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Inflation has been on the rise globally as countries began to ease lockdown restrictions. Three main reasons behind the upswing are (1) low base effect, (2) a surge in commodity prices and (3) fiscal stimulus & cash transfers in developed countries that boosted household spending.

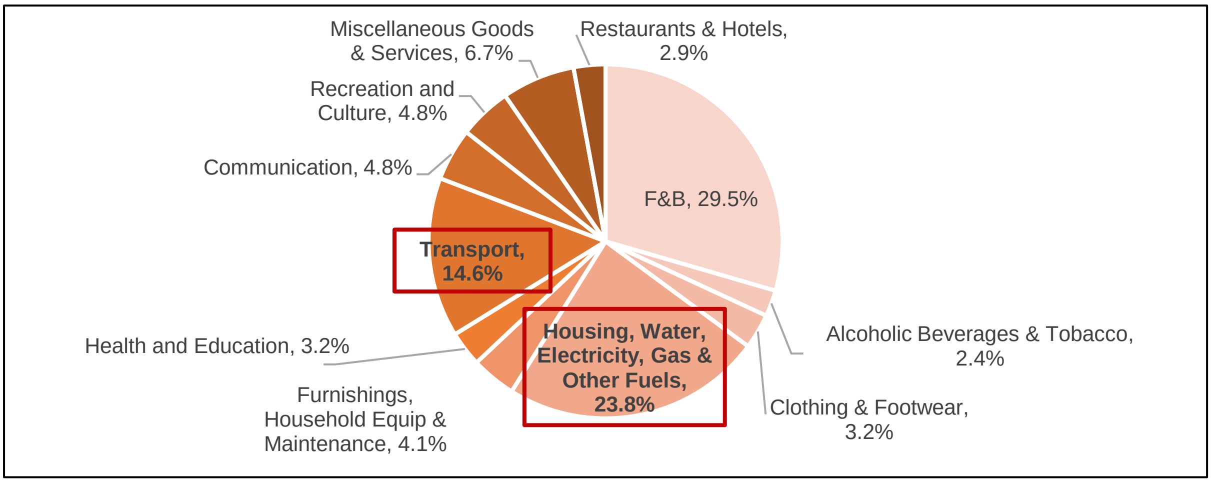
Commodity prices in the pandemic era

A supply-and-demand mismatch has pushed commodity prices upwards. This is attributed to disruptions in industrial production capacity and robust demand for commodities following the reopening of major economies. Commodity price growth is likely to decelerate, albeit remains high, over the medium term as recovery normalises. We expect the y-o-y inflation rate to slow down given the fading of low base effect and the gradual reversal of OPEC+'s production curtailment next year. Nonetheless, dispute between Saudi Arabia and the United Arab Emirates (UAE) – over the extension of the existing deal until December 2022 unless UAE was granted a higher production quota – could derail the unlocking of more crude supply to a tight oil market.

Malaysia's inflation rate to gradually normalise

Headline inflation climbed recently (May 2021: 4.4%), predominantly owing to low base effect from muted fuel prices in 2Q 2020. It is likely to moderate in the near term following the waning of base effect. For 2021, Bank Negara Malaysia (BNM) envisages headline inflation to average between 2.5% and 4.0%, due to cost-push factor of higher global oil prices. Pure cost-push inflation tends to subside quickly. Over the last decade, Malaysia experienced its peak inflation of 4.9% in March 2017, as transport costs climbed on higher fuel prices. In 2018, consumer price index (CPI) subsequently normalised, with a full year average of 1.0%.

Fuel related prices (red boxes) account for 38.4% of Malaysia' CPI basket

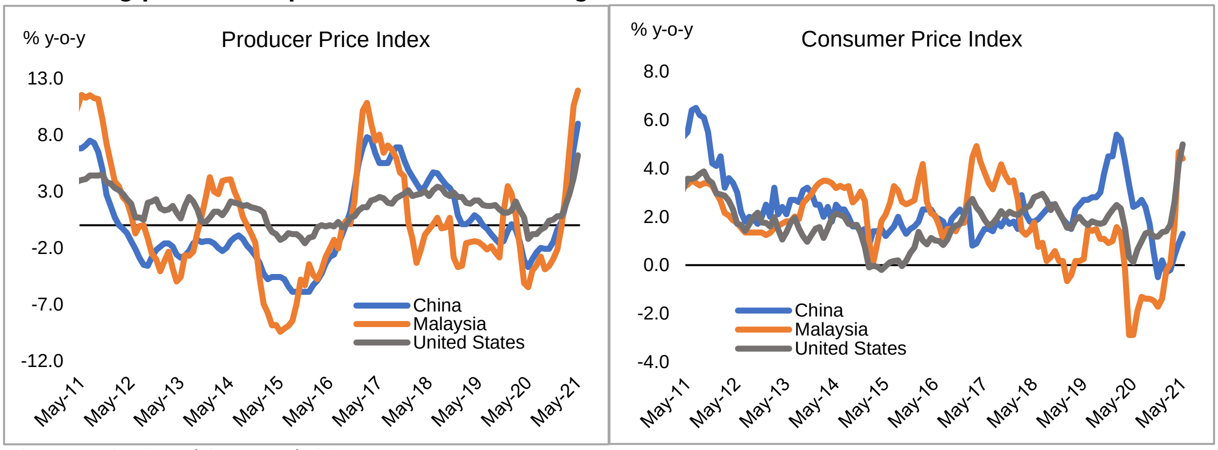


Sources: Department of Statistics Malaysia and SME Bank SCEA

Pickup in price pressure is a global issue but likely to be temporary

On the global front, the United States' (US) CPI recorded a 5.4% y-o-y growth in June 2021, the highest level since 2008. This has raised concerns on the spillover effect to other countries as most assets are priced in USD. While the US Federal Reserve (Fed) allows for inflation to temporarily overshoot its 2% target, recent hawkish comments are signaling the bond purchasing programme to end as early as end-2022 or 2023. The Fed expects the rise in inflation for 2021 to be transitory, notwithstanding a significant upward revision to its near-term inflation outlook.

Mounting production prices in China add to global inflation concerns



Sources: CEIC and SME Bank SCEA

For China, inflationary pressure is reflected more on the producer price index (PPI). It spiked by 9.0% in May 2021, the fastest pace in over 12 years against a backdrop of rising commodity prices. The surge decelerated marginally to 8.8% in June 2021. To contain escalating raw material prices, the Chinese government has been releasing state metal reserves. Meanwhile, we note that CPI remains subdued as the jump in PPI does not fully translate into domestic inflationary pressures (June 2021: 1.1%), given the economy's export-oriented nature. That said, it is slowly trending upwards as food prices rose amid a tight supply, and higher transportation costs remain elevated amid high crude oil prices.

All in all, we foresee global inflation to sustain at a high level in 2H 2021, in line with the World Bank's full year forecast of 3.9% (2017-2019 average: 2.3%), on account of firm commodities prices, heightened production prices in China, supply bottlenecks and accommodative monetary policies.

Impact of inflation & interest rates on SMEs

About 40% of Malaysian SMEs are involved in the wholesale, retail trade & food sector. Considering that food prices account for 29.5% of the CPI basket, rising inflation rate erodes SMEs' profitability as they are not able to pass on cost easily to consumers. Nonetheless, as the temporary inflationary spike gradually eases, cost pressures should also soften over time. In addition to higher costs, SMEs have been facing disruptions arising from the reinstatement of Movement Control Order, affecting their operations since May 2021. This has added on to the plight of SMEs.

Access to credit is critical for SMEs amid this crisis. While persistently low policy rate keeps interest charges low, SMEs may not be able to fully reap benefit from it due to potential difficulties in obtaining credit lifelines from financial institutions. In view of that, SMEs should be looking at all the special financing packages announced by the government and BNM, aimed at providing easy and cheap financing to keep businesses afloat. These financing facilities are offered through SME Bank and commercial banks.

We are of the view that BNM would retain the overnight policy rate at 1.75% for the rest of 2021. This is premised on sturdy demand in the external sector, relatively high inflation rate, and an assumption of a gradual reopening of domestic economy in line with the National Recovery Plan. To date, 8 states have migrated into Phase 2 of the Plan, namely Perlis, Perak, Terengganu, Pahang, Kelantan, Penang, Sabah and Sarawak.

Targeted initiatives by the government for SMEs

Programmes	Details
Financial support from BNM	An additional RM2 bil is allocated under the latest Pemulih package. To date, there is still an existing RM6.6 bil out of RM25 bil provided for the benefit of new applicants.
Prihatin Special Grant	First issued last year, the grant has helped more than 900,000 SMEs, with a total allocation of RM3.58 bil. Under Pemulih, each participating business will receive an extra RM1,000.
Government guarantee scheme by Syarikat Jaminan Pembiayaan Perniagaan Berhad	The ceiling of the scheme for 2021 was raised to RM36.5 bil from RM10 bil. The minimum financing amount is RM100,000 and the maximum is RM10 mil.
Financing facilities by Bank Simpanan Nasional, AgroBank, and the National Entrepreneur Group Economic Fund	This additional funding of RM1.1 bil, together with existing funding, means some RM3 bil in micro-financing is available.
6-month loan moratorium	Since the introduction of the Pemerkasa+ package, over 250,000 borrowers benefitted from the initiative.

Sources: Ministry of Finance, ASEAN Briefing and SME Bank SCEA

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