

Macro Note

Malaysia: Oct Inflation Rises To 4-Month High Of 2.9%

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- Headline inflation rose to a 4-month high of 2.9% y/y in Oct (2.2% in Sep). This came in above ours (2.3%) and Bloomberg consensus (2.8%). Compared to the previous month, the consumer price index (CPI) rose 0.7%.
- The Oct increase was largely due to the transport component (11.3%) owing to higher petrol prices and housing, water, electricity, gas & other fuels (3.2%) following the expiry of the monthly electricity bill discount in Sep 2021. Recent food and vegetable price pressures are reportedly higher due to supply shortages caused by poor weather and worker issues as well as higher cost of raw materials. Meanwhile core inflation inched up to 0.7% y/y in Oct.
- Inflation averaged 2.3% y/y in Jan-Oct, implying that our full-year inflation target of 2.5% remains achievable (official forecast: 2.4%; 2020: -1.2%) as we price-in higher inflation above 3% in Nov-Dec. Looking towards 2022, upside risks to inflation have emerged following a global energy crunch, supply chain bottlenecks, and labour shortage post-pandemic, which could lead to more persistent inflation and second-round effects. With USD/MYR above 4.24 at the time of writing, further MYR weakness could intensify import cost pressures. We project the Overnight Policy Rate (OPR) to rise by 25bps to 2.00% in 2H 2022.

Inflation Rises Above Expectations In Oct

Malaysia's headline inflation rose to 2.9% y/y in Oct (2.2% in Sep). This exceeded ours (2.3%) and Bloomberg consensus (2.8%). The Oct reading marked the highest inflation level in four months since 3.4% in June. On a m/m basis, the consumer price index (CPI) rose 0.7% in Oct (vs. 0.2% in Sep). This brings year-to-date (YTD) inflation to an average of 2.3% in Jan-Oct.

On a y/y basis, the higher Oct inflation was mainly due to increases in the transport component (Oct: 11.3%, Sep: 11.0%) amid higher fuel prices followed by housing, water, electricity, gas & other fuels (Oct: 3.2%, Sep: 0.7%) following the expiry of the monthly electricity bill discount given to domestic consumers under the PEMULIH package for 3 months which ended in Sep 2021. Other components that rose include furnishings, household equipment & routine household maintenance (Oct: 2.1%, Sep: 1.7%); food & non-alcoholic beverages (Oct: 1.9%, Sep: 1.9%); and restaurants & hotels (Oct: 0.6%, Sep: 0.3%). The recreation services & culture, and health components recorded a slight increase of 0.2%, while alcoholic beverages & tobacco rose by 0.3%. Communication was unchanged. Meanwhile clothing & footwear as well as miscellaneous goods & services fell 0.4% and 0.2% respectively. Education also posted a marginal decline of 0.1%.

It was reported there is food and vegetable price pressures due to supply shortages caused by poor weather and worker issues as well as higher cost of raw materials. Food at home rose 2.7% while food away from home increased 1.1% in Oct. Price increases were higher for meat (6.8%), milk and eggs (4.0%), and oil and fats (3.7%). Non-durable goods increased 7.3% y/y (5.4% in Sep).

Core inflation, which covers all goods and services except volatile items of fresh food as well as administered prices, inched up to 0.7% y/y in Oct (0.6% in Sep). It is stable compared with the 12-month average of 0.7%. Services inflation held at 0.4% y/y.

BNM Signals Patience On Rates

With pandemic uncertainty and lingering impact of prolonged and worsened supply chain disruptions, Bank Negara Malaysia (BNM) left the overnight policy rate (OPR) unchanged at 1.75% for an eighth straight meeting on 3 Nov. Post the release of 3Q21 GDP on 12 Nov, the central bank said that they are "mindful of a premature withdrawal of policy support" even as recent indicators suggested a more positive momentum going forward and global central banks are mulling policy normalisation. This implies that BNM may be patient on interest rate moves in the months ahead.

Given further fiscal policy support from Budget 2022, broadly neutral statement from Nov MPC meeting, and a nascent recovery, we continue to expect BNM to stand pat on OPR until mid-2022 and thereafter, we expect a 25bps rate hike to 2.00% in 2H 2022. We think potential triggers for earlier rate hikes would be a more robust and stable domestic growth in coming months and signs of wider pass-through of higher costs to consumers as the economy recovers.

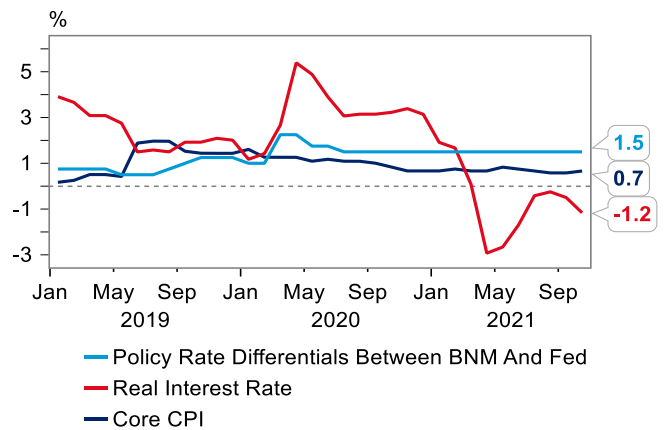
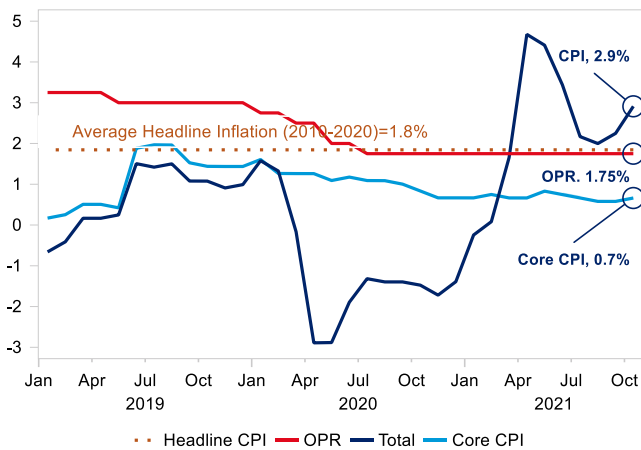
Meanwhile, BNM Governor stressed that Malaysia was not facing any stagflation and that price pressures will remain moderate in 2022. The government forecasts headline inflation to ease to 2.1% in 2022 (UOB forecast: 2.5%) from an estimated 2.4% in 2021 (UOB forecast: 2.5%). Core inflation is expected to remain subdued (or average below 1.0%) for the rest of 2021, before edging upwards though still benign, given continued spare capacity and slack in the labour market.

Key upside risks to 2022's headline inflation outlook could come from the government's decision on subsidies and electricity tariffs that could have potential knock-on effects on prices of other CPI components, volatile global commodity prices, and the impact of prolonged supply disruptions. With USD/MYR above 4.24 at the time of writing, further MYR weakness could intensify import cost pressures.

Consumer Price Index (Headline & Core) vs. OPR **Real Interest Rate (OPR Less CPI)**

Source: Macrobond, UOB Global Economics & Markets Research

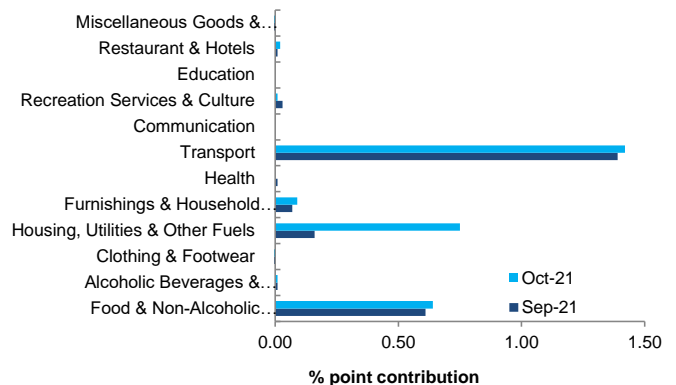
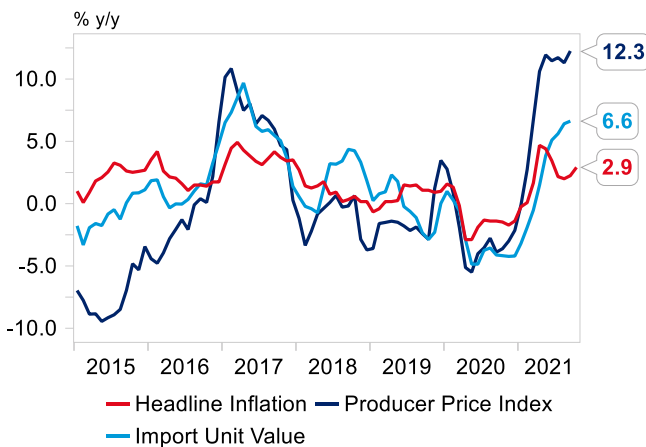
Source: Macrobond, UOB Global Economics & Markets Research



Producer & Import Prices vs. CPI **Key Contributors To CPI**

Source: UOB Global Economics & Markets Research

Source: CEIC, UOB Global Economics & Markets Research



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