending and business costs.** At this point, there is no mention of the effective date for fuel subsidy rationalisation or the new retail fuel prices. The rough timeline for fuel subsidy rationalisation is for diesel prices to be adjusted by June 2024, followed by RON95 fuel subsidy rationalisation in 2H24.

**On the external front, we remain cautious about the potential upside bias for commodity and food prices.** The commodity prices would be buoyed by the higher demand amid the acceleration in global activities coupled with the risks of oil supply disruption amid geopolitical tension in the Middle East. The materialisation of China's economic recovery in 2024 (note 1Q24 GDP at 5.3% YoY was above consensus) could lift the commodity demand and prices, i.e. crude oil prices and base metals. On commodities, we expect higher safe haven demand into gold and elevated crude oil prices as tensions linger. Should tensions escalate, we see upside risks for Brent crude at a high of US\$140 per barrel (versus US\$95 per barrel as per our base case). Fuel subsidies are likely to be extended in the event of elevated crude oil prices to cushion the impact of higher transportation costs and subsequent secondary effects. The impact of higher transportation costs on the overall headline inflation momentum could be sizeable as transport inflation accounts for 11% of the total CPI basket, with fuel sub-components alone constituting 6%. In addition, our proprietary El Nino-Food model suggests that the NOAA Oceanic Nino index leads global food prices by between 12 to 18 months. This implies that there would be a potential spillover effect on Malaysia's food inflation for 1H24.

**The OPR is likely to be maintained at 3.00% for 2024. We see the lack of impetus for Bank Negara Malaysia (BNM) to tweak its policy rate level in 2024, considering the rosier domestic economy prospect amid uncertainties in the inflationary trajectory.** A wide official inflation range of 2.0% to 3.5% should provide sufficient room against future price movements. The central bank might hold its benchmark rate until there is greater clarity over the fuel subsidy reform's exact timeline and magnitude while assessing the lagged impact on the overall inflationary trajectory and economic momentum.

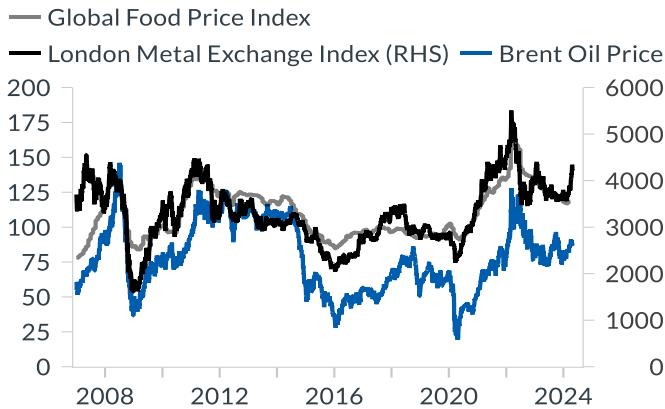
**The inflation momentum for March is driven by upsides across major sub-categories, including food prices and transportation and utilities costs.** The increase in core food inflation momentum is driven by higher prices of imported rice fragrant rice, which recorded a rise of 9.9% (February 2024: 9.6%) and 6.3% (February 2024: 6.3%), respectively. To address the impact of elevated imported prices, the National Action Council on Cost of Living has agreed to reduce the retail price of imported white rice from RM2 to RM3 on 20 March. The water subgroup (0.9% of the total CPI basket) has increased to 31.4% YoY in March versus a strong print of 28.8% YoY in February. In March, Kedah increased the water tariff rates for domestic category users compared to other states that implemented the new tariff rates in February.

**March CPI inflation was sustained at 1.8% YoY compared to a similar reading in the previous month versus Bloomberg's consensus estimate of 2.0% YoY and our house projection of 1.9% YoY. The core CPI inflation inched lower to 1.7% YoY (February: 1.8% YoY).** On a MoM SA basis, the headline and core inflation increased by 0.1% compared to the previous month.

**Housing, Water, Electricity, Gas & Other Fuels costs gained pace by 3.0% YoY in March (February: 2.7% YoY), lifted by water supply prices, which increased by 31.4% YoY (February: 28.8% YoY).** Meanwhile, transport inflation edged higher to 1.3% YoY (February: 1.2% YoY), driven by higher costs of operation in personal transport equipment, which increased to 1.4% YoY (February: 1.3% YoY). Lastly, the Food & Non-Alcoholic Beverages group, which contributes 29.8% of the total CPI, remain steady at 1.7% YoY (February: 1.3% YoY) amidst the stable prices for controlled food items.

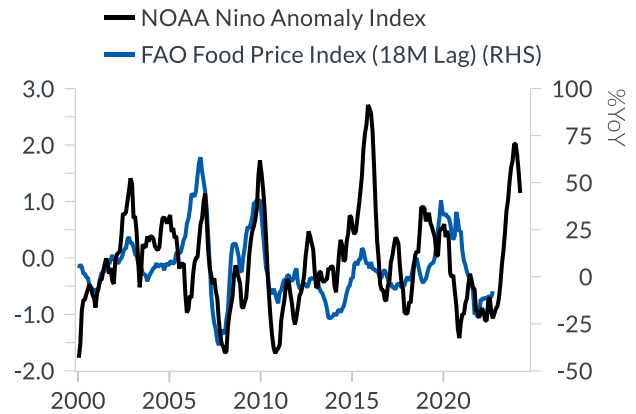
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**Figure 3: Potential upside risks from higher commodity prices...**



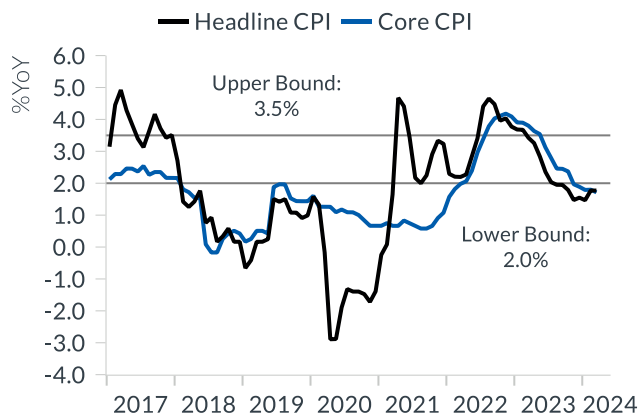
Source: Macrobond, RHB Economics & Market Strategy.

**Figure 4: ...and elevated food prices amid El Niño weather conditions**



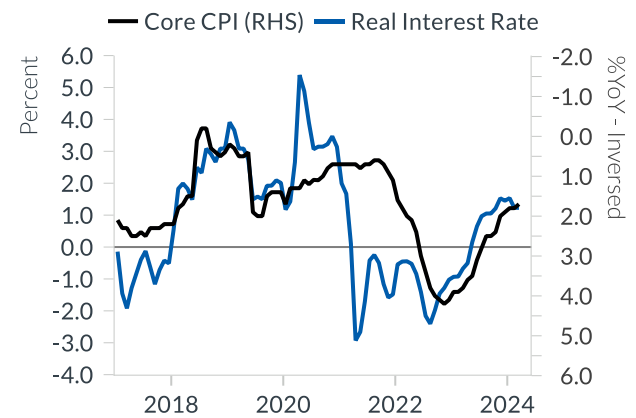
Source: Macrobond, RHB Economics & Market Strategy.

**Figure 5: BNM will likely stay at 3.0% if the headline inflation falls within the projected range...**



Source: BNM, Macrobond, RHB Economics & Market Strategy.

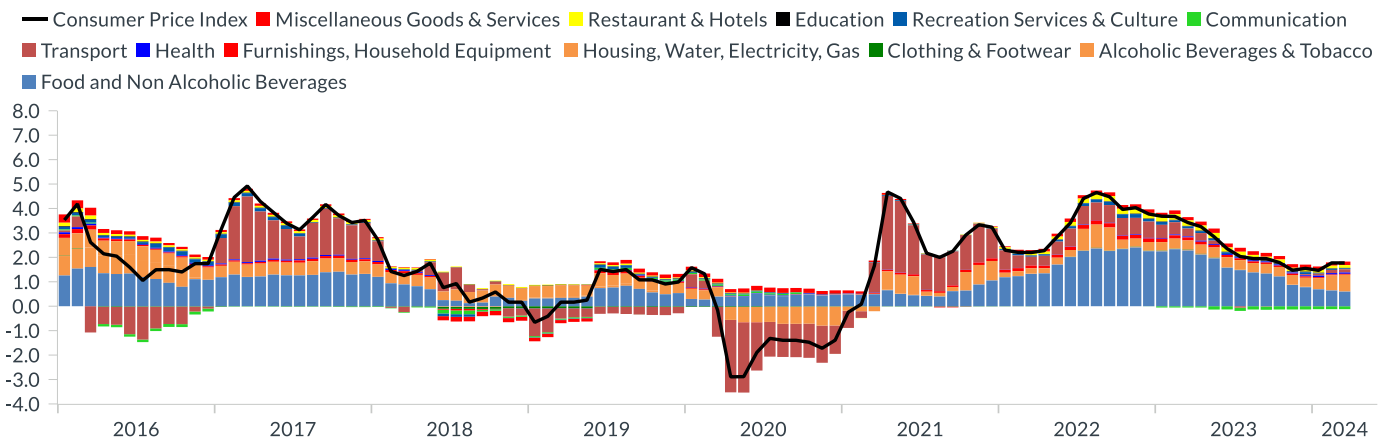
**Figure 6: ...while core inflation remains muted**



Source: Macrobond, RHB Economics & Market Strategy.

**Figure 7: Utilities costs are trending up on tariff adjustments while food inflation is contained by price control**

**Contribution to Headline Inflation**



Source: Macrobond, RHB Economics & Market Strategy.

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