Economy

AMB

Malaysia: January CPI - modest growth

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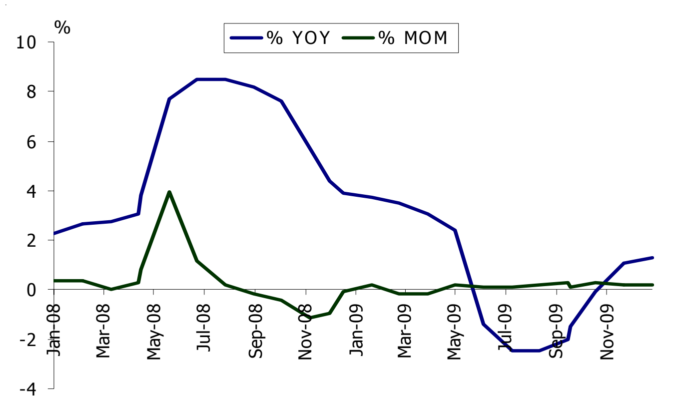
MALAYSIA CPI (% YOY)

	CPI	FOOD	HOUSING & UTILITIES	TRANSPORT
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
2009	0.6	4.1	1.4	-9.4
Oct-09	-1.5	0.8	1.0	-13.2
Nov-09	-0.1	0.9	1.1	-6.9
Dec-09	1.1	1.1	1.1	-0.9
Jan-10	1.3	1.2	1.1	0.7
1Q-09	3.7	9.3	1.6	-2.1
2Q-09	1.3	5.3	1.7	-8.2
3Q-09	-2.3	1.4	1.2	-18.5
4Q-09	-0.2	0.9	1.1	-7.2

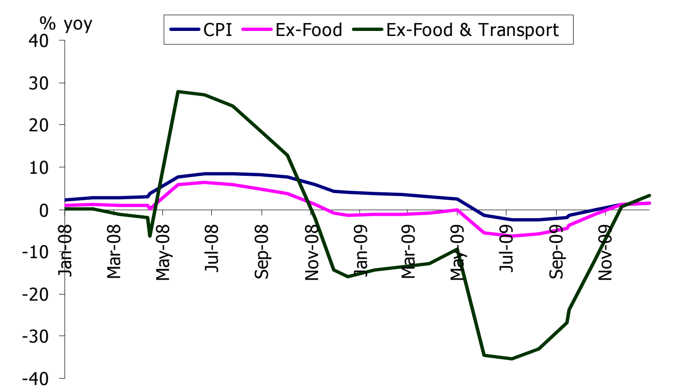
Source : Department of Statistics Malaysia, Bank Negara Malaysia

CPI (% YOY % MOM)



Source : Department of Statistics Malaysia, Bank Negara Malaysia

CPI EX-FOOD, EX-FOOD & TRANSPORT (%YOY)



Source : Department of Statistics Malaysia, Bank Negara Malaysia

- Malaysia's annual inflation, as measured by the CPI rose to 1.3% in January 2010 from 1.1% in December 2009. This was below our and market expectation of +1.5%. The monthly growth in the CPI however remained broadly flat at 0.2%, signaling the continued low inflationary pressures despite the rebound in economic growth in the fourth quarter last year.

- The annual growth in the CPI was broad based across all sub-components except for Clothing/Footwear and Communication. Food and non-alcoholic beverages, which account the biggest weightage of the CPI basket, charted an increase of 1.2% as against the 1.1% rise charted in Dec 09, but is slowed on a monthly basis (Jan: +0.2%, Dec: +0.5%). This reconfirming our view that the impact of higher sugar prices by the government was minimal on the overall inflation. Excluding food and non-alcoholic beverages, inflation rose to 1.4% in January from 1.1% in the preceding month.

- Transport cost had turned around to record a positive annualized growth after declining for thirteen consecutive months as the high base effect faded and the impact of the two-tiered petrol pricing system implemented in September last year begin to strengthen. Against a decline of 0.9% in Dec 09, price index for transportation rose 0.7% following a monthly rise of 0.1%. Housing/Water/Electricity/Gas and other fuels category however maintained its pace of increase at 1.1% for the three straight months with no change on a monthly basis.

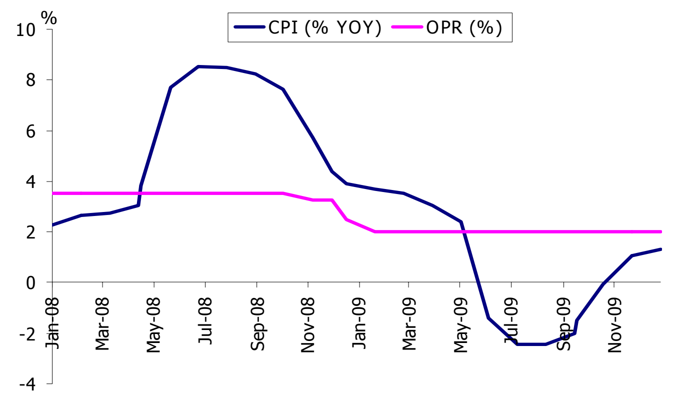
- Price increases were also recorded by the indices of Furnishing/Household/Equipment & Routine (Jan:+0.8%, Dec:+1.2%), Health (Jan:+1.5%, Dec:+1.6%), Recreation Services & Culture (Jan:+2.7%, Dec:+2.5%), Education (Jan: +1.8%, Dec:+2.1%) and Miscellaneous Goods & Services (Jan: +4.4%, Dec:+5.2%).

- The price index of clothing and footwear sub-group continued to decline by 0.7% yoy but at a slower pace compared with -1.3% in Dec 09. This was in response to the 0.6% monthly gain after falling 0.9% in Dec 09. The annual decline in communication costs was unchanged at 0.4% for the third consecutive month.

- Going forward, the headline inflation is expected to continue rising moderately with pressures emanating largely from the supply side. The reduction of subsidy on fuel and higher electricity tariff effectively would cause the CPI to trend higher over the course of this year. We expect inflation in February to remain benign at +1.3% against a backdrop of a modest increase in food prices during Chinese New Year.

- While the review in the electricity tariff (expected to be announced soon, pending Government's approval) is expected to have modest impact on the overall inflation as any increase will not be drastic and expected to be made on a gradual

CPI (%YOY) vs OPR



Source : Department of Statistics Malaysia, Bank Negara Malaysia

basis, the revision on fuel prices beginning 2H10 would exert a stronger pressure on consumer prices although it would be less severe compared to the period of 2H 2008 when fuel prices were raised by 40% in June 2008.

- Similarly, the continuing soft consumer spending would keep the inflation rate stable throughout the year. The recent 4Q09 GDP figure showed that while private consumption and possibly investment had improved from the previous quarter, its growth of 1.7% yoy remained substantially below the pre-crisis levels of 8% to 10%. This slow pace of consumption spending growth is expected to continue in 2010 given the uncertainty of the domestic and global economy. Thus, the inflation rate is also expected to remain subdued at between 2.5 and 3.0%.

- At this juncture, the market is expecting the BNM to raise the OPR by 25 basis points in the upcoming monetary policy meeting as the strength of economy provides comforts and flexibility to the monetary authority to normalize interest rate. At the same time, it is also necessary for the central bank to undertake preemptive measures against inflation and the emergence of imbalances in the financial sector. However, as growth in 4Q09 was contributed largely by exports, government stimulus spending, restocking activities and not by private spending, there is still a need for monetary policy to support growth in private spending. Furthermore, the outlook of external demand remains uncertain and the Government had already tightened its budget for 2010, thus any premature exit from the easy monetary stance could disrupt and cause domestic consumption and overall GDP to grow much slower.

- Based on the aforementioned, we expect BNM to maintain the current OPR rate until its 13 May monetary policy committee (MPC) meeting. By then, there could be sufficient economic data to help in the better assessment of the local economy, including growth and inflation. The magnitude of increase could also be relatively small by 50 basis points to be undertaken in two meetings to 2.50% by 2H10.