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The ringgit tends to strengthen when the oil price rises, especially if oil price movements are sharper or more volatile



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PETALING JAYA: The government's decision to postpone the petrol subsidy programme (PSP) may backfire, if the US-Iran conflict is prolonged and results in soaring crude oil prices.

According to a report by CGS-CIMB Research yesterday, the government may likely be hit by higher fuel subsidies and its fiscal balance will be strained, in the event of a global oil price shock.

Assuming Brent grade crude oil prices increase further to US\$70 per barrel, from the current level of about US\$65, the government will have to fork out additional subsidy payment of RM4.36bil.

This is significantly higher than the RM2bil fuel subsidy allocation under Budget 2020, stated CGS-CIMB Research.

While the higher oil prices will also raise the federal government's revenue, an Brent oil price of US\$70 per barrel will only add RM2.1bil more into the national coffers – leaving a revenue shortfall of RM2.26bil.

It is worth noting that Budget 2020 is based on an average oil price of US\$62 per barrel for the year.

Beginning January 2020, the PSP was supposed to be implemented in Peninsular Malaysia, which will see RON95 and diesel retail prices being gradually floated according to market prices.

Meanwhile, those in Sabah and Sarawak will continue to enjoy a fuel price ceiling of RM2.08 per litre for RON95 and RM2.18 per litre for diesel.

However, a Cabinet decision on Dec 18, 2019 has postponed the implementation indefinitely.

Higher fuel subsidy poser

Income from higher oil revenue won't cover subsidy if US-Iran conflict prolongs

Domestic Trade and Consumer Affairs Minister Datuk Seri Saifuddin Nasution Ismail had said that the postponement was to allow for more sessions to be conducted to better prepare Malaysians to accept the PSP.

He added that the registration process of recipients under the M40 group would be conducted by the Finance Ministry.

Concerns on global crude oil prices have risen following the geopolitical instability in the Middle East.

For context, the US-Iran conflict began after the US killed Iran's most influential general, Qasem Soleimani in an air strike. In retaliation, Iran launched missile attacks on two Iraqi military facilities hosting American troops.

If the US-Iran conflict leads to protracted oil price shock, it is expected to weigh on Malaysia's medium-term outlook.

However, in the immediate term, Malaysia stands to be an immediate beneficiary of US-Iran tensions,

given its status as a net oil and gas (O&G) exporter.

"As a net O&G exporter, Malaysia's current account is insulated from the full force of sharp oil price spikes. Although Malaysia ran a net petroleum deficit of RM9.4bil in the first 11 months of 2019 – with refined petroleum product net imports (RM10.7bil) outweighing crude petroleum net exports (RM1.3bil) – a large chunk of the energy trade surplus is contributed by liquefied natural gas (LNG) (RM32.9bil).

"Hence, if LNG moves in lockstep with oil prices or substitute for potentially displaced crude supply from the Middle East, Malaysia's current account position stands to benefit to the tune of 0.1% to 0.2% of gross domestic product per US\$10 per barrel," said CGS-CIMB Research.

In comparison to other Asean countries, the research firm opined that Malaysia is better placed to weather temporary oil prices spike,

largely due to the country's sizeable energy trade surplus.

Meanwhile, an analysis into historical trend showed that while ringgit tends to strengthen when oil price increases, the correlation is stronger during periods of sharper or more volatile oil price movements.

"In recent years, the ringgit has exhibited positive correlation to oil prices except in 2016 due to sharp foreign outflows from Malaysia's bond market, putting it alongside the Singapore dollar as relative safe harbours in Asean, while Indonesia, the Philippines and Thailand have tended to experience depreciations as a result of higher energy import bills and deteriorating current account positions," the research firm said.

Meanwhile, AmBank Group chief economist Anthony Dass said in a note that investors could rush towards the US dollar, depending

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Ringgit can reach 4.00 by year-end

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on the intensity of the US-Iran tensions.

If this happens, the demand for ringgit will be weaker and would result in depreciation against the greenback.

However, for now, Dass pointed out that there is room for a stronger ringgit.

"The ringgit could reach 4.00 by end of the year against the US dollar from 4.11 in the first quarter of 2020 (1Q20).

"Conservatively, the ringgit could touch 4.18 by end-2020 from 4.11 in 1Q20," he said.

In a separate note yesterday, CGS-CIMB Research explored the potential impact on the stock market as a result of the rising crude oil prices.

Historically, there is a positive correlation between Brent crude oil prices and the FBM KLCI - barometer of Bursa Malaysia.

The correlation could partly be due to Malaysia's net O&G exporter status and the fact that the ringgit typically strengthens during periods of high crude oil prices.

Sector-wise, key beneficiaries are O&G and plantation players, while airline, shipping, rubber gloves and petrochemical companies may be impacted due to higher operating costs.

"Potential winner in the short term from higher oil prices is Dialog Group Bhd. We maintain our end-2020 FBM KLCI target of 1,636 points, but near-term market sentiment may be adversely impacted if the US-Iran tensions escalate.

"Our top three picks are Pentamaster, Yinson Holdings and Tenaga Nasional," it said.