From the Desk of the Chief Economist

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KNOCK-ON IMPACTS OF SOARING COMMODITY PRICES

17 MARCH 2022

ECONOMIC RESEARCH

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COMMODITY PRICES HAVE BEEN SKYROCKETING

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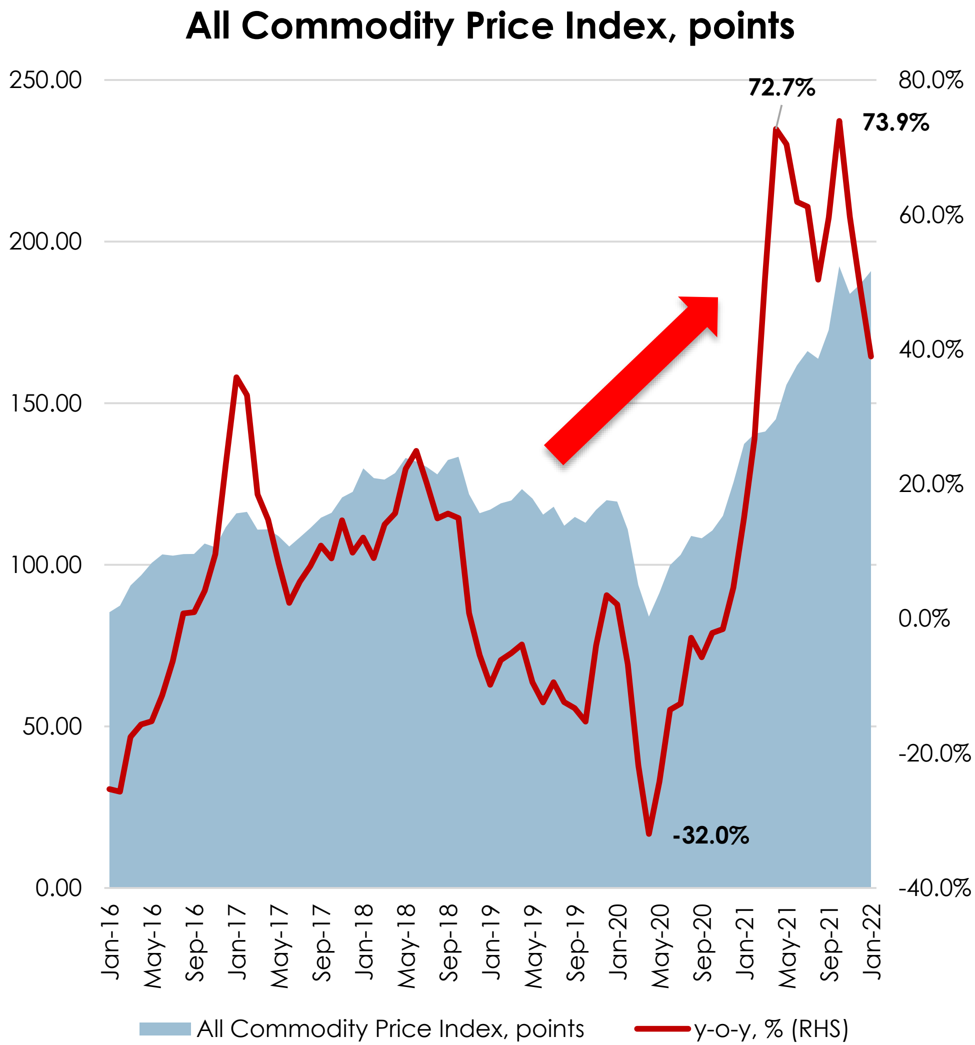

Source: International Monetary Fund (IMF)

- ✓ The sharp increase in commodity prices are turning out to be more pronounced than previously anticipated.
- ✓ For instance, prices for crude oil, grains, metals and other internationally traded commodities are soaring at the steepest rate.
- ✓ Thus far, the Brent crude oil price has surpassed USD130.0-mark on 7 March while the April future contract hit USD138.0 on 9 March.
- ✓ Additionally, Malaysia's key commodity, Crude Palm Oil (CPO) future price has been lingering around RM6,000.0 per tonne.
- ✓ The IMF's All Commodity Price Index also shown that the price has been rising by more that 20.1% y-o-y in January 2022 (December 2021: 23.4%) after the economy reopened from the Covid-19 crisis.
- ✓ This is likely to dampen market participants' sentiment and cloud global economic outlook this year.

PRICES INCREASED STEEPLY ACROSS ALL SEGMENTS

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Brent Crude Oil Future, USD/barrel

CPO Future, RM/tonne

U.S. Wheat Future, USD/bushel

Alumiunium, USD/tonne

Source: Investing.com
*Data as at 4 March 2022

SO, WHAT'S GOING ON?

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1. Demand and supply shocks

Commodity markets are being squeezed from two directions:

- ✓ **Demand-side factor** - demand is booming amid economic recovery alongside strong revival in industry.
- ✓ **Supply-side factor** - significant reduction in inventories, as well as global supply chain disruptions.

- ✓ **The U.S. weekly commercial crude oil inventories** declined significantly to 413.4 million barrels on 25 February 2022 from its peak at 540.7 million barrel on 19 June 2020.
- ✓ This reflects that demand for crude oil returns faster than supply as the global economies reopened from lockdown measures.
- ✓ Hence, this has contributed to an elevating commodity prices, including crude oil.

U.S. Weekly Commercial Crude Oil Inventories, Million Barrels

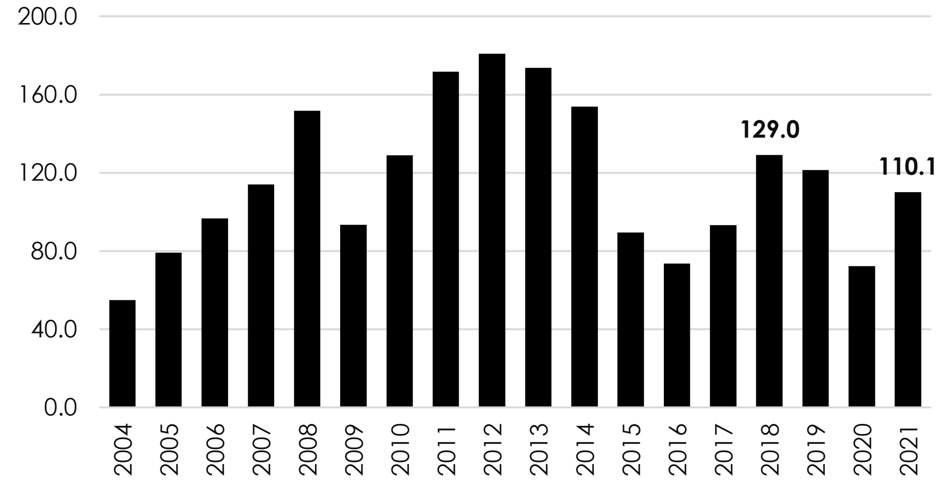
Source: EIA

SO, WHAT'S GOING ON? (CONT'D)

2. Geopolitical tension

- ✓ Russia is one of the world's biggest exporters of crucial raw materials, ranging from crude oil and gas to aluminum and wheat.
- ✓ Meanwhile, Ukraine is a major agriculture supplier of corn and the global key export market for sunflower oil which is heavily used in food processing.
- ✓ The possible exclusion of supplies from Russia due to sanctions and damages in Ukraine have caused the commodity price soared.
- ✓ Thus, continued violence would clearly, be bad for international trading activities.
- ✓ The price of commodity is likely to persist for a period of time should the tension between the two countries is showing no sign of de-escalation.

Russia's Export: Crude Oil, USD Billion



Source: CEIC

	Russia	Ukraine
Top Exported Products	- Crude Petroleum - Refined Petroleum - Coal Briquettes - Wheat	- Corn - Seed Oils - Iron Ore - Wheat - Semi-Finished Iron
Top Imported Products	- Cars - Packaged Medicaments - Vehicle Parts - Computers	- Refined Petroleum - Cars - Packaged Medicaments - Coal Briquettes

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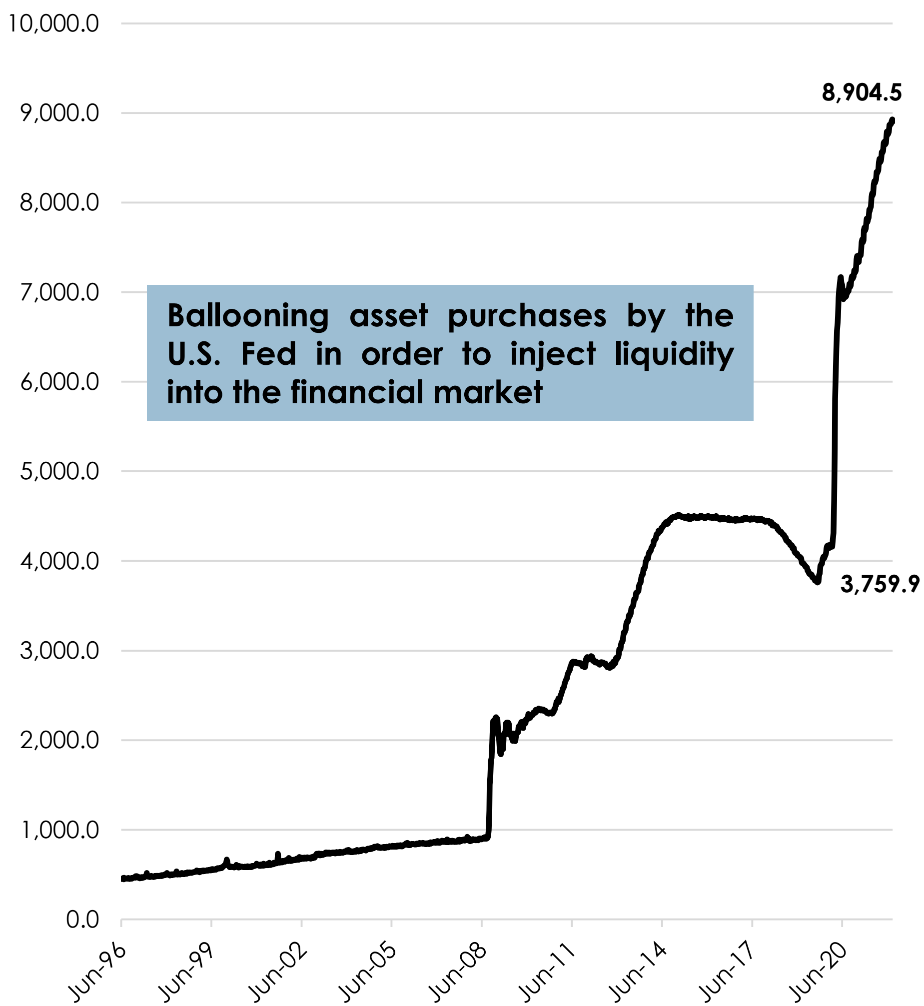
3. Market Liquidity

- ✓ Following the Covid-19 crisis, central banks across the globe have adopted an accommodative monetary stance, as well as expansionary in fiscal policies to mitigate the economic fallout from the pandemic.
- ✓ Hence, the commodity future market has become more volatile in recent years as financialisation of commodities increased amid excess global liquidity.
- ✓ Following this, a large swings in prices were seen in key commodities, particularly crude oil, CPO and metals.

Federal Reserve's Balance Sheet, USD Billion



Source: CEIC

IMPACTS TO MALAYSIA

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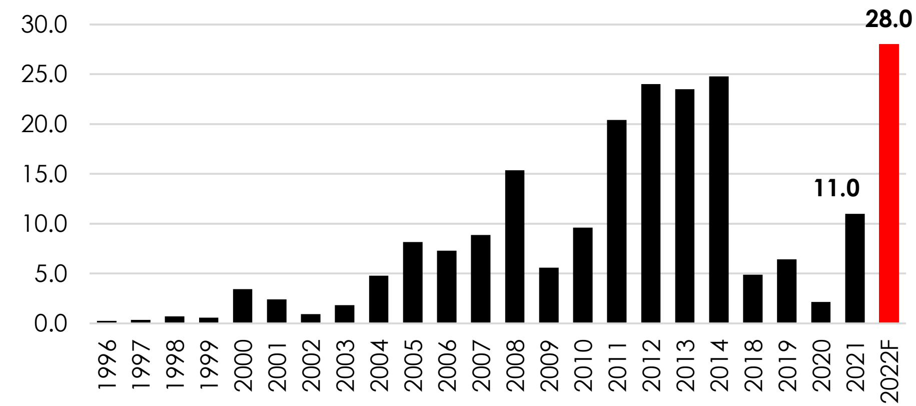
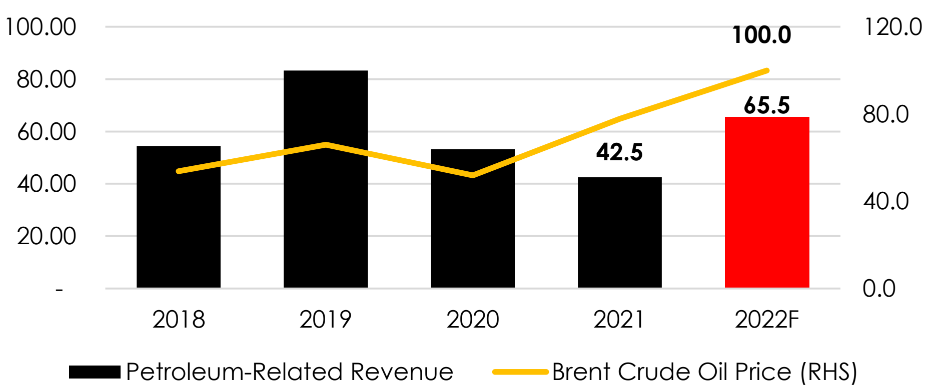
Malaysia's Fuel Subsidy Spending, RM Billion



Sources: MOF, Media, KPDNHEP

Petroleum-Related Revenue, RM Billion vs. Brent Crude Oil Price, USD/ barrel



Sources: MOF, Media, KPDNHEP

1. Government has to bear higher fuel subsidy this year

- ✓ The Brent crude oil price has reached above USD100.0 per barrel since 24 February amid fear of short in supply.
- ✓ Hence, this will translate into rising fuel subsidy spending by the government for domestic fuel consumption.
- ✓ The fuel subsidy is expected to go up to RM28.0 billion this year (2021: RM11.0 billion) if the Brent price maintains above USD100.0 per barrel throughout the year.
- ✓ Nevertheless, based on our studies, the government would stand to benefit as petroleum related revenue is likely to go up to RM 65.5 billion should the Brent price lingers around USD100.0 per barrel.
- ✓ As such, the government has the fiscal room to maintain the prevailing subsidies program. Nonetheless, the benefit of fuel subsidies are generally accrued to the high income. Hence, policy reform is urgently needed but the timing can be tricky.

OUR ANALSYSIS SHOWS THAT REDUCTION IN FUEL SUBSIDY WILL PUSH UP THE INFLATION RATE HIGHER

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The reduction in fuel subsidies will ultimately be reflected in the higher inflation rate, depending on the quantum of the subsidies cut. This is the main tradeoff for the policy reform. Hence, a more holistic fuel subsidies rationalisation is warranted. Ideally, petrol prices should be determined by the market forces. Therefore, it has to be clearly communicated to the population.

Should the government review the fuel subsidy?

Reduction of Fuel Subsidy by:	Fuel Subsidy Savings, RM Billion
RM0.20 per litre	3.0
RM0.40 per litre	6.0
RM0.60 per litre	9.0
RM0.80 per litre	12.0
RM1.00 per litre	15.0
RM1.20 per litre	18.0
RM1.40 per litre	21.0
RM1.60 per litre	24.0
RM1.80 per litre	27.0

The amount of money that government could save up by reducing the subsidy

Sources: Ministry of Finance (MOF), Bank Islam

Our estimation shows that for every RM0.20 per litre reduction in fuel subsidies, it will help the government to save up to RM3.0 billion.

But, what will happen to the inflation?

Reduction of Fuel Subsidy by:	CPI (2022F), y-o-y%
No reduction	2.5%
RM0.20 per litre	2.9%
RM0.40 per litre	3.3%
RM0.60 per litre	3.7%
RM0.80 per litre	4.1%
RM1.00 per litre	4.5%
RM1.20 per litre	4.9%
RM1.40 per litre	5.3%
RM1.60 per litre	5.7%
RM1.80 per litre	6.1%

If the fuel subsidy is removed completely.

***As of March this year, the current fuel subsidy covered by the government is at RM1.65 per litre.**

From the table above, it will result in a higher headline inflation.

IMPACTS TO MALAYSIA (CONT'D)

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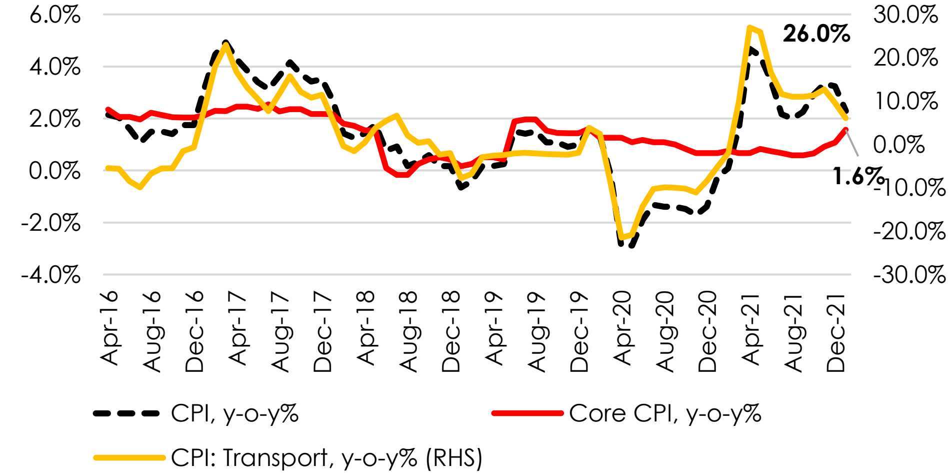
Malaysia's Inflation Rate



Source: CEIC

United Nation (UN) FAO Food Price Index, y-o-y%

Source: UN

2. Heightening inflation risk

- ✓ Thus far, Malaysia's Consumer Price Index (CPI) has been elevating since April 2021 (4.7%) following pandemic-induced supply disruptions and shortages.
- ✓ According to the UN, the Food and Agriculture Organisation (FAO) Food Price Index soared to 140.7 points in February 2022 or 20.7% y-o-y increase (January 2022: 19.3%). This is a new all-time high amid surge in vegetable oil price.
- ✓ Furthermore, China' virus lockdowns could ramp up supply-chain risks and therefore, exerting additional upward pressure on Malaysia's inflation.
- ✓ Global commodity prices are one of the key drivers that droves global inflation.
- ✓ Historically, Malaysia's fuel subsidy rationalisation in June 2008 amid extreme volatility in crude oil price has pushed the inflation by a whopping 7.7% in June 2008 and 8.5% in July 2008 from merely 3.8% in the preceding month.
- ✓ Hence, the price shocks will raise the cost of living, especially on lower income households for whom food and fuel have a higher proportion of expenses.

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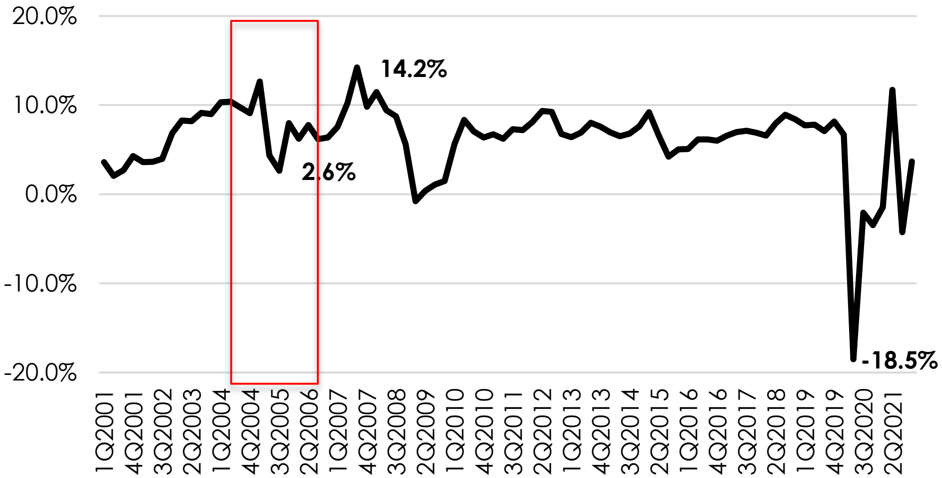
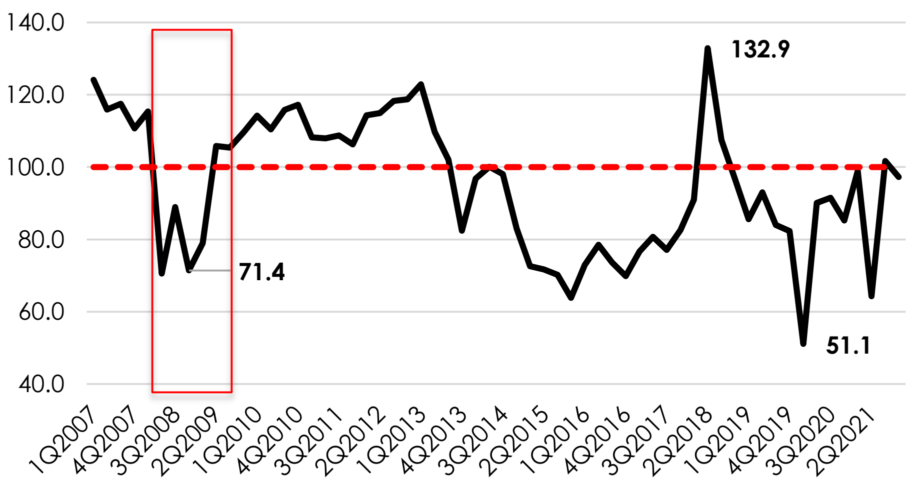
Malaysia's Private Consumption, y-o-y%



Consumer Sentiment Index (CSI), points



Source: IMF

3. Moderation in private consumption

- ✓ Rising inflation will curtail the purchasing power among consumers.
- ✓ True enough, the Consumer Sentiment Index (CSI) plummeted from 115.4 points in 1Q2008 to 70.5 points in 2Q2008 after the sharp reduction in fuel subsidies by RM0.78 on 5 June 2008.
- ✓ This represents a shock to the economy as the quantum of increases were extremely steep. Prices of RON97, RON92 and Diesel rose substantially by 40.8%, 39.4% and 63.3% to RM2.70 per liter, RMRM2.62 per liter and RM2.58 per liter respectively. Following this, Malaysia's private consumption also decelerated from 11.4% in 1Q2008 to 9.4% in 2Q2008.
- ✓ Interestingly, the number of ridership in LRT increased from -3.4% month-on-month (m-o-m) in May 2008 to 2.7%, 9.9% and 4.7% during June, July and August 2008. Similarly, ridership for commuter trains rose by 0.9%, 2.4% and 6.9% during June, July and August 2008.
- ✓ Therefore, the shock in fuel prices does have an impact on the way how people would travel. To some degree, it could also help to reduce the carbon foot print.

CONCLUSION – STAY SHARP EVERYONE

- ✓ **Higher risks of inflation-** The raw material shortages accompanied by expensive energy prices have added pressure on global inflation. This will have an impact to the businesses and consumers purchasing power, leading them to be more cautious in their spending plans.

- ✓ **Risks of policy mistake –** Central banks might see raising the interest rates would be the right policy response as they want to anchor the inflation expectation. Apart from that, removing fuel subsidies could also be on the card in order to contain the fiscal shortfall. However, it's a delicate balancing act and risks for a policy mistake could also be higher.

- ✓ **Uncertainties cloud the global outlook-** The Russia-Ukraine war, as well as China's Zero Covid Policy could potentially cloud the economic outlook. Hence, it is never walk-in-the park for businesses to navigate these challenges despite hope for an economic recovery this year and beyond.

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