THEMATIC REPORT

Authors:
Economics & Policy

Anticipating Possible Retail Fuel Prices Cut

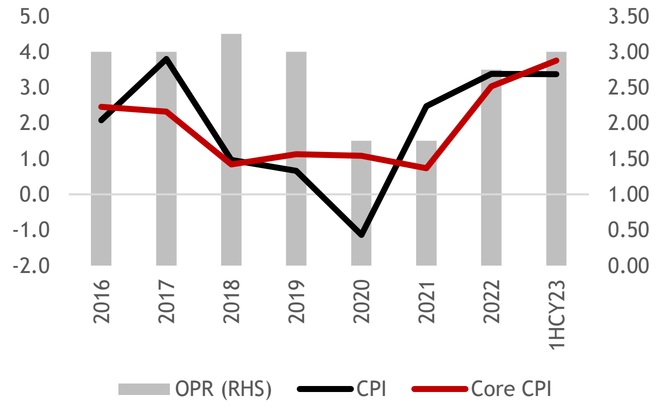
KEY HIGHLIGHTS

- **OPR-FFR differential is at the widest ever. The last time OPR-FFR differential turned negative (i.e. OPR staying below FFR) was between Mar-05 until Nov-07. At this current juncture, the interest rate differential already widened to -225bps.**
- **As of 1HCY23, price growth of food surged by +6.2%yoy (2022: +5.9%) while non-food only increased at +1.7%yoy (2022: +2.2%). During the pre-pandemic, average food and non-food inflation rates during 2016-2019 were only +2.9% and +1.5% respectively.**
- **Assuming the government to cut RON95 price by 10 cents to RM1.95 per litre in Aug-23, we estimate Malaysia's headline inflation to record slightly lower at +2.9% for 2023 as non-food inflation to moderate further towards +1.3% while transport price to experience deeper contraction of -1.7%.**
- **Based on our estimates, for every 1 cents RON95 price differential, the subsidy cost to the government is RM0.43 billion. At RM1.95 per litre, the estimated price differential will be at RM1.15, still way lower than last year's RM1.86. We anticipate the government may opt for the lower retail fuel price in order to ensure price stability and soften living cost pressure in Malaysia.**

ECONOMICS & POLICY

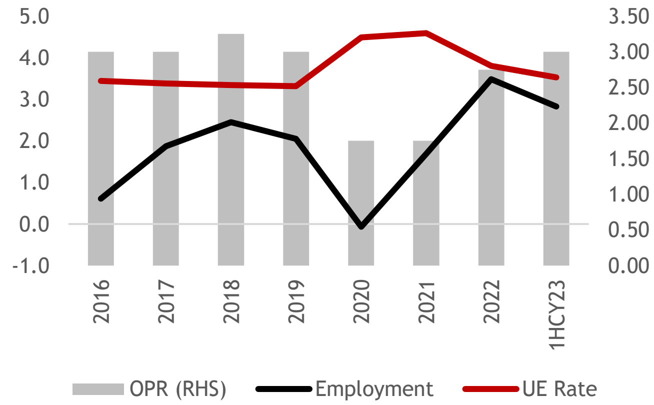
Possible for OPR to reach 3.25% amid sturdy and resilient domestic economic front. Judging from domestic macro figures, there is a possibility for another rate hike of 25bps by BNM in 2HCY23. Core inflation remains elevated at +3.6%yoy in 1HCY23, much higher than last year's average of +3% and pre-pandemic average of +1.7%. Consumer demand is still robust as reflected in distributive trade sales which grew by +10.2%yoy in 5MCY23 (2022: +19.6%). Sales of motor vehicles and retail trade are among the contributing factors, rising by +14.6%yoy and +15%yoy respectively. Approved loan growth continued on double digit pace of +14.4%yoy in 5MCY23 (2022: +28.9%). The robust domestic demand is in line with the strong recovery in labor market as employment growth registered at +2.7%yoy in 5MCY23 (Pre-pandemic yearly average: +1.7%) and jobless rate remained low at 3.5% in May-23. The main downside risk for Malaysia's economy for this year is worse-than-expected external trade slowdown. However, the monetary decision will be subject to the stability of economic growth, the pace of price increases and further improvement in macroeconomic conditions, particularly a continued recovery in the labor market and sustained rise in domestic demand. From a medium-term perspective, the policy rate normalization is needed to avert risks that could destabilize the future economic outlook such as persistently high inflation and a further rise in household indebtedness.

Chart 1: OPR (%) vs. CPI (YoY%)



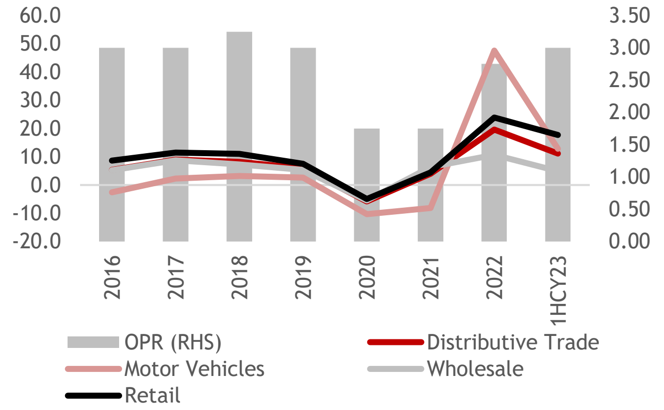
Source: MACROBOND, MIDFR

Chart 2: OPR (%) vs. Labour Market (YoY%)



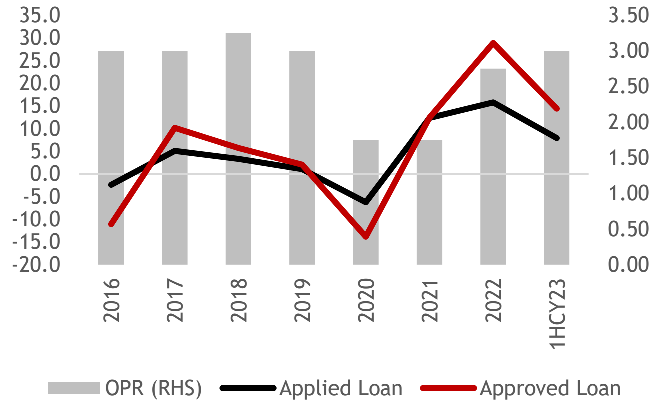
Source: MACROBOND, MIDFR

Chart 3: OPR (%) vs. Distributive Trade (YoY%)



Source: MACROBOND, MIDFR

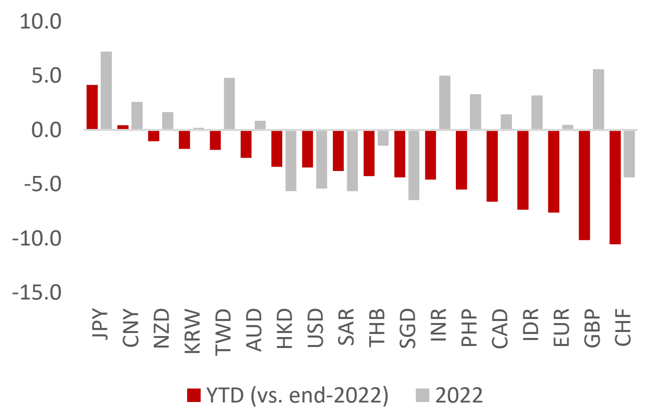
Chart 4: OPR (%) vs. Loan Growth (YoY%)



Source: MACROBOND, MIDFR

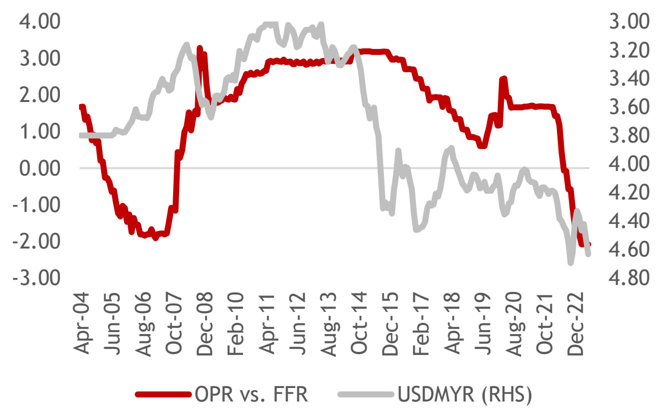
OPR-FFR differential is at the widest ever. The last time OPR-FFR differential turned negative (i.e. OPR staying below FFR) was between Mar-05 until Nov-07. At that time, the interest rate differential was less than -200bps. As the Fed actively and aggressively raised its FFR especially since the middle of last year, once again the OPR-FFR differential returned to the negative territory at -25bps after the Fed's 75bps hike in Jul-22. At this current juncture, the interest rate differential already widened to -225bps. We opine the widening OPR-FFR differential is one of the major factors contributing to the strong USD. Nevertheless, on year-to-date basis, MYR only performed better than JPY by +4.2% and CNY by +0.5%, but weakened versus most other currencies even after considering the recent weakening of USD after the release of better-than-expected US CPI inflation in Jun-23. Fundamentally, MYR is in good position as domestic economy stays on upbeat momentum and as net exporter of commodities (such as LNG and palm oil), Malaysia stands to benefit from the elevated global commodity prices. Like other currencies, MYR has remained on depreciation path as the Fed keeps on delaying its interest rate pause (and ultimately ending its tightening cycle). Also, weaker-than-expected China's business and trade performances indirectly disappointed MYR given that exports to China (13.2% of Malaysia's total exports) fell by -8.8%yoy in 1HCY23 (2022: +9.4%). For 2023, we already revised lower MYR average to RM4.43 per USD and but still projecting for appreciation by year-end towards RM4.20.

Chart 5: MYR Performance vs. Other Currencies (%)



Source: MACROBOND, MIDFR

Chart 6: Interest Rate Differential (%) vs. USDMYR

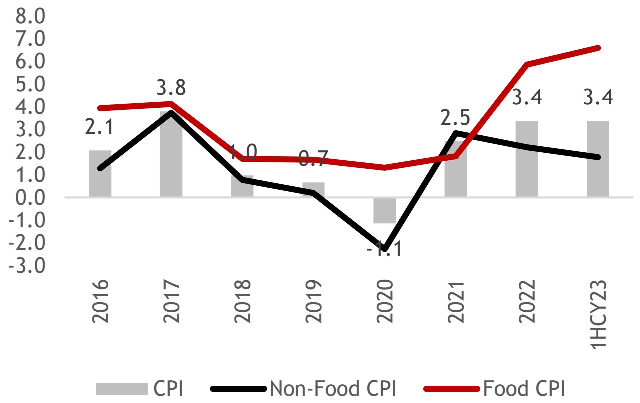


Source: MACROBOND, MIDFR

Stubborn food inflation pressure. Despite of improved global supply chain pressure and normalizing commodity prices, Malaysia's food inflation remains at elevated levels. As of 5MCY23, price growth of food surged by +6.6%yoy (2022: +5.9%) while non-food only increased by +1.8%yoy (2022: +2.2%). During the pre-pandemic, average food and non-food inflation rates during 2016-2019 were only at +2.9% and +1.5%, respectively. In post-pandemic era, both "home food" and "away food" CPI rose strongly by +5.2%yoy (2022: +5.3%) and +8.6%yoy (2022: +6.7%), respectively, in 5MCY23. We opine the continuous depreciation of Ringgit is among the contributing factors on the high food inflation in Malaysia. Moreover, the elevated food inflation indicates that food prices are stickier (on the upside) amid robust domestic spending, and even though commodity prices already corrected from the high levels last year.

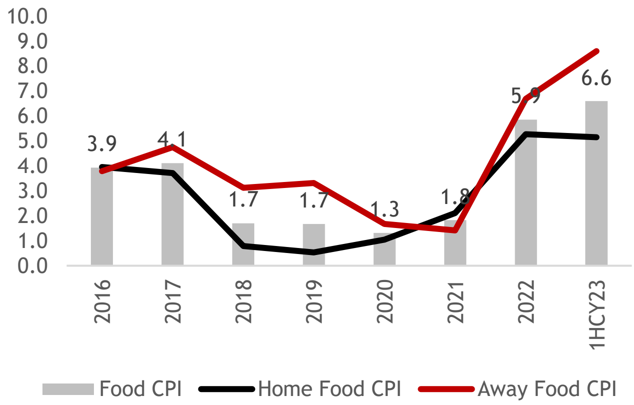
Malaysia still a net food importer. After many decades, Malaysia remains as a net food importer country. The size of food trade deficit is getting larger and almost all food products are on deficits except: (i) live animals; (ii) coffee, tea & spices; and (iii) miscellaneous. As a net importer of food, Malaysia is highly exposed to and vulnerable to changes in external factors, including foreign currency movements. Apart from weaker Ringgit, Malaysia's food prices are exposed to the recent Russia's withdrawal from grain deal, impacts from El Nino and climate change, fluctuations in prices of feedstock and fertilizers, and changes of food-related exports policy or trade barriers by other countries.

Chart 7: Headline CPI Performances (YoY%)



Source: MACROBOND, MIDFR

Chart 8: Food CPI Performances (YoY%)



Source: MACROBOND, MIDFR

Table 1: Food Trade Balance (RM Billion)

	1990	2000	2010	2020	2022
Overall Food	**(1.1)**	**(4.9)**	**(12.1)**	**(21.7)**	**(31.0)**
Live Animals	0.3	0.2	0.3	0.6	0.7
Meat	(0.2)	(0.7)	(1.5)	(3.3)	(5.7)
Eggs	(0.4)	(0.8)	(1.1)	(2.6)	(4.5)
Fish	0.2	0.2	0.2	(1.2)	(2.8)
Cereals	(1.2)	(2.2)	(4.6)	(6.6)	(9.0)
Vegetables & Fruits	(0.2)	(0.8)	(2.8)	(6.5)	(7.9)
Sugars	(0.3)	(0.7)	(2.1)	(2.7)	(3.4)
Coffee, Tea & Spices	0.8	0.3	0.2	0.3	0.7
Animal Feeds	(0.0)	(0.6)	(1.7)	(1.9)	(3.1)
Miscellaneous	(0.1)	0.1	1.0	2.2	3.9

Source: DOSM, MIDFR

Only transport & communication inflation to shrink. Cost of living pressure remains a concern in Malaysia as most items stay on increasing trend even with slightly slower speed. Based on our forecast, there are only two items to experience price contraction this year which are communication and transport. Deflation for communication is expected due to healthy market competition among communication providers. As for transport, zero change in fuel prices and normalizing global oil prices are causing the deflation in the segment. On a flip side, cost of living in Malaysia will be continuously pressured by the food prices which has the biggest weight approximately 30% in the consumption basket. Based on the CPI weightage, we anticipate the government may explore ways to reduce further the transport costs, the third largest burden after foods and housing & utilities, especially if food inflation to sustain at high levels.

Table 2: CPI Performance, Forecast & Weightage

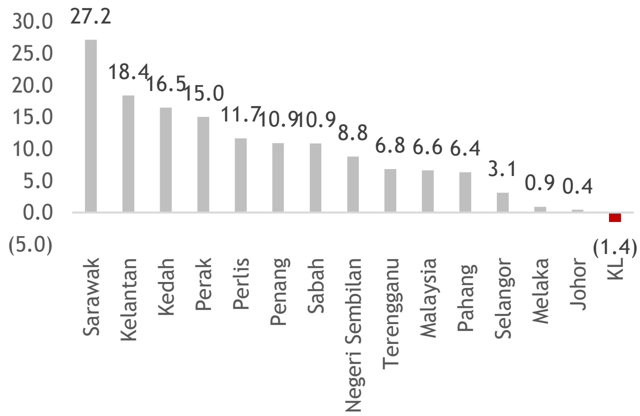
	Ave. 2011-19	2021	2022	2023F	Weight, %
Headline	1.9	2.5	3.4	3.0	
Food	2.9	1.8	5.7	6.0	29.5
Non-Food	1.5	2.8	2.2	1.5	70.5
Alcoholic Beverages & Tobacco	5.1	0.5	0.6	0.7	2.4
Clothing & Footwear	(0.6)	(0.4)	0.1	0.0	3.2
Housing, Water, Electricity, Gas & Other Fuels	1.8	1.6	1.8	1.2	23.8
Furnishings, Household Equip & Maintenance	1.6	1.6	3.5	2.0	4.1
Health	2.0	0.4	0.7	1.5	1.9
Communication	(0.2)	0.0	(0.0)	(4.0)	4.8
Recreation & Culture	1.1	0.5	2.2	1.1	4.8
Education	1.8	0.1	1.1	1.3	1.3
Restaurants & Hotels	2.6	0.4	5.0	5.5	2.9
Miscellaneous Goods & Services	1.4	0.5	2.0	2.2	6.7
Transport	1.4	11.0	4.7	(0.5)	14.6
Fuel	1.8	21.5	5.0	(1.7)	8.5
Non-Fuel	1.4	(0.5)	4.2	1.0	6.1

Source: DOSM, MIDFR

Real income growth remains muted. Only three states recorded higher than pre-pandemic median salary. Kedah, Penang and Perak only made the cut in terms of median salary comparison 2021 against 2019. The income level recovered higher than pre-pandemic level 2019 with Perak at RM1,918 in 2021, +3.2% higher than RM1,858 in 2019; while Kedah's at RM1,757 (2019: RM1,748) and Penang's at RM2,353 (2019: RM2,346). On the other hand, median salary 2021-2019 differential in other states like Melaka (-9.3%), Perlis (-10.6%), Terengganu (-12.7%), Johor (-13.1%) and Pahang (-13.8%) were lower than national's -7.9%. By real wage growth, all states except Kuala Lumpur recorded positive rate ranging from +0.4~27.2%. The concerning part is contraction in real wage growth in KL by -1.4%. The state houses about 5% of total national employment. We opine this adds into higher pressure of living cost crisis which real wage growth turns negative while food inflation spike. In fact, real wage growth in Selangor which constitutes about 23.4% of total employment only grew by +3.1%, lower than Malaysia's +6.6%. We view this as a downside risk to Malaysians' purchasing power and consumer spending as inflation and low real wage growth may derail the consumer demand particularly in the Klang Valley area which represents almost one-third of the Malaysia's population.

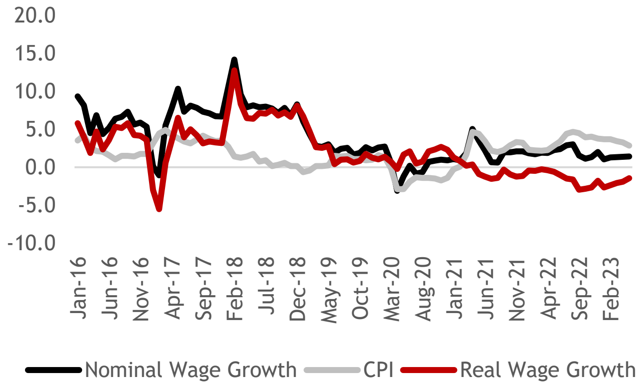
Manufacturing's real wage growth is in negative territory. Based on the monthly manufacturing sales, payroll and employment data, nominal wage growth of overall factory worker remains below headline inflation. Despite of double-digit expansion of exports, nominal wage growth in the manufacturing sector was only at +2% in 2021 and 2022. With inflation at elevated levels, real wage growth for manufacturing workers were -0.5% in 2021, -1.4% in 2022 and -2.1% in 5MCY23. Even though manufacturing workers only represent about 14.5% of national employment, the contractionary real wage growth is concerning and causing negative income pressure. The post-pandemic recovery has yet to provide better compensation to these workers as firms were hit by rising production costs and concerns over future demand outlook.

Chart 9: Real Wage Growth by State in 2021 (YoY%)



Source: DOSM, MIDFR

Chart 10: Real Wage Growth of Manufacturing Sector (YoY%)



Source: DOSM, MIDFR

Fuel targeted-subsidy rollout not anytime soon. In our view, the government may not roll out the targeted fuel subsidy especially for RON95 and Diesel in the near term. Firstly, retail fuel has limited alternatives as compared to cooking oil and electricity. Integrated and efficient public transport is only available in the Klang Valley yet it is specifically for certain areas. Although Electric Vehicle is another alternative, the shift from fuel-powered to electric-powered vehicle will not happen overnight. Based on USD80pb oil price assumption, we estimate market price for RON95 is RM3.10 per litre. In other words, full floating for the RON95 will result in more than 50% price increase which will have significantly big jump in the CPI data. Another reason that we are also concerned is the B40 income classification. If the government were to use national B40 measurement for household income at RM3,166 as the benchmark for subsidized fuel recipients, the increased fuel prices will lead to higher cost of living pressure to the B40s in states like Johor, Melaka, Pulau Pinang, Selangor, Terengganu and Kuala Lumpur. These people will be the hardest hit as their level of income exceeds the national B40 benchmark, therefore not eligible for the targeted fuel subsidy programme. We opine limited alternatives for RON95 & Diesel and complexity of household income levels between states are among the tough challenges for the government to roll-out the fuel-targeted subsidy in the near term.

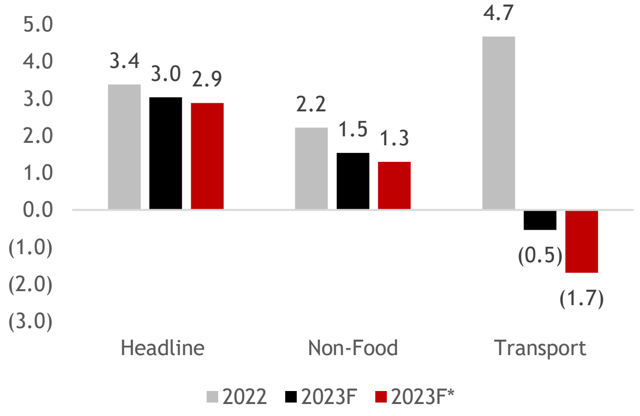
Table 3: Median of Monthly Household Gross Income by State, 2019 (RM)

	T20	M40	B40
Malaysia	**15,031**	**7,093**	**3,166**
Kuala Lumpur	22,610	12,068	6,623
Putrajaya	22,291	11,574	5,976
Selangor	20,175	9,737	4,657
Labuan	15,196	7,889	4,272
Johor	14,629	7,549	3,677
Pulau Pinang	14,002	7,264	3,631
Terengganu	12,137	6,539	3,372
Melaka	14,393	7,001	3,318
Pahang	10,431	5,133	3,017
Negeri Sembilan	13,257	5,866	2,801
Kedah	10,204	5,050	2,686
Perlis	9,782	5,377	2,665
Perak	10,308	5,041	2,614
Sarawak	11,856	5,478	2,541
Sabah	11,461	5,177	2,444
Kelantan	9,500	4,242	2,301

Source: DOSM, MIDFR

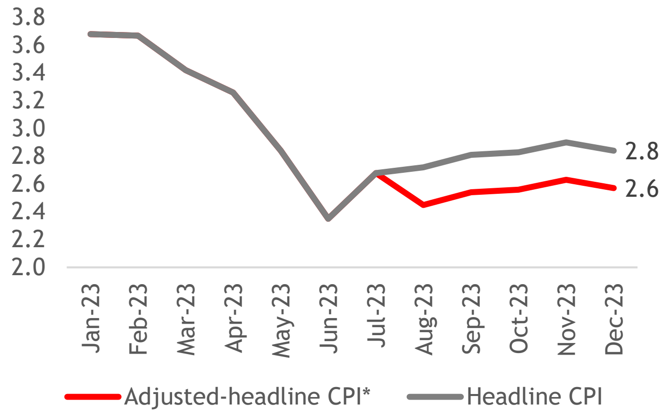
We anticipate the government to slash RON95 price by 10 cents. Considering the continuous elevated food inflation and downward income pressure, we anticipate the government to opt for slashing retail fuel prices particularly RON95 and Diesel in the near term. Structurally, being a net food importer and aggravated by depreciated Ringgit, it will be hard for the government to contain the food inflation. As for income pressure, the gloomy external trade outlook will add more downside to the manufacturing and overall economic activities. Assuming the government to cut RON95 price by 10 cents to RM1.95 per litre in Aug-23, we estimate Malaysia's headline inflation to record slightly lower at +2.9% for 2023 as non-food inflation to moderate further towards +1.3% while transport price to experience deeper contraction of -1.7%. By year-end, the 10-cent cut will bring the monthly headline inflation rate lower to +2.6%yoy as compared to +2.8%yoy (refer Chart 12).

Chart 11: CPI Forecast (YoY%)



Source: DOSM, MIDFR
*If RON95 slashed by 10cents

Chart 12: Assuming RON95 Price Cut Start in Aug-23



Source: DOSM, MIDFR
*If RON95 slashed by 10 cents

Brent crude oil price on track while RON95 price differential lower. As of 1HCY23, the average Brent Crude Oil price is USD79.2pb, slightly lower than Malaysian government's estimate of USD80pb. Based on our estimate, the non-subsidized market price for RON95 should be RM3.10 per litre. For 2022, the RON95 price differential against market price widened to RM1.86 per litre. Thanks to normalizing global oil price, the fuel price differential is estimated to be much lower at RM1.05 per litre for this year. With the lower price differential, we believe the total subsidy expenditure will be lower than last year. During 2011-2013, the RON95 price differential was more than RM2.00 per litre as global oil price hovered above USD100pb while the retail price of RON95 was kept at RM1.90-1.95 per litre.

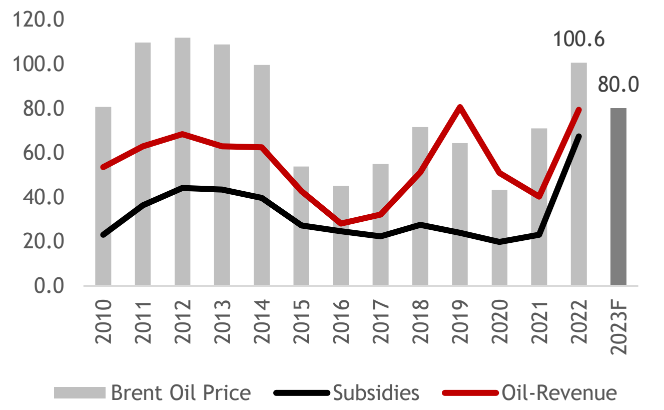
Table 4: Brent Crude Oil Price (USDpb), Ringgit and RON95 (RM per litre)

	Brent Oil Price	USDMYR	Subsidised RON95	Estimated Market Price RON95
2010	80.7	3.22	1.80	3.13
2011	109.7	3.06	1.90	4.26
2012	111.9	3.09	1.90	4.34
2013	108.8	3.15	1.95	4.22
2014	99.5	3.27	2.14	3.86
2015	53.8	3.90	2.00	2.09
2016	45.2	4.15	1.77	1.75
2017	55.0	4.30	2.17	2.13
2018	71.5	4.03	2.21	2.78
2019	64.3	4.14	2.06	2.49
2020	43.2	4.20	1.67	1.68
2021	70.9	4.14	2.03	2.75
2022	100.6	4.41	2.05	3.91
2023F	**80.0**	**4.43**	**2.05**	**3.10**

Source: BLOOMBERG, MIDFR

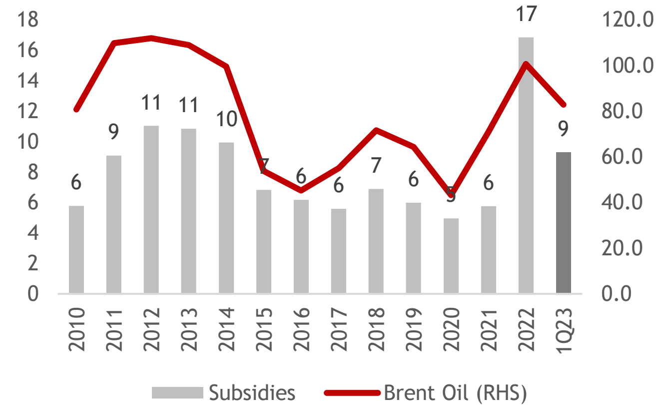
Additional RM4.3 billion for 10 cents reduction in fuel prices. Based on our estimates, for every 1 cents RON95 price differential, the subsidy cost to the government is RM0.43 billion. Assuming the government were to slash the RON95 price by 10 cents to RM1.95 per litre, this will cost approximately RM4.31b additional fiscal expenditure. At RM1.95 per litre, the estimated price differential will be at RM1.15, still way lower than last year's RM1.86. We anticipate the government may opt for the lower retail fuel price in order to ensure price stability and soften living cost pressure in Malaysia. On top of that, the government has better fiscal space given improvement in fiscal debt to GDP ratio which has fallen to 59.3% to GDP as of 1QCY23; and including contingent liabilities, the latest figure is 76.1%.

Chart 13: Brent Oil Price (USDpb) vs. Fiscal Subsidies & Oil-Revenue (RM billion)



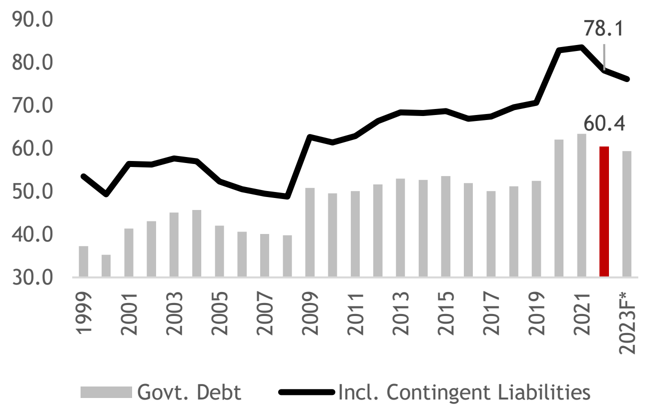
Source: BNM, MIDFR

Chart 14: Average Quarterly Fiscal Subsidies (RM billion) vs. Brent Oil Price (USDpb)



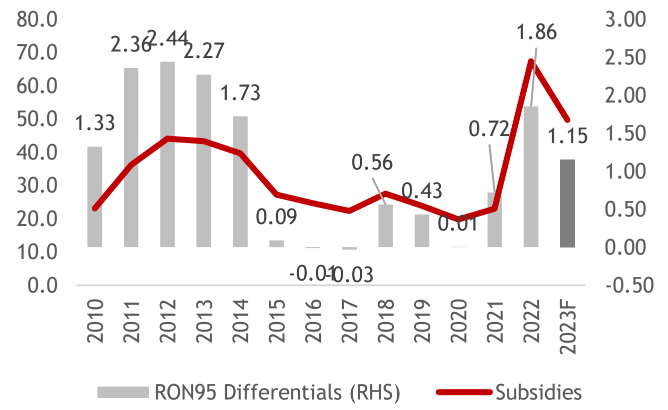
Source: BNM, MIDFR

Chart 15: Govt. Debt & Contingent Liabilities (% of GDP)



Source: BNM, MIDFR
*RON95 maintained at RM2.05

Chart 16: Chart 11: Fiscal Subsidies (RM billion) vs. RON95 Price Differentials (Subsidized vs. Actual Price)



Source: BNM, MIDFR
*RON95 slashed to RM1.95

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology