

14 June 2024

Global Economics & Market Strategy

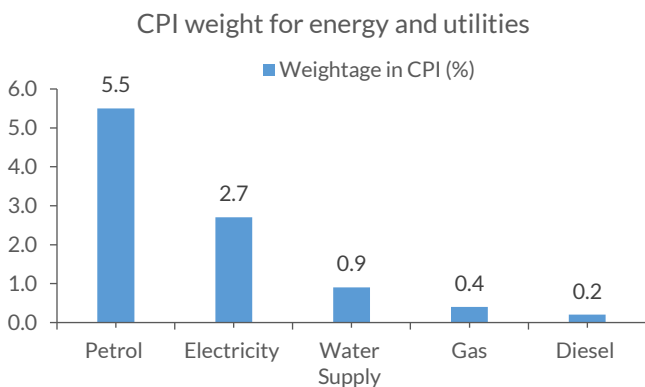
Malaysia: Diesel Price Float Would Have Limited Direct Impact on CPI

- ◆ The diesel subsidy rationalisation is expected to have limited direct impact on the headline inflation, with slightly positive impact on the fiscal position and MYR.
- ◆ The direct impact of headline inflation would be marginal, with the potential upside on the headline inflation less than 0.1%. The diesel weight to overall headline CPI is a mere 0.2%, indicating a minimal potential for significant inflationary effects.
- ◆ Further out, we opined that RON95 petrol subsidy rationalisation might be delayed to end-2024, at the earliest. We expect more details on the RON95 petrol subsidy rationalisation to be released during the tabling of Budget 2025, which is scheduled on 11 October.

Economist

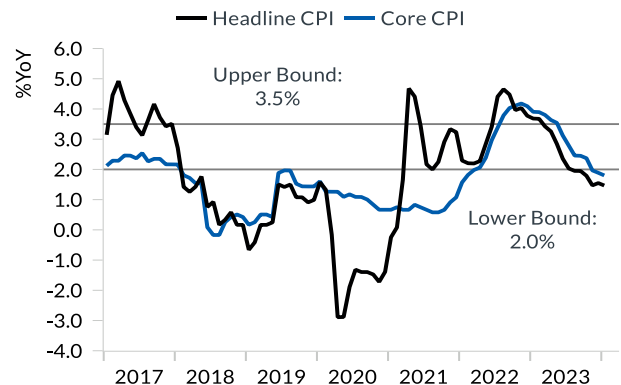
Chin Yee Sian
 +603 9280 8862
chin.yee.sian@rhbgroup.com

Figure 1: Petrol has greater weightage than diesel in CPI basket



Source: Macrobond, RHB Economics & Market Strategy.

Figure 2: BNM is likely to stay pat at 3.0% if the headline inflation fall within the projected range



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

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RON95 petrol subsidy rationalisation might be delayed to end-2024

The government has enforced the new retail prices for diesel in Peninsular Malaysia at RM3.35 per litre, which is effective on 10 June. In our opinion, the diesel subsidy rationalisation would have limited impact on the headline inflation, with slightly positive impact on the fiscal position and MYR.

On inflation front, we think the direct impact of headline inflation would be marginal, with the potential upside on the headline inflation less than 0.1%. First, subsidies will continue for most of the diesel-powered commercial vehicles and for public transportation. Second, the diesel weight to overall headline CPI is a mere 0.2%, indicating a minimal potential for significant inflationary effects. Third, our quantitative analysis (Figure 4) suggests that for every 1% YoY increase in diesel prices, fuel inflation will increase by 0.04%, which translating into 0.002% of headline inflation. Thus, with the 55.8% hike in the retail diesel price, the upside on the headline inflation could go up to 0.1%. Nevertheless, this assumes higher diesel prices affect every diesel-powered vehicle, which is not the case here. In the near term, the government would focus on the enforcement to contain the possibility of disproportionate increase in prices following the recent implementation of diesel subsidy rationalisation.

We maintain our 2024 headline inflation projection at 3.3% YoY, with the balance of the risks tilted to the lower end of our in-house inflation projected range of 3.2%-3.6%, should there be a delay in RON95 fuel subsidy rationalisation. The inflation trajectory going forward would be hinged on a few key catalysts: (1) lagged impact from consumption tax measures, i.e. services tax revision and implementation of Low Value Goods Tax (LVGT), (2) the timeline of RON95 subsidy rationalisation and its quantum of adjustments, (3) potential demand upsides from partial pension fund withdrawals, (4) spill over impact from higher global commodity and food prices. Further, a planned increase in civil servant salaries (effective in December 2024) might potential instil further upsides on the demand-pull inflation pressure as well.

Thus, we keep our view that the Overnight Policy Rate (OPR) would be maintained at 3.00% for 2024. 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 while accessing the lagged impact of the fiscal policy adjustments on overall inflationary trajectory and economic momentum.

Further out, we opined that RON95 petrol subsidy rationalisation might be delayed to end-2024, at the earliest. We view that the Government might assess the lagged impact of diesel prices adjustments on the inflation trajectory and the economy, prior to the implementation of RON95 petrol subsidy rationalisation. We expect more details on the RON95 petrol subsidy rationalisation to be released during the tabling of Budget 2025, which is scheduled on 11 October. The impact of adjustments in RON95 petrol subsidy on the inflation would be greater due to (1) larger consumer base where it involves larger group of private users and (2) petrol has significant weightage of 5.5% in CPI basket (versus diesel at 0.2%). The retargeting of RON95 subsidy rationalisation would require deliberate and more gradual approach, to prevent sudden spike on the inflation. At non-subsidised petrol stations, the RON95 is sold at a market price of MYR3.35 per litre, which is approximately 63% higher than the current subsidised price of MYR2.05 per litre.

The government has enforced the new retail price for diesel in Peninsular Malaysia at MYR3.35 per litre (up MYR1.20 from previously), effective on 10 June. The retail price of diesel fuel for Sabah, Sarawak and Labuan remains at MYR2.15 per litre. The unsubsidised market price based on the May 2024 average, according to the automatic pricing mechanism formula. Moving forward, diesel prices will be announced on a weekly basis to be aligned with market price based on the formula.

To mitigate the impact on domestic prices, selected sectors have been approved to purchase diesel at subsidised rates. The lowest would be for fishermen at MYR1.65/litre, followed by MYR1.88/litre for land public transport under the Subsidised Diesel Control System (SKDS) 1.0, and MYR2.15/litre for eligible logistics vehicles via a fleet card mechanism under SKDS 2.0. Separately, a monthly aid of RM200 will be given to eligible individuals, small farmers and smallholders, with non-luxury diesel-powered vehicles, under the Budi Madani cash assistance scheme. Exceptions are for a small group of personal vehicle users who earn more than RM100,000 a year.

The Budi Madani is projected to benefit 700,000 diesel vehicle owners in total (which includes 400,000 commercial vehicles and 300,000 private vehicles), covering about half of active diesel vehicles in Peninsular Malaysia. As per the Department of Statistics Malaysia data, the RM200 cash handout is expected to cover 80% of diesel vehicle owners, based on consumption patterns.

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Meanwhile, we expected slightly positive impact on the fiscal position and we maintain our 2024 fiscal deficit projection at 4.3% of GDP. Based on official estimates, an annual savings of MYR4 bn is anticipated from diesel subsidy retargeting, which implying that the potential savings from diesel subsidy rationalisation for 2024 is estimated at around MYR2 bn. The savings from diesel subsidy rationalisation would be rechannelled into the upgrading of infrastructure as well as improvement of education and healthcare system. Besides that, we do not rule out the potential upsides in the social assistance for 2024, in tandem with the subsidy retargeting. Other savings from the subsidy retargeting measures would include savings of MYR4.5 bn from retargeting of electricity subsidy as well as MYR1 bn from the floating of chicken prices. In addition, the government is expected to receive additional revenue of MYR4.5bn from the recently implemented low value goods tax, capital gains tax, and the services tax revision.

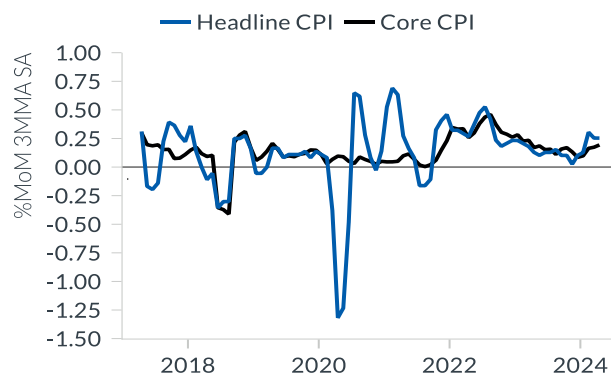
Our end-2024 and 2025 MYR projections stood at 4.7 and 4.6 per USD, assuming improved fiscal and current account balance and normalisation of FFR by the end-2024. The implementation of diesel subsidy rationalisation would supplement other existing fiscal consolidation measures, which is expected to improve the fiscal position in relative to 2023. Our proprietary MYR model suggests that the MYR movement reflects US-MY rate differential and fiscal and current account balances. In the intermediate term, the positive carry in holding USD over MYR might remain rich as U.S. Federal Funds Rates (FFR) may see just one cut (with the balance of risks magnified towards no cuts) in 2024. Nevertheless, the improvement in domestic macroeconomic backdrop i.e. fiscal and current account position is expected to keep the MYR stable, following greater clarity in the fuel subsidy rationalisation measures.

Figure 3: Regression suggests that RON 95 prices has the highest beta in influencing Malaysia's fuel CPI

Dependent Variable: Fuel Inflation (%YoY)				
Regression Statistics				
Multiple R	0.9998			
R Square	0.9996			
Adjusted R Square	0.9995			
Standard Error	0.3515			
Observations	69			
	Coeff	Std Error	t Stat	P-value
Intercept	-0.17	0.05	-3.56	0.00
RON 95(YoY%)	0.85	0.01	67.14	0.00
Diesel (YoY%)	0.04	0.01	3.00	0.00
RON97(YoY%)	0.08	0.00	44.22	0.00

Source: RHB Economics & Market Strategy. The regression model assumes the impact of diesel prices changes on every diesel-powered vehicle.

Figure 5: Core inflation momentum has picking up in recent months...



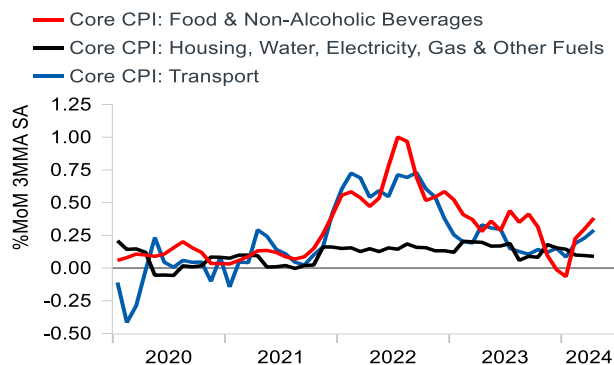
Source: Marobond, RHB Economics & Market Strategy.

Figure 4: MYR is a reflection of the current and fiscal account balances as well as US-MY real rates

Dependent Variable: USD-MYR				
Regression Statistics				
Multiple R	0.867			
R Square	0.751			
Adjusted R Square	0.727			
Standard Error	0.256			
Observations	70			
	Coeff	Std Error	t Stat	P-value
Intercept	6.96	0.40	17.38	0.00
Current Account % GDP (-1)	-0.10	0.02	-6.40	0.00
Fiscal Account % GDP (-4)	-0.07	0.04	-1.89	0.05
Public Debt YoY (3QMA) (-2)	-0.04	0.01	-2.81	0.01
KLCI (x100) (-1)	-0.13	0.00	-5.72	0.00
Brent (x100) (-1)	-0.48	0.00	-2.82	0.01
US-MY Real Rates (-4)	0.02	0.03	0.91	0.36

Source: RHB Economics & Market Strategy.

Figure 6:on higher transport costs and food prices



Source: Macrobond, RHB Economics & Market Strategy.

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**KUALA LUMPUR**

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 9280 8888
Fax : +603 9200 2216

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel : +6221 509 39 888
Fax : +6221 509 39 777

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799