Economic Beat
midf RESEARCH

20 February 2014

MALAYSIA

January CPI – Effects of electricity tariff hikes kicking in, compounding the upward pressure

Effects of electricity tariff hikes could be the main factor and with increases in the sub-indices starting to be more broad-based, the second round effects could be faster and wider. The January Consumer Price Index (CPI) edged up higher to rise by 3.4% YoY in January, matching our expectation but above consensus (3.3%) as the effect of the average hike of 15% in electricity tariffs effective January 2014 started to kick in. CPI has been gradually inching up MoM since September 2013 even after the one-off hikes in fuel prices, followed by abolishment of sugar as well as the higher tobacco excise duty in the following months which should have worn off on MoM basis.

On MoM basis, inflation accelerated, following sustained increases. The CPI rose by 0.6% from December. The index surged by 0.8% MoM following the hike in fuel prices in September 2013, but it continued to rise MoM by an average of 0.3% in the subsequent months up to December 2013. MoM changes in CPI are usually rather volatile, with surges normally followed by declines, zero changes or very small increases. A persistent MoM rises in the FCPI by 0.3 – 0.4% indicates pressure on prices are gradually building up.

The increase in the CPI continued to be led by Food & Non-Alcoholic Beverages sub-index, followed by Transport and Housing, Water, Electricity, Gas & Other Fuels. Food & Non-Alcoholic Beverages rose by 4.2% YoY (Dec: 4.5%), contributing a 1.3 percentage point (p.p.) or 39.4% to the 3.4% increase in the overall CPI. A year ago, this sub-index was the main driver for rises in inflation, contributing as much as 50.5% to the rise in CPI. The smaller share was attributed to the changes in prices of key administered items as well as changes in other sub-indices. Transport rose by 5.3% YoY (Dec: 5.0%).and contributed 0.8p.p to the rise in the CPI index during the month while the Housing, Water, Electricity, Gas & Other Fuels accelerated to 3.2%YoY (Dec: 2.4%) and contributing 0.7p.p.

Most notably, the surge in the producer price index (PPI) for December indicates producers have started to feel the pain and may want to pass the higher cost to businesses and in turn, consumers. The surge in PPI by 4.3% was driven by the marked increase in Local Production index by 6.4% (Nov: 3.3%, Oct: 0.7%), while Imports index continued to decline by 0.4% for the 12th consecutive month. PPI was on a declining trend since June 2012 before it reversed in October 2013. The higher electricity tariff effective January as well as the weaker Ringgit may see PPI to edge up higher in the coming months and that implies producers would have no choice but to pass on the higher costs to businesses and in turn, consumers.

Recent trend supports our view that second round effects have started to kick in sooner than expected as the economy undergoes structural change in factors determining inflation, with supply shocks and external factors to have greater impact. As we have highlighted numerous times on the topic of inflation, as long as the domestic demand is strong enough, there is room for significant second round effects on inflation resulting from changes in the prices of administered goods, particularly if expectations among businesses that inflation will continue to rise is well entrenched. The anticipation of more hikes in prices of administered items this year could have also led businesses to pre-emptively raising the prices of their goods and services.The anticipation of compounding effects of multiple price hikes could see inflationary pressure to persist well into 2015 when the Goods and Servives Tax would be rolled out. Going forward, we should expect more adjustments in prics of administered goods as the government continues with it gradual phase out of the subsidies in line with the government's move to make the economy more market-driven and trim its expenditure and that could be the driving force of the structural change. There is a possibility that some items may not be subsidised anymore in the next few years.

For 2014, CPI may rise by 3.0 – 3.5% assuming that no other hikes in prices of administered goods. If we add on the toll rate hikes and another fuel price hike next year, that would see CPI to rise faster, by 3.5 to 4.0% in 2014. **We continue to factor in the possibility of Bank Negara raising the Overnight Policy Rate (OPR) by 25bps in 2Q 14 to restore the positive real interest rate as well as keeping inflation expectations in check**. The central bank may hike up again in 2H 2014 if there is a firm sign of much wider spillover effects on prices of goods and services and growth likelyy to be at the top range of the official forecast (5.5 – 6.0%)

Chart 1: Consumer Price Index – Major components

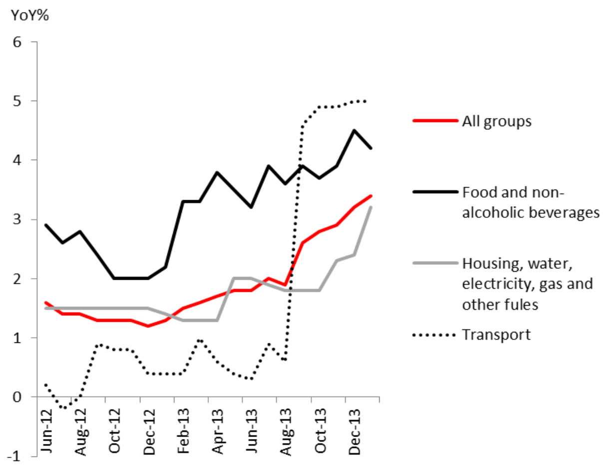
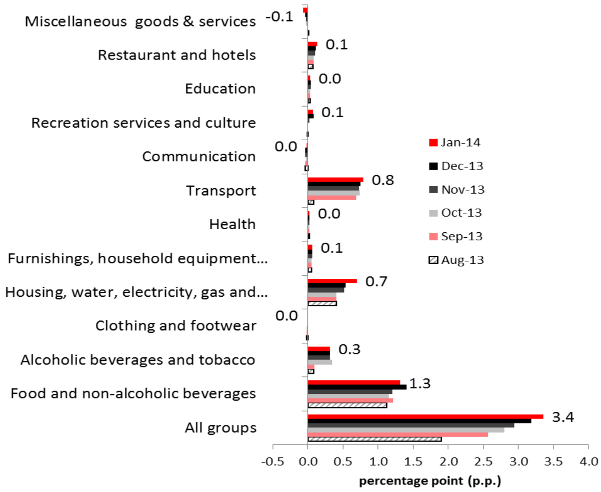
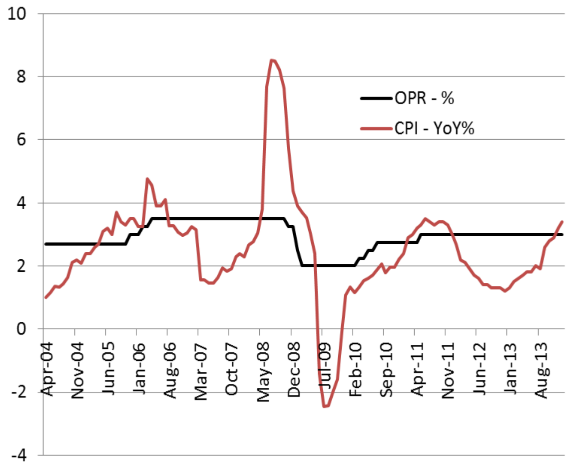


Chart 2: Contribution to the change in main index



Source: DoS

Chart 3: Real interest rate may stay in negative Territory for a sustained period if OPR not raised



Source: BNM

Chart 4: The MoM chnages in CPI following chnages in prices of administered goods

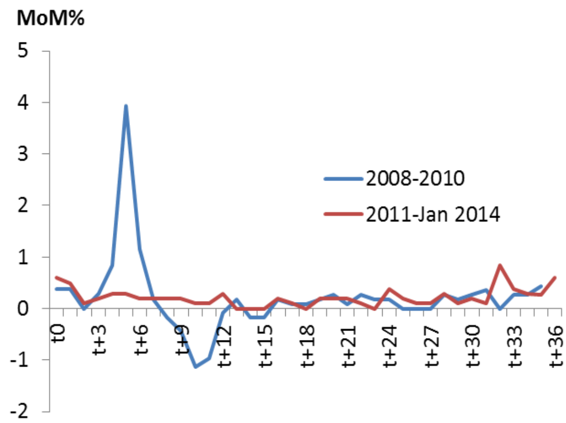
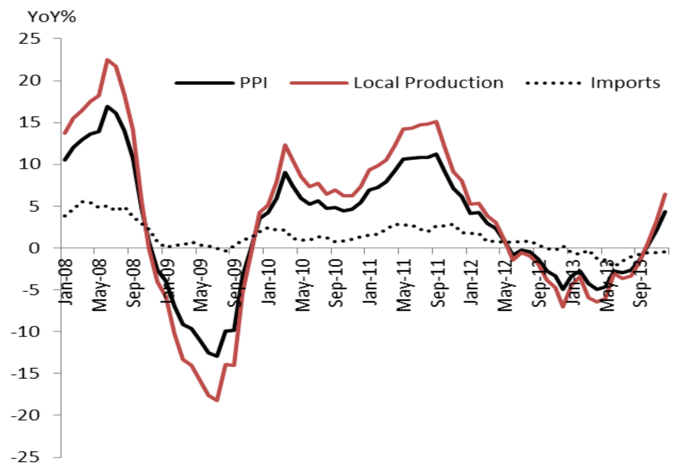


Chart 5: PPI surged on markedly higher local production cost



Source: BNM

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.