

25 June 2024

Global Economics & Market Strategy

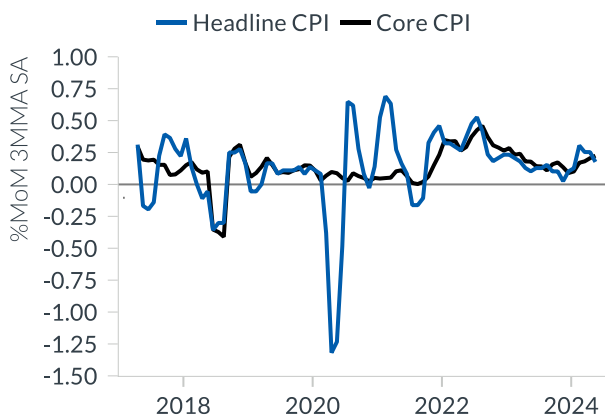
Malaysia: We Revise Our 2024 Inflation Forecast to 2.6% YoY

- ◆ We revise our 2024 headline inflation projection to 2.6% YoY versus our former forecast of 3.3% YoY. Our revision is founded on (1) marginal direct impact of diesel subsidy rationalisation on headline inflation and (2) delay in the implementation of RON95 petrol subsidy rationalisation to end-2024 (at the earliest), which is against our prior view for RON95 petrol subsidy rationalisation to commence sometime in the middle of this year.
- ◆ The inflation trajectory going forward would hinge on: (1) lagged impact from services tax revision and implementation of Low Value Goods Tax (LVGT), (2) timeline of RON95 subsidy rationalisation and its quantum, (3) potential demand upsides from partial pension fund withdrawals, and (4) spill-over impact from higher global commodity and food prices.
- ◆ May CPI inflation edged higher to 2.0% YoY (April: 1.8% YoY) versus Bloomberg consensus of 1.9% YoY and our house projection of 2.0% YoY.

Economist

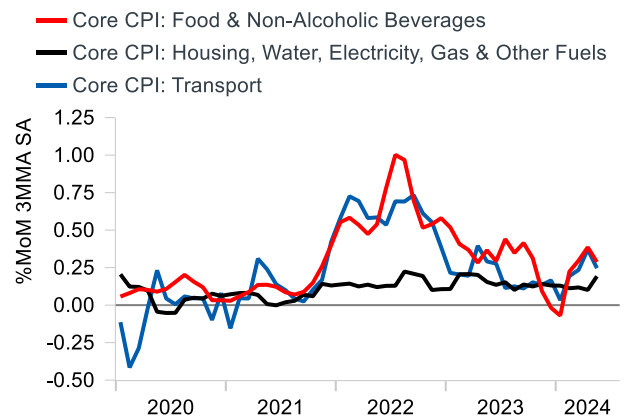
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Figure 1: Core inflation momentum trended higher...



Source: Macrobond, RHB Economics & Market Strategy.

Figure 2: ...on higher utility costs



Source: Macrobond, RHB Economics & Market Strategy.

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Core Inflation Momentum Edge Higher on Increasing Utility Costs

We revise our 2024 headline inflation projection to 2.6% YoY versus our former forecast of 3.3% YoY. The projected range is revised to 2.5 -2.8% YoY, versus our former estimation of 3.2-3.6% YoY. Our revision is founded on (1) marginal direct impact of diesel subsidy rationalisation on headline inflation and (2) delay in the implementation of RON95 petrol subsidy rationalisation to end-2024 (at the earliest), which is against our prior view for RON95 petrol subsidy rationalisation to commence sometime in the middle of this year.

The inflation trajectory going forward would hinge on: (1) lagged impact from services tax revision and implementation of Low Value Goods Tax (LVGT), (2) timeline of RON95 subsidy rationalisation and its quantum, (3) potential demand upsides from partial pension fund withdrawals, and (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.

The direct impact of diesel subsidy float in Peninsular Malaysia would be marginal, with potential upside on the headline inflation less than 0.1%. The subsidies will continue for most of the diesel-powered commercial vehicles and for public transportation. In addition, the diesel weight to overall headline CPI is a mere 0.2%, indicating a minimal potential for significant inflationary effects. Our quantitative analysis 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. The government would focus on the enforcement to contain the possibility of disproportionate increase in prices following the recent implementation of diesel subsidy rationalisation.

Further out, we opine that RON95 petrol subsidy rationalisation might be delayed to end-2024 (at the earliest), with more details to be released during the tabling of Budget 2025 on 11 October. 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. Based on our estimate, every 1% increase in RON95 retail price would have 0.05% upside in headline inflation, implies that the free float of RON95 petrol might have potential upside on inflation by 3.05% (based on the unsubsidised RON95 petrol price of RM3.30/litre as at 19 June versus the current retail price of RM2.05/litre). We view that the retargeting of the RON95 subsidy rationalisation might take form in a more gradual approach, as it involves a larger consumer base with a significant weightage of 5.5% in the CPI basket (versus diesel at 0.2%).

We continue to see persistent global inflation amid elevated food, oil, and metal prices, suggesting potential spill over effect on Malaysia's inflation for the year. Our proprietary indicators for food inflation continue to suggest higher prices, at least into end-2024. Separately, oil prices will be underpinned higher oil demand in tandem with acceleration of global activities coupled with policy induced supply cuts.

The Overnight Policy Rate (OPR) is likely to be maintained at 3.00% for 2024. We see the lack of impetus for the central bank to tweak its policy rate level in 2024. A wide official inflation range of 2.0% to 3.5% should provide sufficient room against future price movements. The policymakers might hold the OPR rate while assessing the lagged impact of fiscal policy changes on the overall inflationary trajectory and economic momentum.

May CPI inflation edged higher to 2.0% YoY (April: 1.8% YoY) versus Bloomberg consensus of 1.9% YoY and our house projection of 2.0% YoY. The core CPI inflation inclined by 1.9% YoY for the month (April: 1.9% YoY). The core inflation momentum continues to trend higher for the month, driven by upside in utility costs. On a MoM SA basis, both the headline and core inflation increased by 0.3%, respectively compared to the previous month. Food & Non-Alcoholic Beverages group, which contributes 29.8% of the total CPI, increased by 1.8% YoY (April: 2.0% YoY), amid a slower increase in subgroup of food away from home. Meanwhile, transport inflation inched higher to 0.9% YoY (April: 0.8% YoY) amid a higher incline in operation of personal transport equipment. Lastly, Housing, Water, Electricity, Gas & Other Fuels costs gained pace by 3.2% YoY (April: 3.0% YoY), driven by higher increase in the expenditure class of water supply. This is in tandem with the increase in water tariff rates for domestic category users in Perak starting May 2024.

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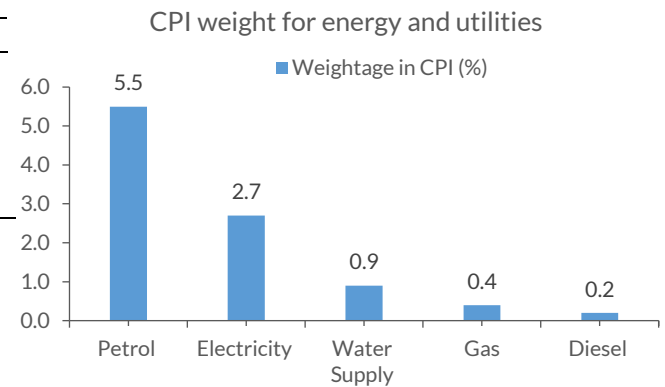
Figure 3: Regression suggests that RON 95 prices has the highest beta in influencing Malaysia's fuel CPI...

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

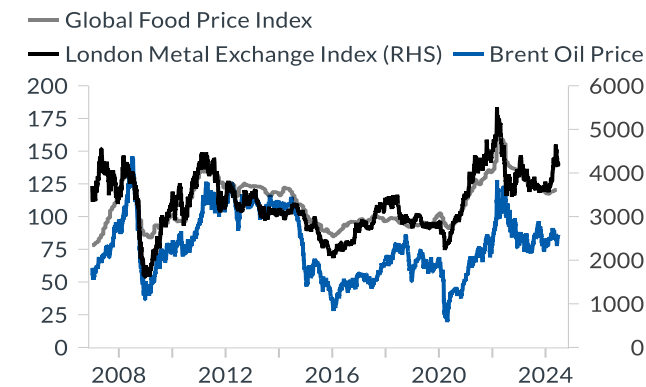
Source: RHB Economics & Market Strategy. The regression model assumes the impact of diesel prices changes on every diesel-powered vehicle.

Figure 4: ...and petrol has greater weightage than diesel in CPI basket



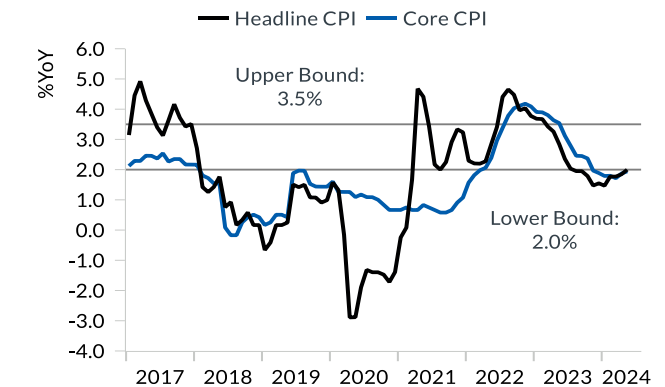
Source: CEIC, RHB Economics & Market Strategy.

Figure 5: Upsides on inflation amid higher commodity prices and elevated food prices



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

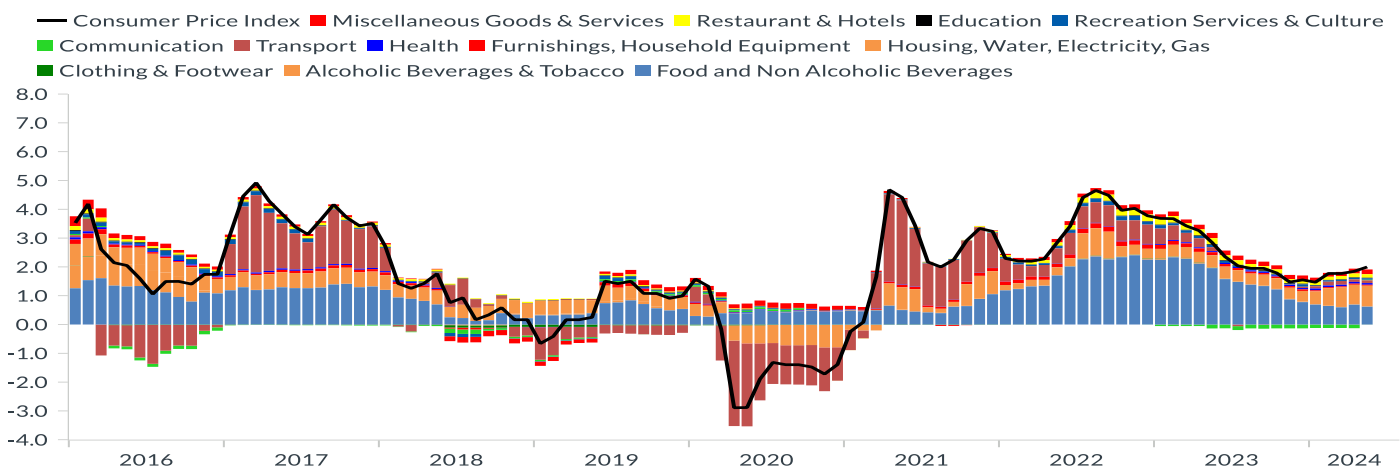
Figure 6: BNM is likely to stay pat at 3.0% if the headline inflation fall within the projected range



Source: Macrobond, RHB Economics & Market Strategy.

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

Contribution to Headline Inflation



Source: Macrobond, RHB Economics & Market Strategy.

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