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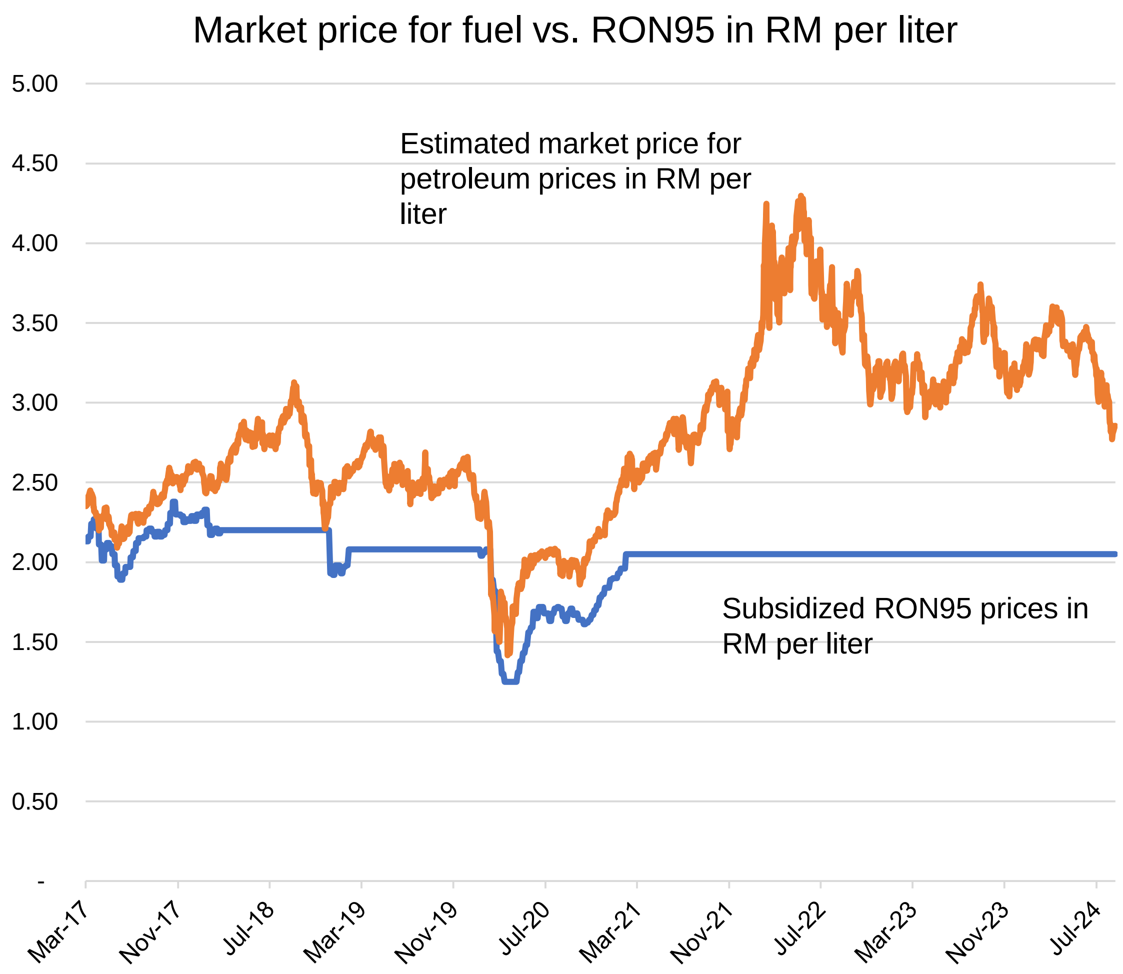
18 SEPTEMBER 2024

Synthesizing the fuel price hike.



Sources: CEIC, Bloomberg & BMMB's Economic Department

There have been increasing discussions about raising RON95 fuel prices to alleviate the government's financial burden and ensure that financial assistance, including subsidies, becomes more targeted. However, removing fuel subsidies has always been an unpopular move, given its potential economic impacts, particularly on inflation and consumer sentiment. Additionally, the political landscape could be affected, as higher inflation often leads to reduced purchasing power in the short term.

We aim to provide insights on this topic despite facing data limitations. Firstly, it's important to establish the market price of fuel in Malaysia. While the preferred reference is the Means of Platts Singapore (MOPS), as it is a common benchmark in the Asian region, we will use Brent crude oil prices due to better data availability. Although not ideal, Brent crude serves as a reasonable substitute in this context, as our purpose is to offer an estimate of the difference between the subsidized fuel prices and the actual market price. Subsequently, the impact it may have on inflation and government finances after removing the RON95 subsidies.

Considering the USDMYR exchange rate, Brent crude oil prices, and other fixed variables like the Alpha, operational costs, oil company margins, and sales tax or subsidies, the estimated market price of petrol in Malaysia is around RM2.86 per liter. This is 81 sen higher than the current subsidized RON95 price of RM2.05 per liter. However, the gap between the market and subsidized prices is the narrowest it has been since June 9, 2022, when the estimated market price was RM4.28 per liter.

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Time for RON95 adjustment is now

It may be an opportune time to remove RON95 subsidies, considering the current crude oil prices, which are expected to decline in the future. According to consensus estimates, Brent crude prices are forecasted to decrease from USD82 per barrel in 2024 to USD74 per barrel by 2027. This projection is driven by reduced demand from major economies like China, alongside a structural shift as consumers increasingly adopt electric vehicles (EVs).

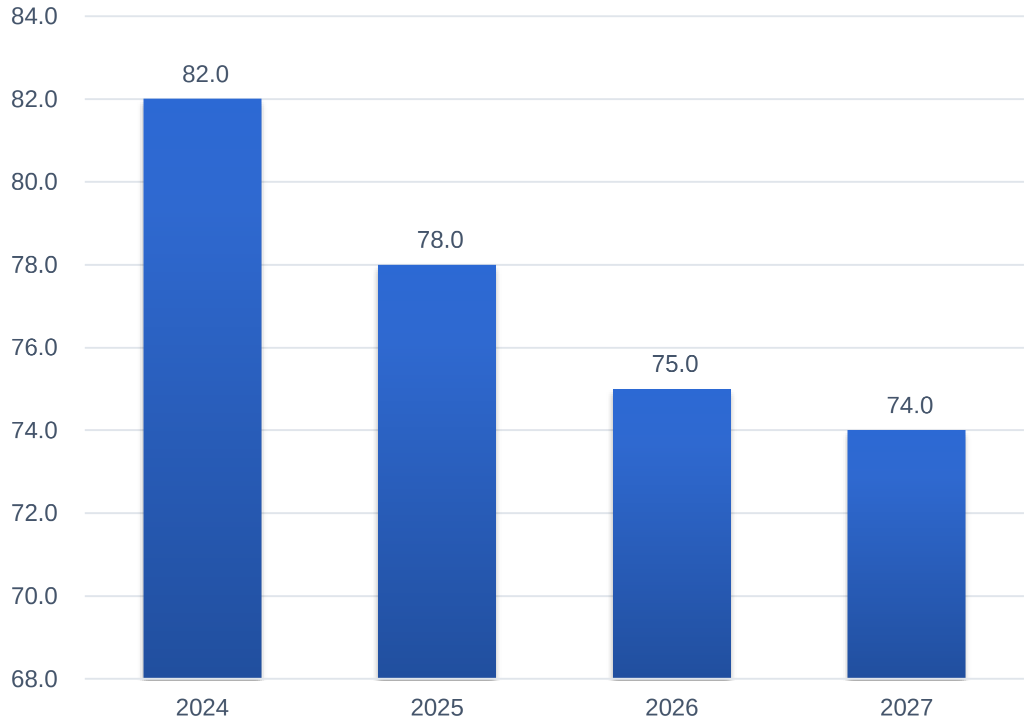
Next, is the question of what would be the impact to inflation?

We anticipate that the adjustment will be implemented all at once, as multiple incremental increases in RON95 prices would not only anger the public but also heighten inflation expectations. In this context, we expect inflation to rise to around 3.3% to 3.5% in 4Q2024, up from approximately 2.0% to 2.1% in 3Q2024.

What about the impact to fiscal position?

This move could have a positive impact, as it would reduce fiscal deficits. According to Budget 2024, RM35.8 billion has been allocated for subsidies and cash transfer programs. From this amount, we estimated that a total of RM21.5 billion will be dedicated to RON95 subsidies. If the government removes these subsidies in October 2024, the estimated savings would be around RM5.4 billion. This could reduce the fiscal deficit from the current estimate of 4.3% of GDP to 4.1% of GDP for 2024 (compared to 5.0% in 2023).

Median forecast for Brent crude prices (USD per barrel)



Source: Bloombergt

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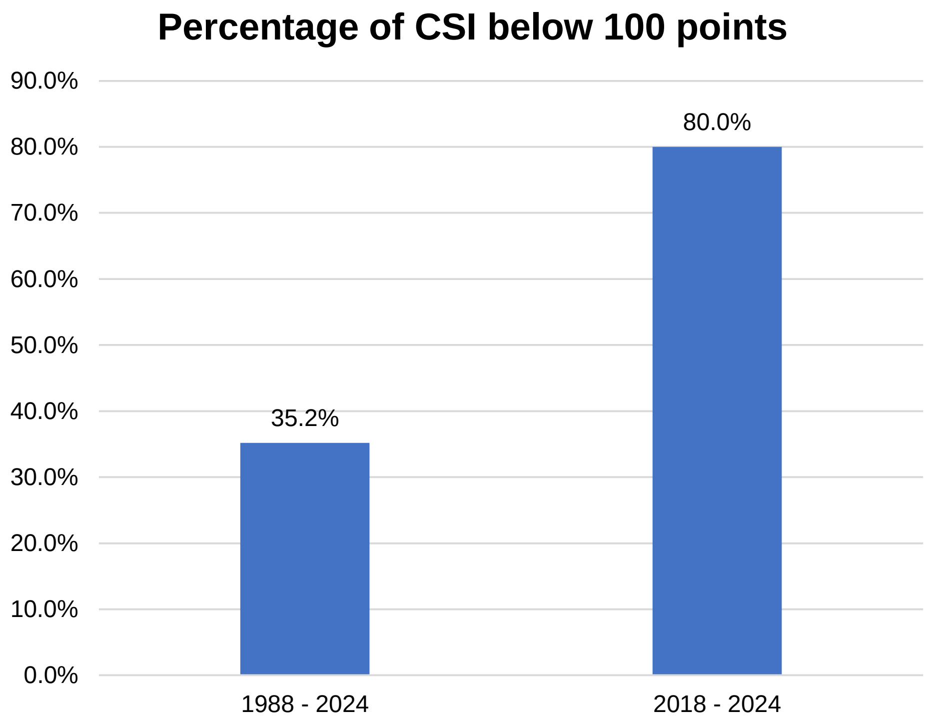
The changes can be an uphill task for the government.

We anticipate that the changes will not be easy for the general public. RON95 makes up 5.0% of the total Consumer Price Index (CPI), compared to just 0.2% for diesel, indicating widespread use of RON95 among Malaysians. Additionally, businesses' pricing behavior is a key concern, as they may choose to raise prices to maintain profit margins.

Therefore, a strong and effective communication strategy and delivery system will be crucial to building credibility with the public, particularly regarding the redistribution of cash aid to those eligible for direct government transfers. Additionally, strict enforcement of laws such as the Price Control and Anti-Competition Act (2011) will be essential to prevent unjustified price hikes by businesses.

So far, Malaysian consumer sentiment has been generally pessimistic. This is reflected in the Consumer Sentiment Index (CSI), which has remained below 100 points for 80% of the time between 2018 and 2024, indicating widespread pessimism among Malaysians.

However, with a strong and effective communication strategy, the negative perceptions can be mitigated. Implementing such reforms requires determination and political will, as they will benefit the country in the medium to long term.



Sources: MIER, CEIC & BMMB's Economics Department
Consumer Sentiment Index (CSI): > 100 points = Consumers are mostly optimistic
< 100 points = Consumers are mostly pessimistic