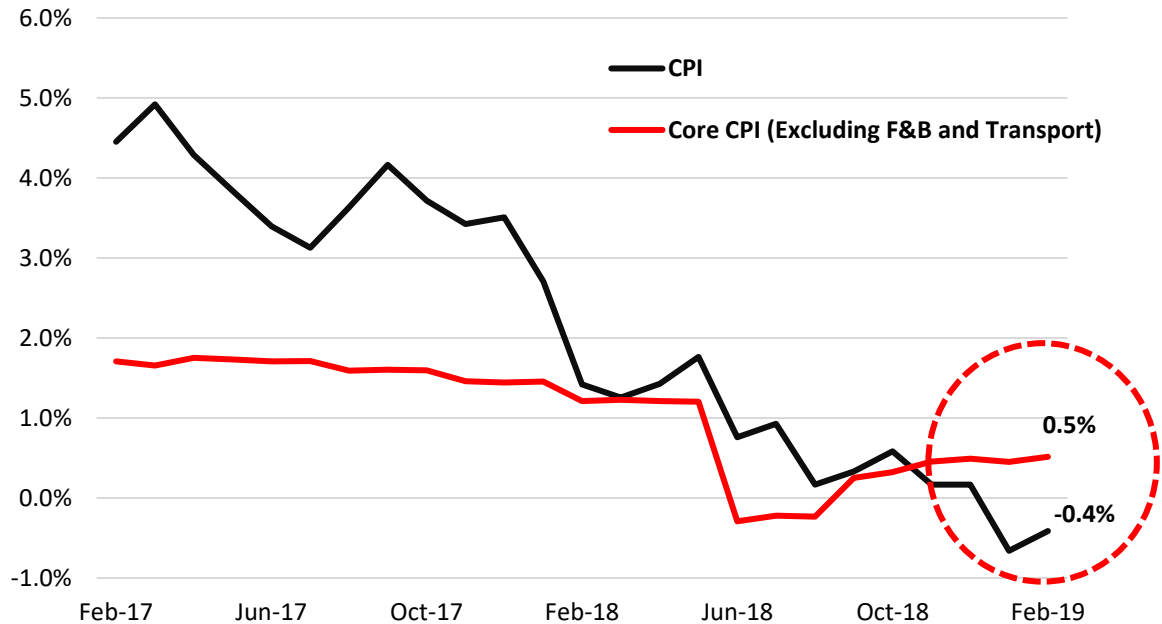


Second month of deflation...

Facts

- Malaysian economy is experiencing a second month of deflation. The Consumer Price Index (CPI) declined 0.4% year-on-year (y-o-y) in February 2019 from -0.7% in the preceding month (Consensus: -0.3%, Bank Islam: -0.3%). The deflationary trend was mainly attributed by Transport index which fell by 6.8% in February (Jan: -7.8%), followed by Clothing & Footwear (Feb: -3.2% vs. Jan: -3.3%), Miscellaneous Goods & Services (Feb: -2.2% vs. Jan: -2.4%) and Recreation & Culture (Feb: -0.4% vs. Jan: -0.4%).
- As for the Transport sub-indices, Fuels & Lubricating Personal Transport Equipment Operation of Personal Transport Equipment (OP) dipped by 11.4% in February (Jan: -12.6%) which is in tandem with lower RON95 prices compared to February 2018. Prices of RON95 stood at RM2.08 per liter against RM2.17 per liter in February 2018. Similarly, Purchase of Vehicles declined by 3.0% (Jan: 3.0%). Both indices contributed 10.0% of the overall CPI.
- Meanwhile, Food & Non-Alcoholic Beverages, Alcoholic & Tobacco and Housing, Water, Electricity Gas & Other Fuels sustained at 1.0% (Jan: 1.0%), 1.1% (Jan: 1.1%) and 2.0% (Jan: 2.0%) respectively. The three indices accounted for 55.7% of the overall index. On the other hand, the Furnishings, Household Equipment & Maintenance grew moderately by 0.1% in February after decline by 0.3% previously. On top of that, Food Away From Home and Milk & Eggs sub-indices increased by 3.4% (Jan 3.3%) and 1.8% (Jan: 0.6%) respectively in February. Thus, deflationary trend was not broad based (See Chart 3).
- This was evidenced from our core inflation, which excludes Food & Non-Alcoholic Beverages and Transport which posted 0.5% in February (Jan: 0.5%). The core inflation rate has been growing at the same rate for four consecutive months.
- There are few states within Malaysia recorded deflationary trend such as Terengganu (Feb: -1.4% vs. Jan: -1.5%), Kedah & Perlis (Feb: -1.3% vs. Jan: -1.3%), Melaka (Feb: -1.3% vs. Jan: -1.3%), Sabah & WP Labuan (Feb: -0.9% vs. Jan: -1.0%), Pahang (Feb: -0.8% vs. Jan: -1.1%) and Selangor & WP Putrajaya (Feb: -0.2% vs. Jan: -0.5%). Nevertheless, Federal Territory Kuala Lumpur and Pulau Pinang were the exceptions with positive growth of 0.3% (Jan: 0.2%) and 0.2% (Feb: -0.2%) respectively. So the big cities are still very much inflationary and cost of living is indeed rising albeit at slower pace.
- As such, the deflation rate has averaged at -0.5% in 2M2019 (+2.1% in 2M2018) while the core CPI grew softer by 0.5% in 2M2019 (2M2018: 1.3%).

Chart 1: Malaysia's Inflation rate y-o-y%



Source: CEIC

Table 1: Consumer Price Index (CPI)

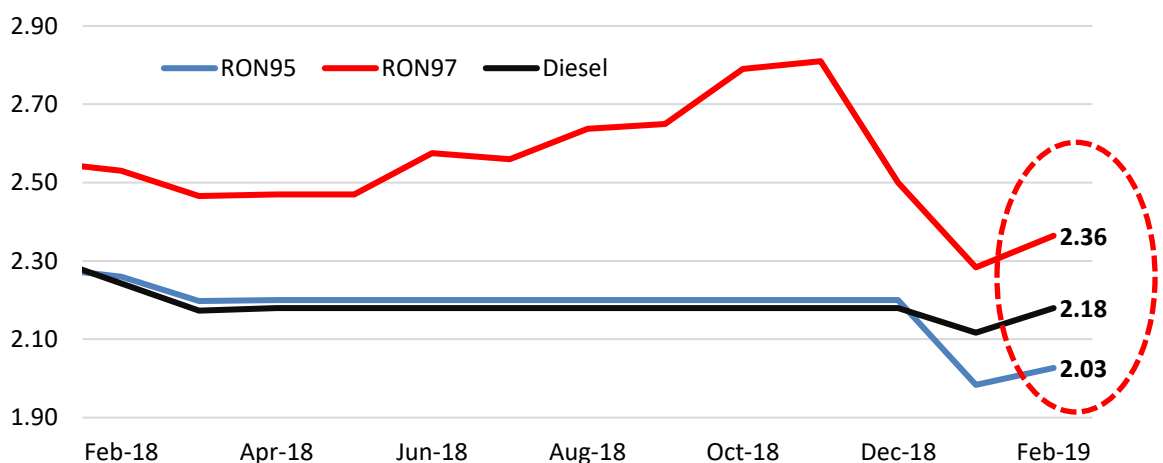
| | Weight | Nov-18 | Dec-18 | Jan-19 | Feb-19 | 2M2018 | 2M2019 |
|---|---------------|-------------|-------------|--------------|--------------|-------------|--------------|
| Consumer Price Index | 100.0% | 0.2% | 0.2% | -0.7% | -0.4% | 2.1% | -0.5% |
| Food and Non Alcoholic Beverages | 29.5% | 1.1% | 0.7% | 1.0% | 1.0% | 3.4% | 1.0% |
| Alcoholic Beverages and Tobacco | 2.4% | 1.0% | 1.1% | 1.1% | 1.1% | 0.2% | 1.1% |
| Clothing and Footwear | 3.2% | -3.1% | -3.2% | -3.3% | -3.2% | -0.5% | -3.2% |
| Housing, Water, Electricity, Gas & Other Fuels | 23.8% | 2.0% | 2.0% | 2.0% | 2.0% | 2.1% | 2.0% |
| Furnishings, Household Equipment and Maint. | 4.1% | -0.1% | 0.1% | -0.3% | 0.1% | 2.3% | -0.1% |
| Health | 1.9% | -0.2% | -0.4% | -0.5% | -0.4% | 2.2% | -0.4% |
| Transport | 14.6% | -2.3% | -2.0% | -7.8% | -6.8% | 2.7% | -7.3% |
| Communication | 4.8% | -1.3% | -1.3% | -1.2% | -1.2% | -0.6% | -1.2% |
| Recreation and Culture | 4.8% | -0.3% | -0.2% | -0.4% | -0.4% | 0.4% | -0.4% |
| Education | 1.3% | 1.4% | 1.1% | 0.9% | 1.3% | 1.2% | 1.1% |
| Restaurants and Hotels | 2.9% | 1.2% | 1.3% | 1.2% | 1.3% | 2.1% | 1.3% |
| Miscellaneous Goods and Services | 6.7% | -2.6% | -2.4% | -2.4% | -2.2% | 0.6% | -2.3% |
| Core CPI (excluding F&B and Transport) | | 0.5% | 0.5% | 0.5% | 0.5% | 1.3% | 0.5% |

Source: CEIC & Strategic Management Bank Islam

Our view

The deflationary trend was quite worrying although other major components such as food and utilities have remain on the rise. Such trend came at a time when economic growth is expected to moderate and therefore, the deflation rate recorded in the past two months could be a symptom that demand has been weak. Bear in mind that deflation is equally bad as the fall in general prices would mean lower profits for firms. If it becomes protracted, it may have an impact to factor demand such as labour as firms will not be incentivised to increase their production in view of poor visibility for profits. At the moment, what we saw, lower fuel prices have been the main catalyst for the deflation given their sizeable share in the CPI constituent. And the recent move by the government to cap the RON95 prices at RM2.08 per liter would limit the impact of higher crude oil prices. Currently, Brent crude is hovering at USD67 per barrel and it has been gradually rising since December 2018.

Chart 2: Average Petrol prices in Malaysia (RM per liter)



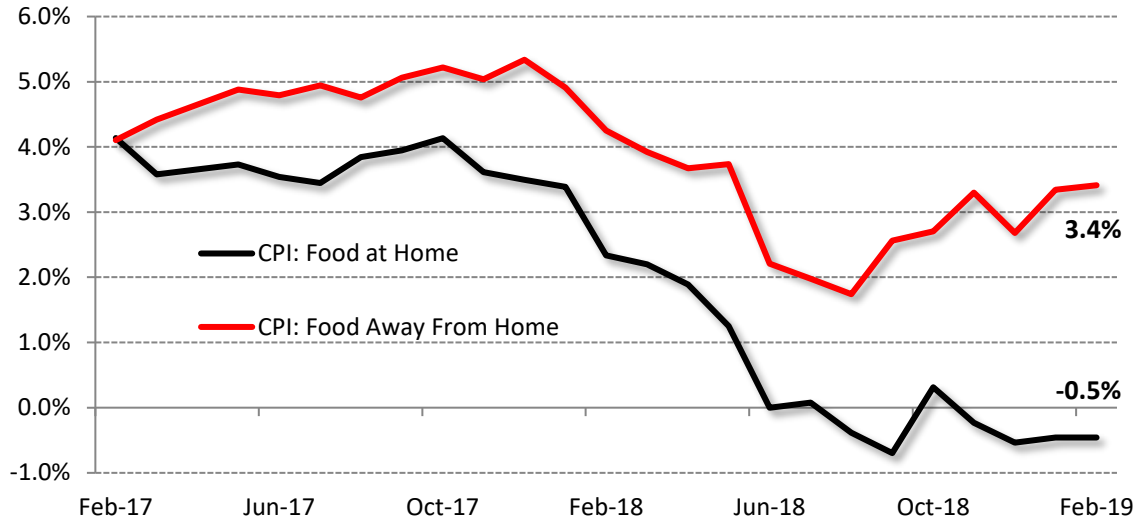
Source: CEIC

Be that as it may, Malaysians are still experiencing a higher cost of living. In the recent news, the consumer rights group has protested against the increase in the prices of fast food chains in Malaysia. They claimed that there was an increase of 30% in the fast food prices compared to 2014 when Good and Service Tax (GST) was implemented.¹ As we can see from Chart 3, it depicts that the sub-indices for food away from home has been progressively rising from 3.3% in January to 3.4% in February 2019. This could really explain the 0.1% increase in restaurants and hotels index as the food's operators have to raise its selling price amid rising costs of raw materials and production. Thus far, the government has introduced several initiatives in order to ease the cost-of living pressures in Malaysia. Among the initiatives are to put price controls on selective products whose commonly-bought by Malaysians.² They also intended to reduce exports of foods whenever supplies are low in Malaysia. Lower supplies domestically will spark an interest for the suppliers to increase the prices irresponsibly and thus will reduce the consumers' purchasing power.

¹ <https://www.freemalaysiatoday.com/category/nation/2019/03/01/group-sees-red-over-fast-food-price-hike/>

² <https://www.todayonline.com/world/bread-noodles-and-sausages-could-join-malysias-controlled-price-list>

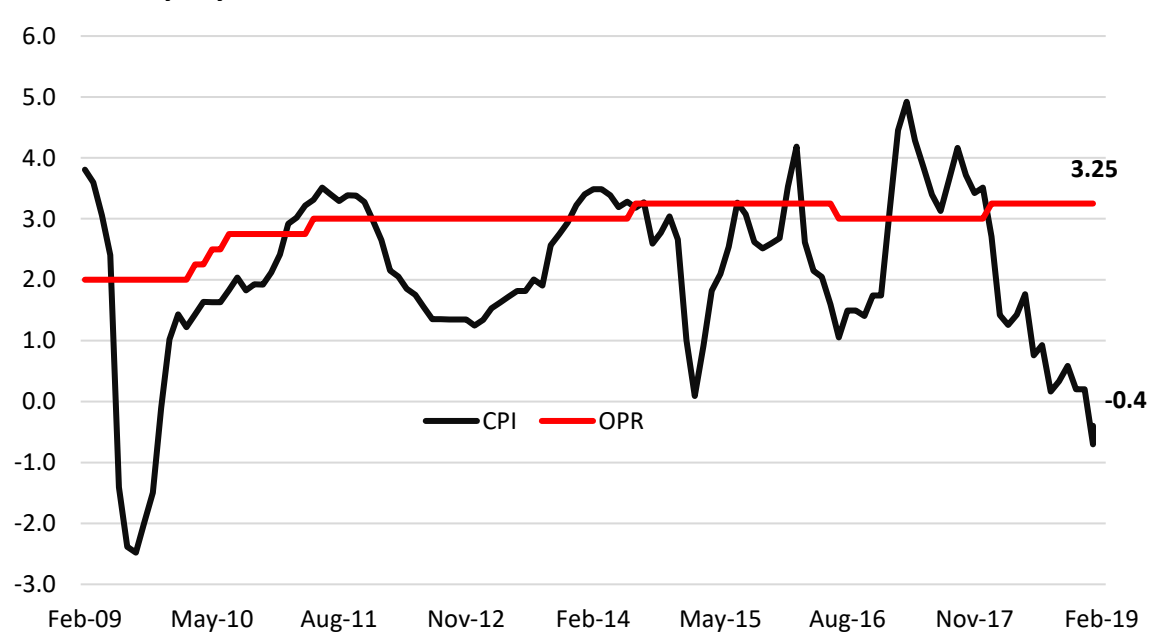
Chart 3: Food at Home & Food Away from Home sub-indices y-o-y%



Source: CEIC

On a different spectrum, the current deflationary trend will give some policy space to BNM. Essentially, the BNM has the flexibility to reduce the OPR rates if they foresee economic growth is deteriorating in the next few months. For now, we maintain our call for **Overnight Policy Rate (OPR) at 3.25% in 2019**. However, the downside risk has become elevated and could warrant policy respond from the central bank. We will update our OPR projection after attending the analyst briefing with BNM scheduled on 27 March.

Chart 4: CPI y-o-y % vs. OPR %



Source: CEIC

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