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Inflation under control

PETALING JAYA: Malaysia's rising inflation, which surged to its highest in more than a year in July, is unlikely to hinder the country's third quarter (3Q) gross domestic product (GDP) performance for 2022.

Malaysia University of Science and Technology professor Geoffrey Williams said he expects subsidies and price controls to continue for the rest of the year, thus keeping inflation under control.

"Inflationary pressures are easing worldwide with oil, palm oil, freight costs, agriculture costs, grains and feedstock prices all falling. Supply-chain pressures are easing too. So inflation is not the issue.

"The 3Q GDP performance will be driven by policy tightening, external demand and a normalisation of spending after the bulge in June," he told StarBiz.

Centre for Market Education chief executive officer Carmelo Ferlito believes that the effects of inflation will manifest through the deceleration of private consumption, with the situation potentially worsening in 4Q.

"It depends very much on the struggle between cost of living, raw materials and general uncertainty versus the mood brought in by the growth momentum and, hopefully, the end of lockdowns."

Over the short term, HELP University economist Paolo Casadio said the rise in employment and the momentum of consumption stemming from the reopening of the economy will help to outweigh the impact of inflation.

"In the longer term, we will see more moderate consumption, in line with the fundamentals of disposable income," he said.

Malaysia's inflation jumped 4.4% to 127.9 in July 2022, as the cost of food continued to accelerate.

The increase in the consumer price index, the highest since April 2021, was in line with the median forecast of a Reuters poll of analysts.

The Statistics Department said the increase in July's inflation was also due to the low base effect last year as a result of the electricity bill discount from 5% to 40% according to total usage given to domestic consumers.

For July, the food index rose 6.9%, serving as the main contributor to the increase in overall inflation.

Core inflation and inflation without fuel registered an increase of 3.4% and 4.2% respectively in July 2022, as compared to the same month of the preceding year.

On a monthly basis, inflation increased 0.4% as compared to June.

For the January to July period, inflation increased 2.8% as compared to the same period last year.

UOB senior economist Julia Goh and economist Loke Siew Ting in a recent note said they are raising their 2022 full-year inflation estimate to 3.5% from 3% previously.

They said the revision comes following the full reflection of price adjustments for various price-administered items and higher-than-expected inflation outturns from May to June.

“In addition, the combination of factors including the previous year’s low base effects, still-high commodity prices, persistent currency weakness and intensifying cost pass-through effects will continuously keep headline inflation above 4% levels for the remaining months of the year.

“Our revised inflation outlook has yet to factor in the impact of the new targeted fuel subsidy mechanism that is currently under pilot testing since July.”

Goh and Loke pointed out that this new mechanism, utilising e-wallets, would be trialled for three-to-six months before it is implemented nationwide.

Apart from a new targeted fuel subsidy mechanism, they noted that the Energy Ministry would be submitting a proposal to the Cabinet on the implementation of a targeted electricity bill subsidy for the next Imbalance Cost Pass-Through cycle period (from January to June 2023).

“This comes as the cost of maintaining the electricity tariff for July to December this year is estimated to reach almost RM20bil, which is three times higher than the RM7bil cost for January to June.

“However, Finance Minister Tengku Datuk Seri Zafrul Abdul Aziz assured in early August that the decision to introduce targeted subsidies will only be made when the economic situation permits after the rate of inflation can be properly controlled. As such, we maintain our 2023 full-year inflation projection of 2.8% for now.”Casadio meanwhile expects inflation to come down by the fourth quarter of this year.

“We do not think that this will change the trajectory of private consumption significantly in the short term.”

He added that the shock to the economy is expected to come from external events.

“This may have an impact on investments, net external demand and the inventory cycle.

“The forecasts for GDP growth in 2022 is now set at around 8.5%, barring significant statistical revisions of historical data that we think are likely.”

Malaysia’s economy posted an 8.9% growth in 2Q, due to strong domestic demand from 5% year-on-year in 1Q22. Ferlito pointed out that the strong 2Q22 performance was mainly due to the low baseline from 2Q21.

“Let’s not forget that Malaysia was the only country in the region recording a negative performance in 2Q21, due to the lockdown. The performance in 3Q21 was even worse (minus 2.7% quarter-on-quarter) as most of the economy was shut down.

“Therefore, if we look at the yearly performance, 3Q22 will look good. The real pace of growth will be determined by the quarterly performance. Sustainable growth is driven, I believe, by private investments and we have seen positive signals in 2Q22. We may see the same trend in 3Q22.”

Casadio meanwhile noted that the last three quarters saw strong GDP growth, mainly driven by private consumption.

"This brings an inertial annual growth of 8.5% for 2022. It means that, even in the case of no growth for the next two quarters, the economy has already guaranteed an 8.5% annual growth for 2022."

He added that the growth expected in 3Q22 will still be centred on private consumption as the main contributor, albeit on a more moderate level.

"This is normal and it should not be seen as a signal of weakness. We expect that the overall increase in final demand will be more or less offset by an equivalent contraction of inventories, leaving close to zero growth quarter-on-quarter and corresponding to a 12% growth year-on-year."

For the remainder of 2022, Casadio said Malaysia's economy could be potentially dragged by the slowdown experienced in Europe, China and the United States.

"In the short term, the inertia of consumption will continue for a while despite the higher inflation figure. In 4Q, we expect to see a contraction in investments due to the slowdown in global economies."

Given a robust GDP growth print in 2Q22, UOB's Goh and Loke said signs of further economic expansion in the second half of 2022 will likely follow-through with a third 25 basis points rate hike at the next monetary policy meeting this month.

"This will bring the overnight policy rate to 2.5%. Besides internal factors, we believe the expected outsized Federal Reserve rate hikes in the coming months and global monetary conditions would also be taken into consideration by Bank Negara at the meeting."

Following the stronger-than-expected GDP performance in 2Q, MIDF Research in its latest monthly economic review said it is upgrading its 2022 growth forecast to 6.6% from 6% previously.

"Reading from the better prospects as indicated by the Leading Index (LI), we foresee the growth momentum continuing into the second half of 2022. This will be backed by increased spending and business activities as the economy transitions into the endemic phase, with Covid-19 restrictions having been relaxed and rising tourist arrivals."

The LI is a predictive tool used to anticipate an economic upturn and downturn in an average of four to six months ahead.

While measures like Bantuan Keluarga Malaysia cash handouts and Employees Provident Fund withdrawals helped to boost spending in 2Q22, MIDF Research said it sees more normalised growth for domestic spending towards the latter part of the year.

"Nevertheless, an improving labour market and better income prospects will continue to support domestic spending activity.

"For external trade, we expect growing external demand especially for electrical and electronics items. Petroleum and palm oil will also support the growth outlook this year."

However, MIDF Research said it remains cautious of possible downside risks from the external front, such as weaker growth prospects in major trading partners (namely China and US), escalation of geopolitical tensions and continued disruption in the global supply chain.

“Despite these external uncertainties, we believe that the more-than-6% growth can be achieved, given the strength and the sustained improvement in domestic demand.”

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