

Food and transport keep Malaysia's inflation elevated

We revise our forecast of Bank Negara Malaysia policy to one 25bp OPR hike in 2H18



Source: istock

Strong CPI inflation

Food and oil-related transport prices have been the primary sources of a near-doubling of CPI inflation through June this year, and we believe these factors remained in play in July, albeit some moderation due to the retracement of Ramadan food price spike and lower crude oil price transmitting to domestic fuel prices. We forecast 3.4% YoY inflation in July, in line with consensus and down from 3.6% in June.

4.1%

2017 June CPI YoY

almost double the 2016 figure of 2.1%

Our expectations

While we expect supply shocks to consumer prices to remain muted, sustained strong domestic demand supported by an acceleration in employment and wage growth will continue to exert a demand-side pull on prices over the rest of the year, keeping core inflation high. Non-food CPI, the proxy for core inflation, has bounced to 4.1% in 1H17 from 1.3% in 2016. We consider our 3.6% forecast for headline CPI 2017 inflation subject to more upside than downside risk. Bank Negara Malaysia, the central bank, forecasts 3- 4% inflation this year.

Possible policy tightening?

Strong growth and upward inflation pressures may tip Bank Negara Malaysia towards the US Fed in tightening this year. The MYR underperformance relative to other Asian currencies this year, which is likely to persist due to tightening of offshore trading, and negative real interest rates are other reasons for the BNM to do so.

However, we do not think BNM will want to risk hampering the current economic recovery ahead of general elections. Elections are scheduled in mid-2018, but there is a growing likelihood of PM Najib using the backdrop of a strong economy and fragile opposition to hold an election before the end of this year.

We retain our forecast of no change to the BNM's overnight policy rate, currently 3%, this year. There is scope to revise our forecast for 2018 from no move to one 25bp OPR hike in 2H18 on the view that lifting the political constraint on economic policy will allow the central bank to create some policy space to prepare for the next cyclical downturn.