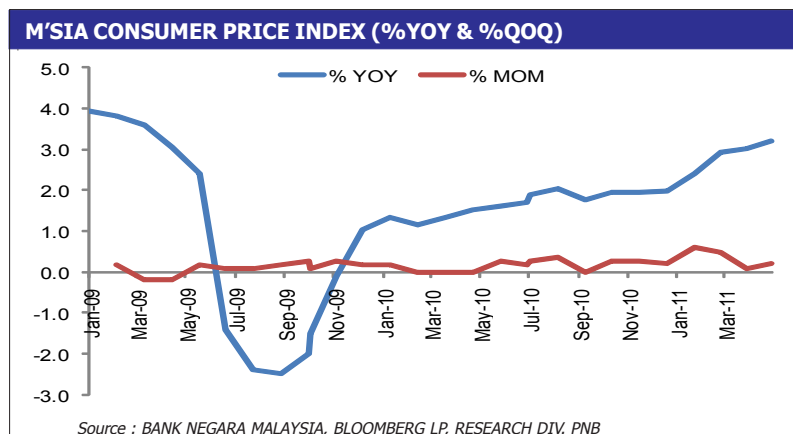


- Domestic inflation as measured by Consumer Price Index (CPI) rose to 3.2% in April from March's 3.0%. This exceeded our and consensus' estimation of 3.1%. On a mom basis, the CPI grew marginally by 0.2% in April from March's muted growth of 0.1%. The increase was mainly contributed by higher food and fuel costs, signifying the supply-side factor remained as the main driver of domestic inflation as opposed to demand.**



- Food & transport led rising cost.** In tandem with the rising global food prices, domestic food price index climbed by 4.9% in April 2011 as compared to a year ago, the fastest pace since June 2009. (March: +4.7%). The FOA food index for April recorded a y-o-y increase of 36.5%. On a m-o-m basis, food prices grew by 0.3%, suppressed by subsidies, and was in tandem with the FAO food index monthly growth of 0.5% which was significantly lower than the index's 10-month m-o-m average of 3.2%. Transport costs in turn accelerated by 5.3% y-o-y in April and were higher than March's y-o-y growth of 4.6%, on the back of a faster 0.6% m-o-m rise against March's 0.1%. Both food and transports contributed the most to the overall increase in the overall CPI with a 45.7% and 24.2% contribution respectively.
- Rising core-CPI.** The core-CPI, excluding volatile food and transport prices, continued its upward trend. Core-CPI increased by 1.7% y-o-y in April from March's 1.6%. Among the core-indices, alcoholic, beverages & tobacco as well as restaurant & hotels led the overall y-o-y increase, indicating the existence of some demand pull pressures amid the rise in supply side pressures. On a m-o-m basis, the core-CPI however remained unchanged. While prices of most sub-groups recorded no growth during the month, recreation services and culture charted a 1.5% increase.
- Follow the global trend but still below regional economies.** Despite the uptrend, Malaysia's inflation rate continued to lag the other Asian economies. However, domestic inflation is closely tracking the developed economies particularly the US (3.2%) and Europe (2.8%) where inflation in these countries accelerated in recent months due to surging global oil and other commodity prices.
- Inflation outlook on the upside risks.**

i) Domestic inflationary pressures in the coming months would accelerate following the Government decision to further reduce fuel subsidies. The subsidy rationalization program has continued in light of the sharply higher global oil prices. Despite its recent slide (currently at USD97/barrel as compared to its highest USD113/barrel in April this year), global

CONSUMER PRICE INDEX

	April			March			Jan-Apr 2011	
	Index	% YOY	% MOM	Index	% YOY	% MOM	Index	% YOY
CPI	102.6	3.2	0.2	102.4	3.0	0.1	102.3	2.9
Core-CPI (ex-food & transport)	101.4	1.7	0.0	101.4	1.6	0.2	101.2	1.5
Major sub-groups								
Food & Non-Alc. Beverages (30.3%)*	104.0	4.9	0.3	103.7	4.7	0.0	103.5	4.5
Housing & Utilities (22.6%)*	101.2	1.6	0.0	101.2	1.6	0.1	101.1	1.5
Transport (14.9%)*	104.2	4.6	0.6	103.6	4.6	0.1	103.6	4.7

Source : Department of Statistics, Bloomberg, Research Division

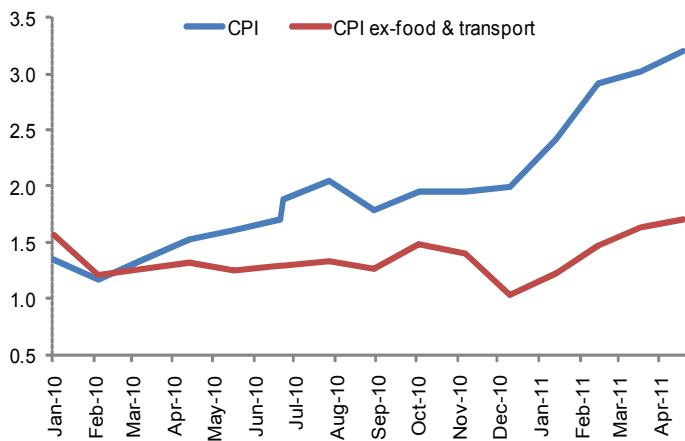
oil prices may be sustained at USD100/barrel going forward based on the strong demand from China and India amidst the continued supply disruptions from Libya. At USD100/barrel, the Government has to bear about RM18 billion in petroleum subsidy compared with RM8 billion when oil prices stood at USD80/barrel last year.

ii) **Widening gap between producer price index (PPI) and consumer price index (CPI).** The PPI has increased faster than the CPI, indicating consumer inflation will continue to rise in the near future. The rising international and commodity prices are better reflected in the PPI as subsidies on food and petroleum products have muted the rise in the CPI. However, the PPI will eventually cause producers to pass the higher costs to consumers to protect their profit margins apart from the lower base effects last year.

iii) **Potential increase in prices due to firming domestic demand.** Domestic demand particularly consumption has supported growth during 1H11 and is expected to strengthen in the 2H on account of increased private spending following the implementation of the ETP projects. Combined with the earlier mentioned factors, potentially Malaysia's rate of inflation can pass 3.5% level during the 2H11. As such, for the whole of this year, Malaysia may chart an average rate of inflation of more than 3.0% as opposed to 1.7% in 2010. At this juncture, we are projecting the inflation rate for 2011 to average 3.2%, close to the government forecast of 2.5-3.5%. For May, we expect the CPI to increase by around 3.2%, stemming from the rise in sugar prices (up 20 sen/kg to RM2.30 on May 09) and petrol RON97 (up 20 sen to RM2.70/litre on May 18).

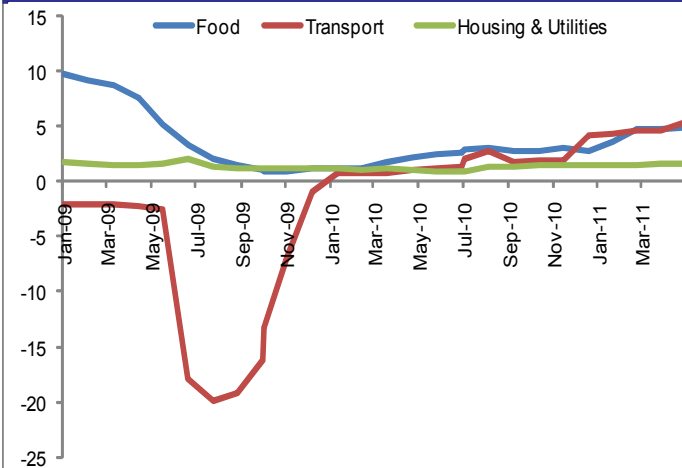
- **Expectation of a 25-50 bps hikes in 2H11.** The upside risks on inflation will likely cause BNM to raise interest rates further in 2H11. The latest BNM MPC meeting (May 13) saw the OPR raised by 25 bps to 3.00%, the first time this year, after left unchanged in the previous three meetings. The increase is in line with global interest rates trend where most countries, particularly emerging economies have increased interest rates to combat the rising inflationary trend. In its statement, BNM sees the potential inflation risks going forward amid sustained economic growth. We believe that the monetary policy will be biased towards combating inflation given the environment of high global oil prices and expectations of stronger domestic demand during the 2H11. Hence, we expect the OPR to be raised by another 25-50 bps in 3Q11, bringing our full year-end target to be at 3.25-3.50%.

TOTAL CPI VS CORE CPI (%YOY)



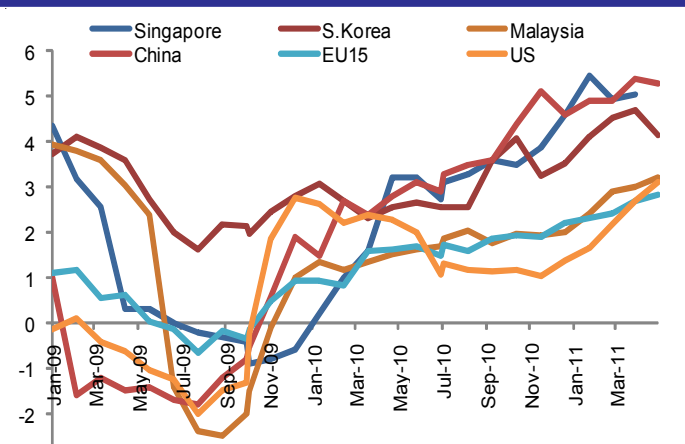
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB

CPI SUB-COMPONENTS (% YOY)



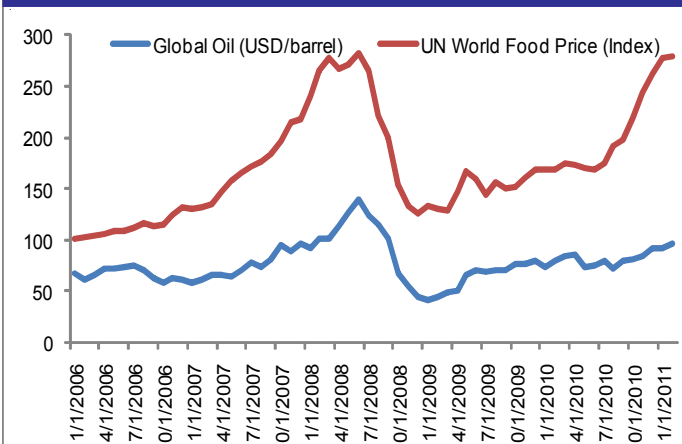
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB

CPI FOR SELECTED COUNTRIES (% YOY)



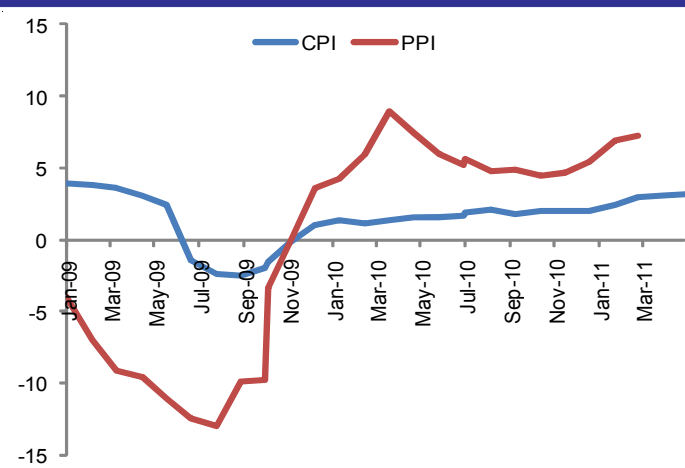
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB

GLOBAL OIL VS UN WORLD FOOD PRICES



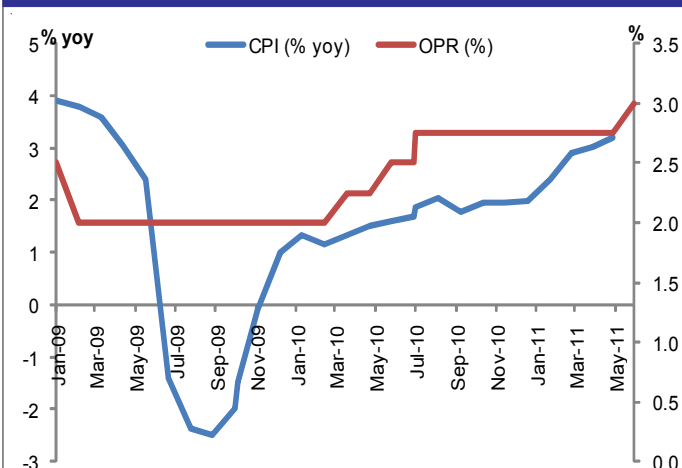
Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB

M'SIAN PRODUCER PRICE INDEX VS CONSUMER PRICE INDEX



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB

CPI (% YOY) VS OPR (%)



Source : BANK NEGARA MALAYSIA, BLOOMBERG LP, RESEARCH DIV. PNB