

Inflation Stays High Amidst Moderation in the Outlook by BNM

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- The recent data on consumer prices released by the Department of Statistics suggests that **domestic inflation remains as a supply side phenomenon, and supply constraint and cost would continue to drive inflation during 4Q11.**
- The **Consumer Price Index (CPI) for October had increased by 3.4% y-o-y, similar to September, mainly attributed to increases in the prices of food and non-alcoholic beverages.** Food inflation, on a monthly basis, doubled from the 0.2% charted in September, causing the annual growth rate to accelerate to 5.6%, the fastest pace since April 2009.
- On the other hand, **pressures on the demand side would have eased as reflected in the 0.1% m-o-m drop in the core-CPI which had provided comfort to BNM to retain the overnight policy rate at 3.00%** at its monetary policy meeting on Nov. 11.
- In the core-CPI components, prices of several items such as restaurant and hotels as well as miscellaneous goods and services which recorded an upward trend during mid-year, to a certain extent, have eased. Likewise, the prices of alcoholic beverages and tobacco on y-o-y showed a significant decline in the absence of increases in the sin taxes in the Government budget 2011 and this year.
- **We are revising upwards our inflation forecast slightly for the whole of 2011 to an average of 3.2%** from 3.1% on account the CPI for the January to October this year had increased by 3.2% and **the recent floods in the ASEAN countries would further exert upward pressure on food prices.** We expect inflation to stay high at 3.3% in the 4Q11.
- In our discussion with BNM on 23rd Nov, **the central bank foresees inflation for the year to be around 3.1%** which suggests a slightly slower inflation during the 4Q11. **While BNM concurs on the adverse impact of Thailand floods on domestic food prices, the monetary authority is of the opinion that the effect would be minimal** as Bernas has already made prior arrangement to lock in rice prices with other producing countries such as Vietnam and Pakistan.
- **BNM also foresees inflation for next year will continue to be driven by the supply side,** rather than the demand side. While there was no inflation forecast for 2012 revealed during the discussion (as the new forecast is scheduled to be released during the announcement of BNM Annual Report in March 2012), BNM had highlighted that the rate of inflation for 2012 would very much depend on the base-line price in 2011.
- In this regard, we are of the opinion that given the increased base for this year, **the annual inflation rate expected by BNM next year would be between our forecast of 2.5-3.0%.**
- Despite the central bank optimism of achieving the projected GDP growth rate of 5.0-6.0% next year, **it expects the inflationary pressures stemming from the demand side likely to remain muted.** Chances of subsidy rationalisation therefore remains, as the monetary authority also expects the impact of subsidy reduction on the overall consumer prices would not be significant as compared to the effects of the government decision to raise domestic fuel prices by as much as 40% during 2008, causing the rate of inflation to jump to a high of 8.5% in July, 2008.
- While BNM remains cautious on the prospect of inflation, **the increased concern on the downside risks on growth would oblige BNM to keep the Overnight Policy Rate (OPR) at 3.00%.** Likewise, **we do not expect any cuts in the OPR during 1Q12,** in the light of sustained high global crude oil prices at between US\$90- US\$100 per barrel and the potential further rises in food prices due flooding in Thailand and surrounding area.