

21 April 2020

Economic Research

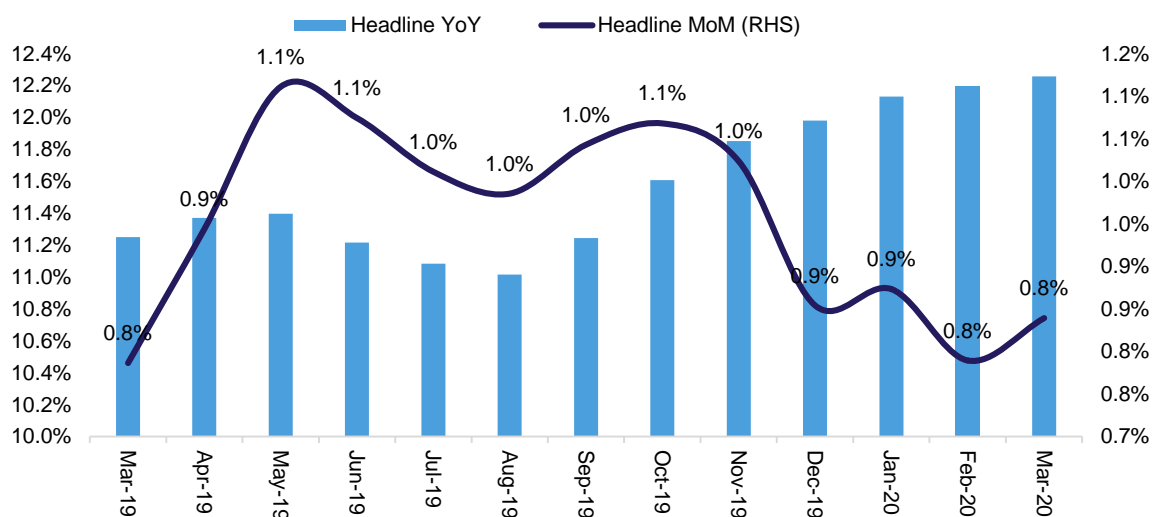
Economic Commentary

Delayed Transmission Softens Inflation Expansion in March

- Headline inflation ticked up by 6bps to 12.26% year-over-year in March
- Core price index grew at a faster pace by 30bps to 9.73% YoY
- Food price index grew by 7bps to 14.98% YoY

Inflation data released by the National Bureau of Statistics this morning showed consumer prices rose by 0.84% MoM in March, coming above 0.79% MoM in February, but below our forecast of 0.93% MoM change. The increase compared to the prior month largely mirrored 7bps MoM increase in both the food and core index to 0.94% and 0.80% respectively. The modest growth in the core and food index largely reflect the delayed transmission of the disruptive impact of the breakup in the supply chain and higher transportation cost of essential items due to the lockdown, both of which should have resulted in temporary higher prices. Going by the breakdown of the food index, the modest increase emanated from a slower expansion in farm produce (+2bps to 0.88% MoM), which neutered increase in processed foods (+62bps to 1.6% MoM). On the core index, Transport sub-index firmed 1bps MoM, while Clothing & Footwear (+3bps to 0.78% MoM), Health (+1bp to 0.81% MoM) and HWEGF (+5bps to 0.60% MoM) recorded modest increases.

Figure 1: Inflation Trend: YoY and MoM

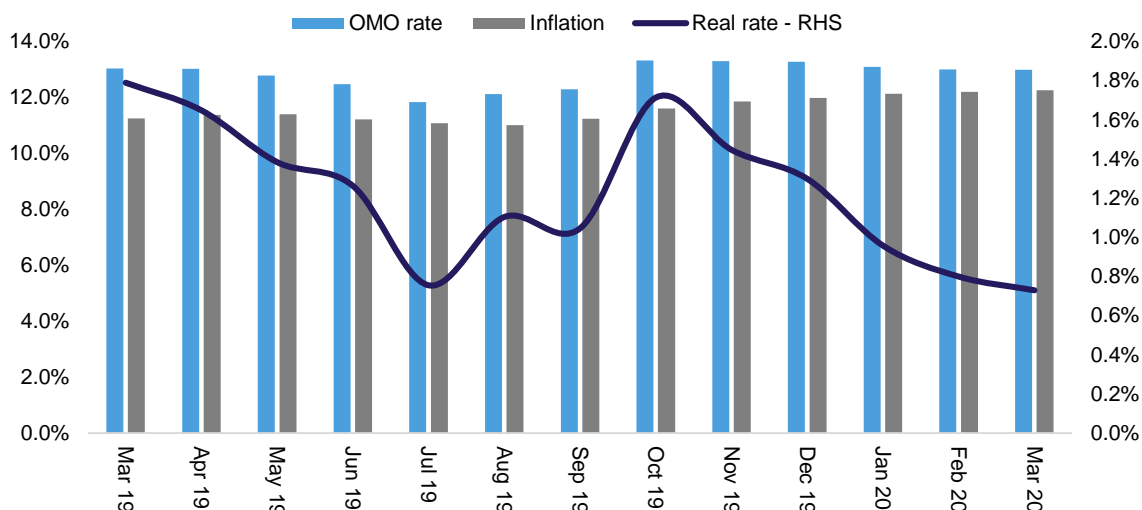


Source: NBS, NOVA Research

Perusing the numbers relative to the prior year, headline inflation expanded by 12.26%, coming ahead of February level of 12.20%. The expansion emanated from increases in both the core and food index. Solidifying the pace in the prior month, the core index surged 30bps to 9.73% YoY, following increases in Furnishing (+12bps to 9.50%), Transport (+6bps to 9.49% YoY), Health (+5bps to 9.99% YoY) amongst others. The food index (+7bps to 14.98% YoY) continues to reflect closure on food prices (with a gradually fading impact as seen in the MoM movement). Relative to same period in the prior year, the food index is 153bps higher than the March 2019 level of 13.45%

YoY while the core index increased by 27bps from 9.46% YoY in February 2019. Overlaying the twelve-month average inflation rate on average fixed income yield of 6.75% and the closing rate of the 364-Day NTB at last week's auction of 4.0%, translates to negative real return of 486bps and 761bps respectively.

Figure 2: Trend in Real Rate of Return



Source: NBS, FMDQ, NOVA Research

While we had stated that the disruptive impact of a breakup in the supply chain would transmit to temporary higher prices (due to feedthrough from scarce imported commodities and higher demand for local substitutes), the abrupt adjustment to the exchange rate and jump in prices of essential items (due to the lockdown) will further magnify the upside in prices. However, we note the downward adjustment to PMS prices, but we believe the impact will be muted since it was not immediately effected across most states and yet to reflect in downward adjustment to transportation expense. Also, the delay in the effective date for the increase in electricity tariff to July still played well with our earlier model. But we expect the impact of the exchange rate depreciation, higher transportation cost of essential items due to lockdown and expected fluctuation in PMS prices due to monthly price modulation (as crude oil prices adjust) to have a combined effect on inflation for the rest of the year.

HWEGF - Housing, Water, Gas, Electricity, and other Fuel