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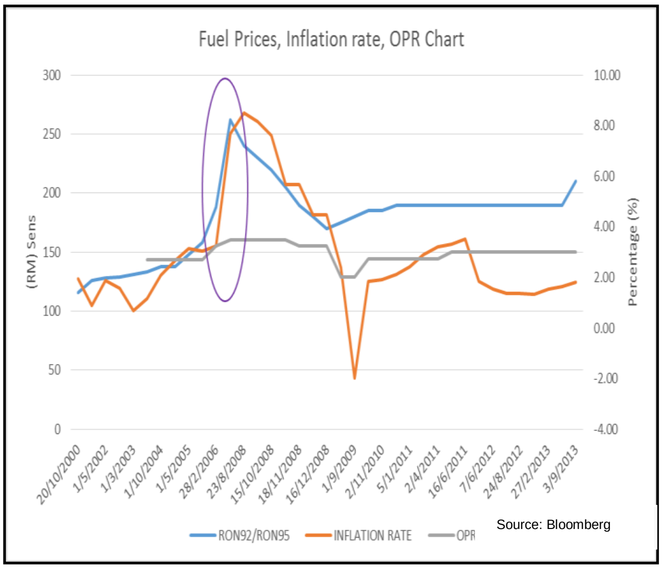
ECONOMIC HIGHLIGHTS: Is Inflation Imminent After Recent Hike In Fuel Prices?

Hitting Headlines

The government announced a fuel price hike of RM0.20 for RON-95 and Diesel to RM2.10 and RM2.00 respectively. This is a price hike of circa 10.0% -11.5% from previous prices. The authorities stated that the reduction of fuel subsidies will enable the government to save RM1.1 billion per year on fuel subsidies from the allocated budget of RM24.4 billion for fuel subsidies in 2013. This is the first hike in fuel prices since December 2010, in a bid to rein on Malaysia's budget deficits after the recent negative outlook rating by Fitch rating agency.

In line with the subsidies rationalisation, authorities also stated savings from subsidies reduction will be utilised for the 1Malaysia People's Aid (BR1M) as measures to absorb the impact of higher fuel prices for low income. It is expected the BR1M amount to increase to RM1, 200 for each household and RM600 for singles from RM500 and RM250 respectively.

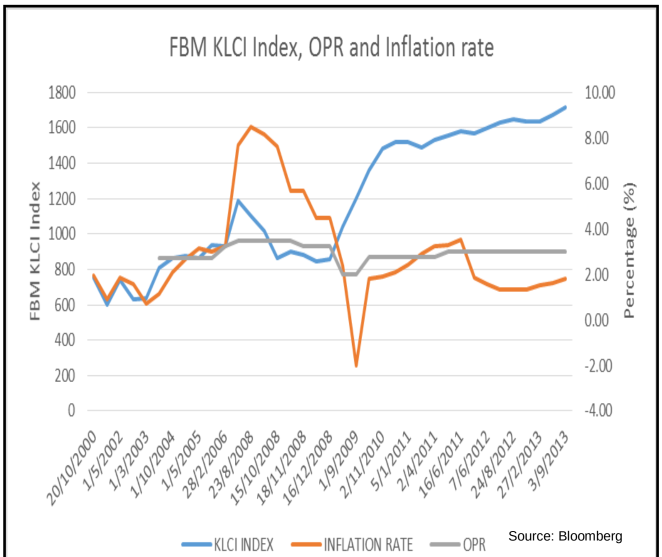


Source: Bloomberg

What is the likely impact on inflation rates and overnight policy rate (OPR)?

To gain better insight into the matter, we compared previous fuel hikes and noted that the previous sizeable fuel hike was in 5 June 2008 as highlighted above. Fuel prices were increased by 40% (RM0.78) to RM2.70 from RM1.92. Inflation levels immediately rose for the month to 7.7% (June 2008) from 3.8% in the previous month. The fuel hike currently is only circa 10% (RM0.20) and may immediately raise inflation rates to circa 2.3 %~ 2.5% from 1.8% in August 2013 based on our estimates.

On the potential impact on OPR due to inflationary pressure, we noted that after the normalization of interest rates by Bank Negara from 2.75% to 3.00% in April 2011 of which inflation rates were circa 3.0%. Inflation levels of circa 3.0% remained up till end 2011 before slipping further till date. This would indicate Bank Negara would be able to tolerate inflation levels of at least 3.0% before consideration to raise rates is made. Thus, we reckon interest rates would likely remain at current levels of 3.0%.



Source: Bloomberg

What's the impact on FBM KLCI?

We witnessed that OPR rates were increased from 2.0% to 3.0% from February 2010 to May 2011. However, the local index rose steadily by 22% over the corresponding period. This indicates that even with increasing rates, the local index may still be on an upward trajectory. The local index will most likely be more affected by foreign fund flows and upcoming budget 2014 as in our previous research report.

Conclusion

Impact from the fuel price hike this time around will not prompt Bank Negara to increase OPR rates. OPR rates risk increment if inflation rates reach above 3.0%, that being said Bank Negara may tolerate those inflation rates as previously occurred.

For Phillip Research Sdn Bhd

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