

Malaysia: June CPI - enter the deflationary zone?

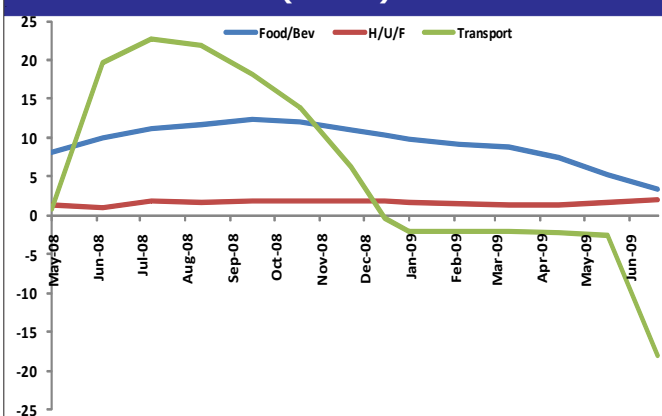
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MALAYSIA CPI (% YOY)

	CPI	FOOD	HOUSING & UTILITIES	TRANSPORT
2005	3.0	5.7	1.2	6.3
2006	3.6	3.4	1.5	11.0
2007	2.0	3.0	1.3	2.3
2008	5.4	8.9	1.6	8.9
Mar-09	3.5	8.8	1.4	-2.1
Apr-09	3.0	7.5	1.4	-2.3
May-09	2.4	5.2	1.6	-2.5
Jun-09	-1.4	3.4	2.0	-18.0
3Q-08	8.4	11.7	1.8	20.9
4Q-08	5.9	11.2	1.8	6.6
1Q-09	3.7	9.3	1.6	-2.1
2Q-09	1.3	5.3	1.7	-8.2

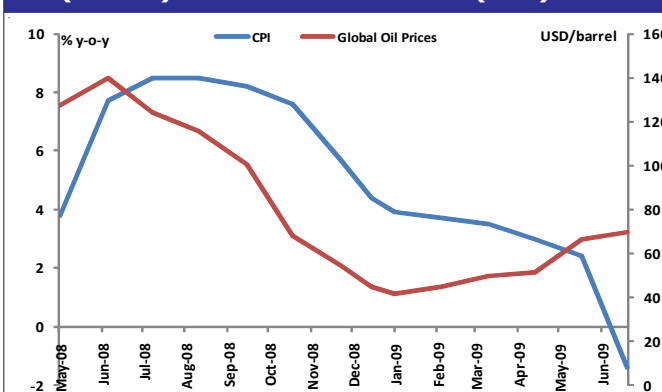
Source : Department of Statistics Malaysia, Bank Negara Malaysia

CPI BY COMPONENTS (% YOY)



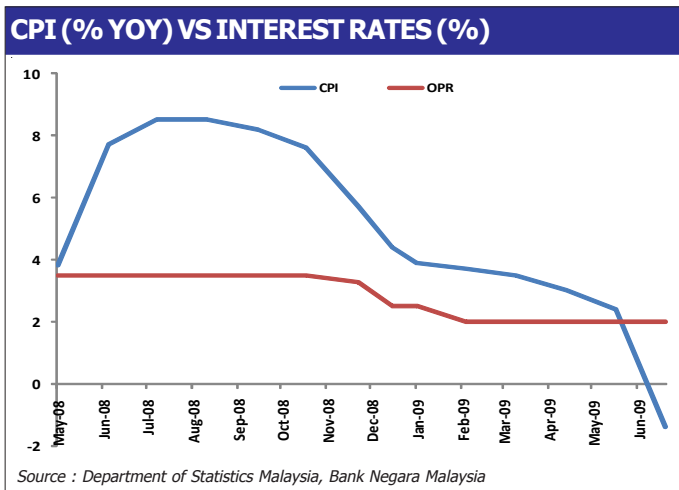
Source : Department of Statistics Malaysia, Bank Negara Malaysia

CPI (% YOY) VS GLOBAL OIL PRICES (USD)



Source : Department of Statistics Malaysia, Bank Negara Malaysia

- Malaysia's consumer price index (CPI) for June declined at an annualized 1.4%, its first since 1986 (deflationary period then following the collapse of commodity prices in the previous years, followed by financial assets and property) although m-o-m it edged up 0.1%.
- The latest development is in tandem with the fall in consumer prices that have occurred in many economies, including Singapore, Thailand, Taiwan, China, US, Japan, Canada, France and Sweden.
- **Is the global economy, including Malaysia, facing the risk of deflation?**
- **Highly remote, we think!**
- It is true that consumer and business demand had been severely depressed by the global economic and financial meltdown, causing prices to soften. However, we regard the recent plunge in headline inflation seen in many countries, developed and developing, as an aberration, rather than a trend.
- To be specific, it was largely attributed to an outlier caused by the sharp spike in the global oil price that in turn pushed the transport cost and charges substantially higher during the second half of last year.
- In the case of Malaysia, the sudden and huge 78 sen per liter hike or 40.6% jump in petrol pump prices (from RM1.92 per liter to RM2.70 and prices are controlled by the Government) had resulted in the transport and communication sub-component of the CPI rising to above 20.0% for much of the second half of 2008.
- As the petrol prices were gradually readjusted downwards (seven times to RM1.80 per liter now) on the back of falling global crude oil prices, the transport and communication sub-component posted negative growth, culminating in a minus 18.0% y-o-y in June 2009. The large negative growth in this sub-component is likely to stay for the remaining months of this year, and thus putting downward pressure on the overall consumer inflation, before beginning to normalize towards the later part of this year.
- Save for the transport charges, other subcomponents continued to post positive rise. Food in particular, with a weight of 31% of the overall CPI, grew 3.4% y-o-y in June and moderating from double-digit rates in the second half of last year.



- For a deflation to occur the fall must be for a sustained period of time (a year or more), and the decline must go beyond consumer prices, but also in the value of hard assets including financial, commodities and properties.
- At this juncture, the prices of financial assets, equity in particular, had in fact rising (that had also raised questions as to whether the market had overshot the underlying fundamentals), while property prices are reasonably resilient in spite of the falling general economy.

- Going forward, the continuing large negative transportation sub-index growth expected in the coming months would be partially offset by price increases expected in certain consumer goods and services. Already in the pipeline and announced by the Government would be transportation cost (a 30% increase in bus and taxi fares effective August 1), petrol pump prices in September, and possibly electricity tariff (expected to be announced in August 09).
- These together with projected recovery, albeit moderate, in domestic demand would result in the headline inflation begin to turn positive but very much towards the end of this year. The 2H of 2009 may see the CPI declining at an average 0.3% (from 2.5% in 1H) to result in the whole of 2009 consumer inflation of about 1.0% but not more than 2.0% (from 5.4% in 2008).
- Policy-wise, as inflation would remain a non-issue, greater fiscal efforts could be directed at hastening the recovery process envisaged in the 2H of 2009 and the coming year. With depositors expected to enjoy a widening real rate of return, and as the recovery process becoming clearer and entrenched, we do not expect the Central Bank to deviate from their current monetary policy stance when they meet on July 29, or even in their future meetings scheduled for the rest of this year (four meetings).