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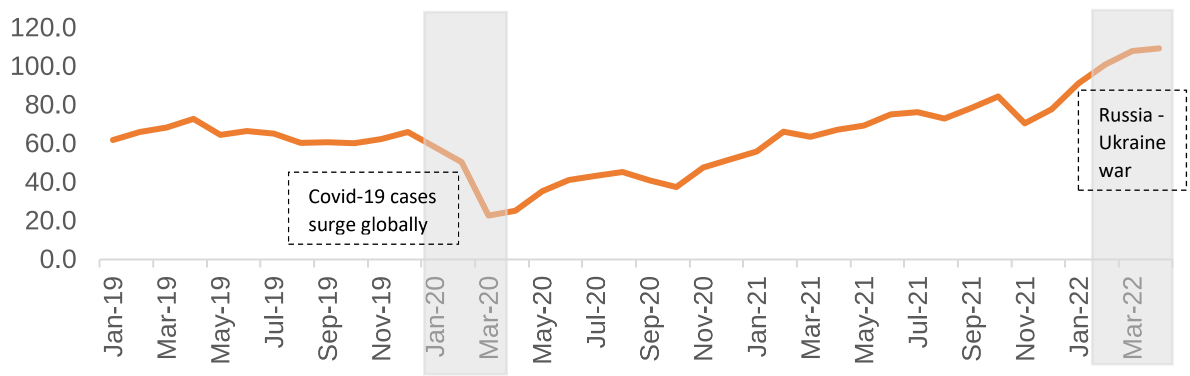
Brent crude oil price plunged to below USD20 per barrel (pb) in Apr-20 as a result of unprecedented Covid-19 pandemic. Nonetheless, **oil price begun to improve and trended upwards since Apr-20 as global demand gradually return coupled up with some supply-side constraints**. In 2021, the average Brent crude oil price stood at USD71pb vs 2020's average of USD43pb. Fast forward to 2022, prices of Brent crude oil surged above USD100pb mainly due to the Russia-Ukraine skirmishes. Up until 17th May 2022, Brent price averaged at approximately USD101pb, **up 61% y-o-y** from the same period last year but has eased from the peak of close to USD130pb in Mar-22.

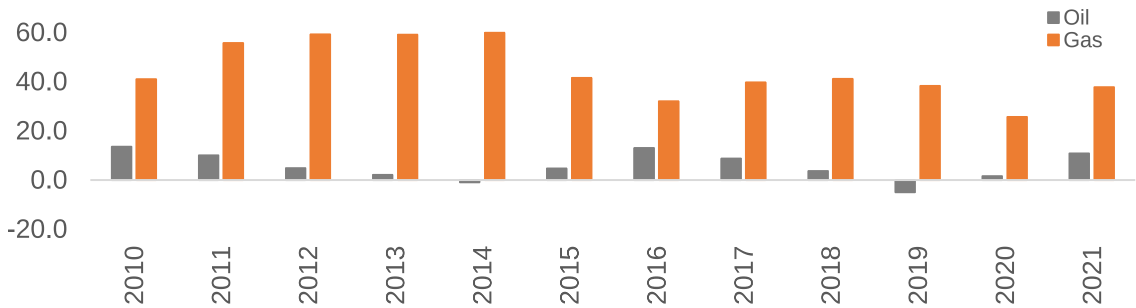
Fig. 1: Brent Price (USD pb)



We expect **Brent price to average between USD100 - USD110pb this year**, driven by a number of factors primarily the (1) **lingering Russia-Ukraine war** as Russia is a global oil & gas (O&G) juggernaut and (2) **OPEC maintaining its existing production** policy which is to gradually increase production by 432k bpd every month (compared to 10mil barrels cut a day last year). Moreover, concerns over **environmental priorities and low investments** in this industry can also underpin **high oil prices for a longer period**.

Generally, high oil prices are good for commodity **net exporter nations such as Malaysia**. It is worth noting that our trade balance of refined petroleum had been negative for almost a decade, until the full commencement of the Refinery and Petrochemical Integrated Development (Rapid) project in 2021.

Fig. 2: Petroleum & Gas Trade Balance (RM bil)



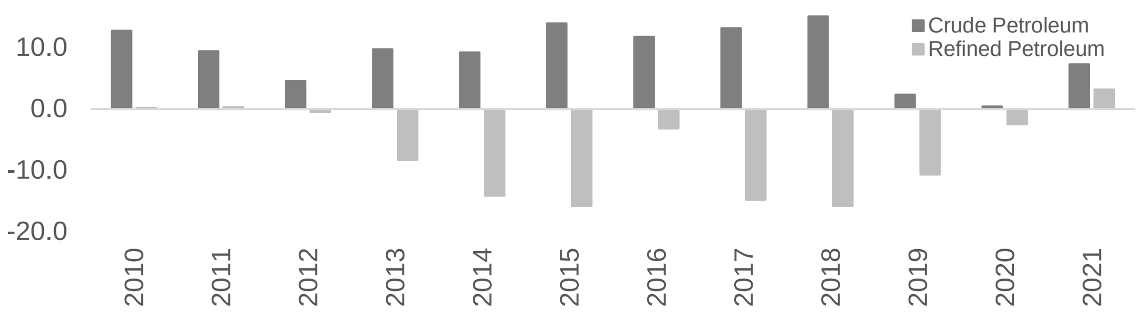
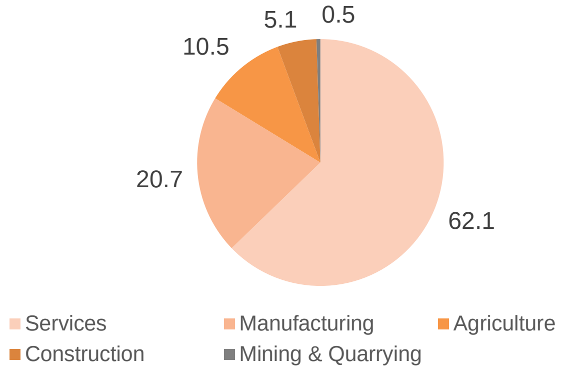


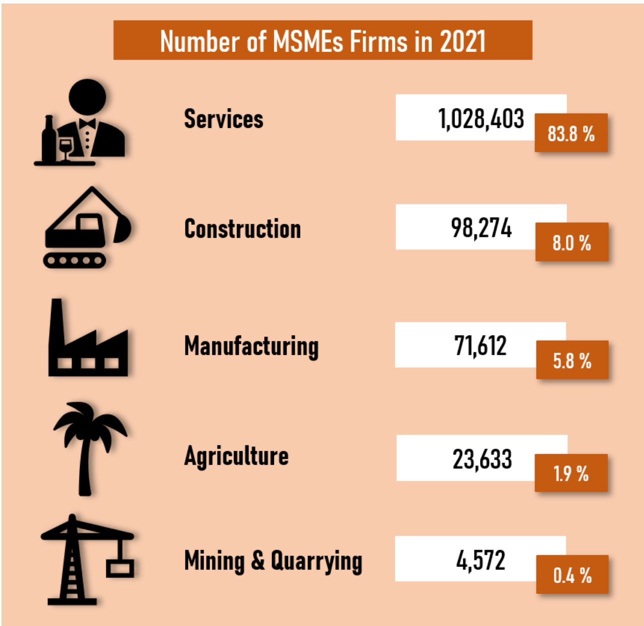
Fig. 3: Crude & Refined Petroleum Trade Balance (RM bil)

Fig. 4: SMEs GDP by Sector (% share)



From a Gross Domestic Product (GDP) perspective, mining and quarrying sector accounted for close to 7% of total GDP in 2021, slightly lower than the pre-pandemic trend of 8%. **Focusing on SMEs**, the **mining and quarrying sector** made up only **0.5% of total SMEs GDP in 2020** (latest data available) due to the **capital-intensive nature and high barriers of entry** in this segment.

Fig. 5: Number of MSMEs firms in 2021



This corresponds to the **number of SME establishments** which is also the **lowest** in mining & quarrying sector. In the latest 2021 Micro, Small and Medium Enterprises (MSMEs) profile, there are 4,572 firms in the mining & quarrying sector or 0.4% of all MSMEs. For comparison, services sector constituted 83.8%, amounting to 1,028,403 firms. Meanwhile, in terms of **contribution of SMEs exports** to the total exports in 2020 (13.5%), the **mining sector was not in the picture** as SMEs exports consisted of manufacturing (9.4%), services (3.9%) and agriculture (0.3%) sectors.

This suggests that while **Malaysia generally benefits from higher oil prices**, the **gain would directly be enjoyed by large firms rather than the SMEs**. Nonetheless, **positive spill over effect to the supply chain**, such as transportation/distribution of fuel, construction/repair of pipelines, cleaning services of sea tankers and engineering consulting services could indirectly benefit SME players that services the mining & quarrying sectors.

While the world is combating the rapid inflationary environment, **Malaysia's headline inflation has remained relatively muted** at 2.3% in April due to government **fuel subsidies**. However, this is **unsustainable in the long run** as escalating oil prices are already pressuring government's fiscal balance given that higher revenue raised from the current oil prices are **inadequate to cover the subsidy bill**. Based on the government's estimation of RM300 mil additional revenue for every USD1pb rise in Brent crude price, Budget 2022's oil price assumption of USD66pb and the current market price at ~USD110pb, there is an upside of RM13.2 bil to the government revenue. However, the fuel subsidy bill of RM28bil incurred would dwarf the increase in oil revenue hence a **net negative impact** on Malaysia's fiscal position. As such, the government has begun to mull over targeted fuel subsidy plans.

Fig. 6: Headline & Core Inflation (%)

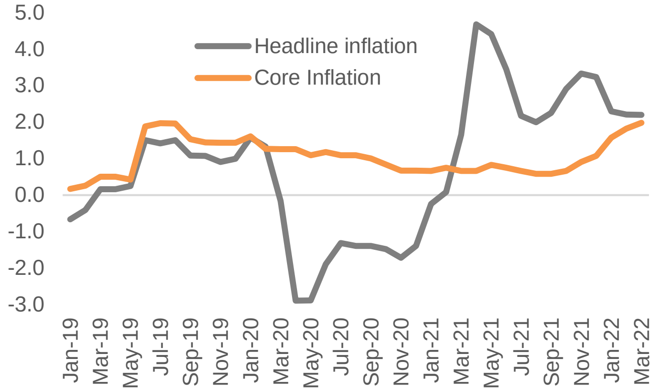
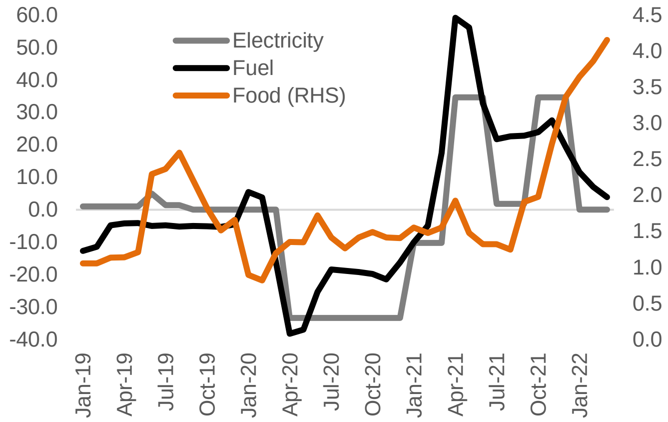


Fig. 7: Components of Consumer Price Index (% YoY)



Even with subsidies in place, Malaysia's inflation is expected to trend higher this year with BNM forecasting headline and core inflation rate within range of 2.2% - 3.2% and 2% - 3% (2021: 2.5% and 0.7%) respectively. **Food inflation soared to 3.9% YoY in 1Q22** (4Q21: 2.7% YoY) attributed to rising commodity prices such as oil and fertilisers, among others.

A research article by Hesary, Rasoulinezhad and Yoshino (2019) has concluded that **oil price shocks would have a significant impact on agricultural food prices, therefore threatening food security.** Although our domestic economy is currently shielded by the fuel price cap, we are still exposed to **imported inflation** given our position as a **net importer of food.**

Potential subsidy rationalisation programme alongside the implementation of new minimum wage and post-pandemic labour shortages, are expected to **drive inflation higher** towards year-end. This will be a burden for producers as it will result in higher production costs. While **large companies have more flexibility** to either absorb the higher cost or pass them on to consumers, **SMEs face bigger challenges and will need to be more creative** in terms of product offerings/differentiation, improve labour productivity, accelerate digitalisation/automation, among others to remain competitive and ensure long-term viability.

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