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Global Markets Research

Research Alert

Malaysia's Subsidy Re-targeting and Reforms

Impact from subsidy cuts for chicken, eggs minimal; to save RM3.8bn in coffers
Tiered subsidy cuts for fuel; impact disproportionate to coffers and consumer spending
Expect unpopular reform on the government revenue in the next 2-3 years

Overview

Headline inflation has trended lower for Malaysia and globally in line with moderating cost conditions, food prices and energy/transport. Trends in shelter costs was mixed globally, but generally stayed elevated and remained a major contributor to inflation among some majors. Moving forward, Malaysia's inflation outlook remains highly susceptible to developments in subsidy rationalisation measures, global commodity prices and financial market developments. The MOF expects inflation rate to range widely between 2.1 -3.6% for 2024, with the balance of risks, in our opinion tilted on the upside especially on the back of the subsidy retargeting plan.

Sequencing of reforms to smoothen impact on the economy

Since Economy Minister YB Rafizi Ramli has recently said that the government will roll out the targeted RON95 subsidy in 2024, we thought that it is only timely for us to address the potential impact from the subsidy cuts and price controls on prices and government coffers, with focus on chicken/eggs, electricity and fuel, which have been announced. Just a recap, price control for chicken has been removed since 1-November but has been delayed for eggs. We are pencilling in a tiered cut in electricity subsidies at the end of 1Q but have not factored in impact from RON95 at this juncture pending more clarity on timing.

Minimal impact from the removal of chicken and egg price controls

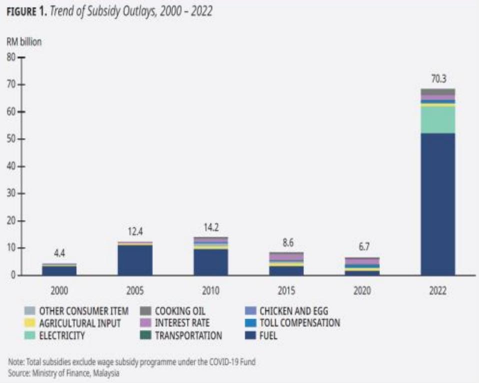
The removal of price ceiling for chicken is expected to have minimal impact on inflation as it is currently sold close to market price (Oct: RM10.02 vs ceiling: RM9.40/kg). In any case, the ***weightage of fresh meat is relatively small at 1.9% of the CPI basket,*** and as such, we have maintained our CPI readings to remain sub-2.0% in the next few months***. Eggs, meanwhile, accounts for 0.4% of the CPI basket,*** and together, the removal of price ceiling for both is also expected to ***save the government RM3.8bn in government coffers***.

Tiered subsidy removals for electricity

In June 2023, the Natural Resources, Environment and Climate Change (NRECC) Ministry announced that the top 1% of electricity users in the country will pay a higher tariff between July and December 2023. This will affect 83k consumers who will face a minimum monthly increase of RM187 (+25%) in electricity bills. ***In August, inflation for the housing, water, electricity, gas and other fuels of the CPI basket (2.7%) jumped 0.5% m/m,*** but overall inflation accelerated only slightly by 0.1ppts to +0.2% m/m. Headline inflation remained unchanged at +2.0% y/y.

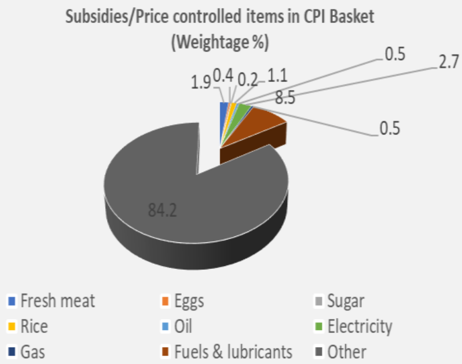
The latest move is in line with government's target to lift part of the subsidy for the highest 10% of electricity consumption, but at the same time, maintaining the same subsidy for 90% of consumers. **As it is, 10% of consumers with the highest electricity consumption enjoyed 50% of the subsidy. while 50% of the consumers with the lowest electricity consumption enjoy only 10% of the subsidies provided. For 2024,**

Figure 1: Trend in total subsidy outlays



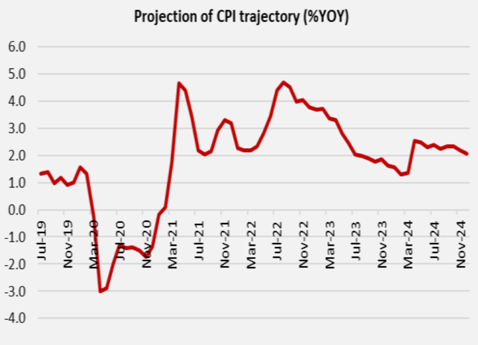
Source: MOF

Figure 2: Subsidies/price-controlled goods as a % of the CPI basket



Source: DOSM, HLBB Global Markets Research

Figure 3: Inflation forecasts



Source: HLBB Global Markets Research

this targeted approach is expected to save over RM4.6bn of the projected electricity subsidy of RM20bn in 2024.

Expect cut in diesel subsidy in 1Q, fuel in 2H

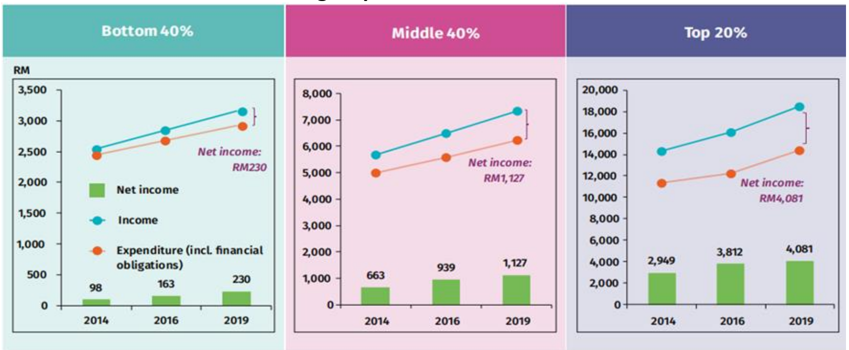
In Budget 2024, the Government also reiterated its intention to rationalise diesel prices in phases in order to prevent leakages. Price of subsidised diesel will, nonetheless, continue to be enjoyed by selected segments such as freight transport. We are expecting this to happen in 1Q and it is expected to ***save the government RM4bn in coffers and expected to send inflation upwards by 0.3ppt, ceteris paribus.***

YB Rafizi also said that the government will roll out the targeted RON95 subsidy measures in 2H of 2024. We have not factored this into our CPI calculation of 2.2% for 2024, but ***fuel as a whole, accounts for 8.5% of CPI calculation***. Thus, every 10% increase in fuel prices ***could potentially send inflation up by approximately 0.9ppts***, ceteris paribus during that month. We expect the top income group to be affected but the impact on saved government coffers will be greater**. *Latest available data from 2009 showed that top 20% of the income group received 42% of fuel subsidy that year.*** News report subsequently reported that top 20% of the income group received 53% of blanket fuel subsidies, quoting YB Rafizi Ramli. Assuming status quo and based on ***RM23.1bn spent on RON95 subsidies in 2022***, this could potentially save the government RM9.8bn to RM12.2bn although we expect the impact to be milder given that the wealthy segment may prefer to use premium fuel, RON97 which is no longer subsidised.

Impact on household spending disproportionate

While the cut in subsidies and consequently, higher prices pose challenges for households, the impact varies from one income group to another. The ***B40 households has higher marginal propensity to consume and spend relatively more on food (35% of monthly consumption expenditure) as opposed to the M40 (30%) and T20 households (23%).*** This, if price pressures are driven by food items, cost of living pressures are disproportionately experienced by lower-income households. The pandemic has brought about weak income growth and gig economy. This means that in the face of marked price increases, some households will face greater difficulty sustaining their consumption. To the extent that lower income households have a relatively smaller net income (income net expenditure and financial obligations), this leaves them relatively more vulnerable to cost-of-living pressures.

Average monthly income and expenditure (including financial obligations) for households in different income group

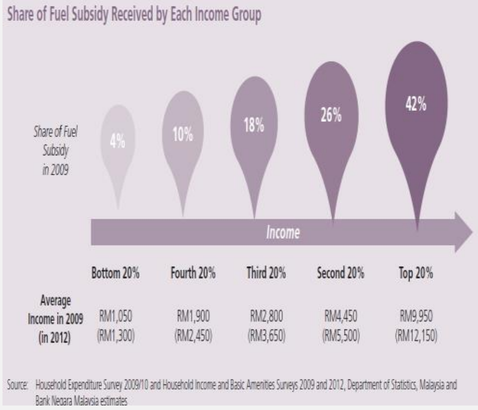


Source: BNM Annual Report 2021

Painful reform over the next 2-3 years: Moving away from cash subsidies, and hopefully, reform of the government revenue

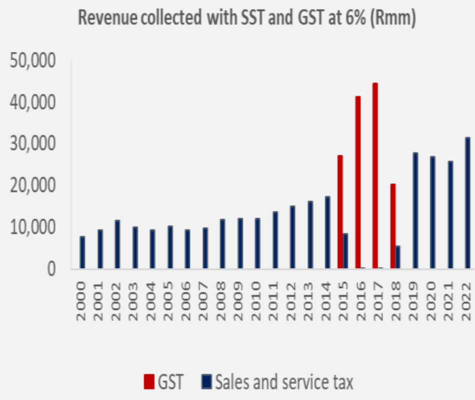
YB Rafizi also reiterated Government's commitment to continue with its unpopular painful reform in the next 2-3 years, moving away from cash handouts and added that "sequencing" of the whole reforms is important. Taking centre stage amidst all this, in our mind, was Government's decision to increase the sales and service tax by 2ppts to 8%, rather than our preferred but unpopular implementation of GST to widen its tax base.

Figure 4: Fuel subsidies enjoyed by income group, 2009



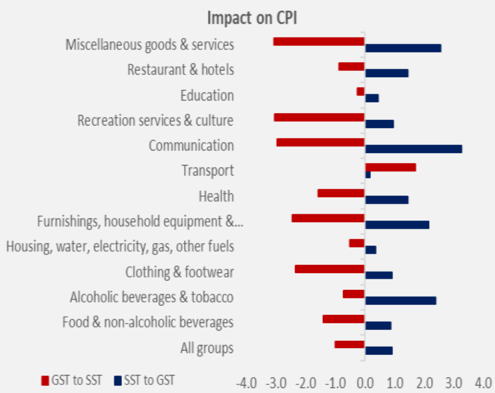
Source: BNM Annual Report 2012

Figure 5: Revenue collection from SST, GST



Source: BNM

Figure 6: GST contributes 1ppts to inflation



Source: BNM

Just a recap, the GST was implemented back in 1 April 2015 at 6% and was subsequently reduced to 0% on 1 June 2018. ***The implementation of GST raised inflation by 0.9ppts during the month of implementation,*** while the reversion back to SST cut CPI by 1.0ppts in that month. The impact, both ways, was consistently and mostly felt within the furnishing household equipment & routine, communication and miscellaneous goods and services.

In terms of government finances, government revenue increased from RM17.2b in 2014 to RM41.2bn in 2016. On a quarterly basis, revenue increased from RM5.2bn in 1Q of 2015 to RM8.9bn in 3Q, effectively raising the government revenue by at least ***$1.0bn per month. This is compared to a RM0.7bn increase in government revenue should the government raise the SST by 2ppts to 8%,*** ceteris paribus. Balancing this against the more manageable inflationary pressures from SST, it is therefore understandable for the authorities to decide on the lesser of the two evils.

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