TENAGA NASIONAL

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Inflation in 2014: Just a spike or start of a spiral?

THE inevitable cannot be avoided. Come 2014, which is just about two weeks away, inflation – the economic scourge that consumers dread the most – is at the doorstep of Malaysia's economy, waiting to rear its ugly head again.

For the last 40 years, the inflation rate as reported by the Statistics Department was rather benign, averaging 3.7% annually, rearing its ugly head only once in March 1974 when it hit 23.9%. The four-decade trend gave no nightmares to consumers. But for 2014, consumers are already getting the jitters, as higher property assessment, power, and possibly fuel, not forgetting the withdrawal of sugar subsidy, will cause a cascading effect on prices of food, rent, and other services, eating deeper into consumers' almost empty pockets. With monthly wages of most consumers stagnating, and expected to remain so in the foreseeable future, the standard of living is sure to drop a notch or two, forcing many, especially those in the lower-income group, and those living in urban areas, to seek a second job just to survive.

Inflation in the form of higher prices of goods and services will certainly happen. But whether the inflation will still be due to cost-push factors, as most economists argue it to be, or whether there will also be an element of demand-pull as well, remains debatable. (In simple terms, cost-push inflation is where prices of goods and services rise due to higher prices of raw materials that go into making the product or service. Demand-pull inflation is where the prices of goods and services rise due to a higher demand as a result of higher spending power.) Next year's rise in power tariffs for commercial and industrial users will raise production cost, which will eventually be translated into higher selling prices to consumers.

Tenaga Nasional had announced that commercial and industrial consumers' power bills would be increased by an average 16.85% – 1.2-18% for the former, and 0.9-17% for the latter. Already, retailers and small and medium industry (SMI) producers are sounding the alarm that the increase of 6.91-sen/kilowatt-per-hour (kWh) for commercial users and 5.21-sen/kWh for industrial users are "shocking" and "too big", thus forcing them to "have no choice but to pass on the increase" to consumers. Electricity is an important component of total manufacturing costs, in the range of 6-16%. For SMIs, the higher power cost will certainly put their 3-8% profit margins under pressure. For commercial users, the average rise in power cost will reduce their earnings by 2-4%, leaving them with a 1% profit margin.

Shopping malls are hard hit, as electricity is the single largest expenditure, thus impacting their competitiveness and status as a shopping destination. Among retail outlets, food and beverage, which consume the most electricity, will be worst affected as power makes up 10-15% of total operating costs. But Bank Negara governor Tan Sri Dr Zeti Akhtar Aziz was quite optimistic when she said that businesses could absorb the power tariff increase, due to two reasons – growing demand for products, and firms exploring cost-saving measures. Thus, firms "don't have to pass on everything to the consumers". Bank Negara has estimated that the new tariff will directly affect only 30% of users.

For consumers, Christmas and Chinese New Year are seen as "bleak and gloomy". First came the rationalisation of the fuel subsidy in September when the pump prices of RON95 petrol and diesel were raised by 20 sen per litre. At the same time, the 34-sen per kg subsidy on sugar was removed. Next came news of the imposition of a 6% goods and services tax, replacing the

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10% sales tax from April 1, 2015. Then, Kuala Lumpur City Hall raised assessment rates – which upset everyone, arguing the rates were "too high", and unilaterally imposed. Now, the new power tariffs will add another burden to consumers, come 2014.

Though some may argue that further increases in basic amenity charges may not be forthcoming next year, many think otherwise. Certainly it will not be the end, as the government has said it would continue with the subsidy rationalisation programme, which in essence would mean doing away with subsidies, and which in turn would mean higher prices for food, fuel and services. Energy, Green Technology and Water Minister Datuk Seri Dr Maximus Ongkili did not discount the possibility of further increases in fuel prices next year. Higher fuel prices will force manufacturers, especially the SMIs, to raise the retail prices of their products.

With such continuous push on costs and ultimately on prices, many are now doubting Bank Negara's argument that higher consumer demand in the domestic market could even materialise, at least for 2014. The belief that the higher power tariffs could trigger another surge in inflation may just hold water. Many also believe that by itself, the higher power tariffs may not push the inflation rate to exceptionally high levels, but taken together, all the cost-push factors could cause a significant rise.

Already, Maybank Investment Bank has revised its 2014 inflation rate for Malaysia to 3.3-3.7%, up from 3-3.5% previously. The revision is based on electricity rates, which make up 2.9% of the consumer price index, and the weighted total average tariff hike from both the direct impact through household bills, and the potential pass-through impact from commercial and industrial users. Add to this is the possible increase in fuel prices. But Bank Negara's assessment shows that the new power tariff will increase inflation by only 0.4 percentage points, bringing the rate to just over 3% based on the current rate of 2.8%. Zeti said: "We don't look at month-to-month. We look at the trend, and our assessment is this adjustment is going to have a temporary effect on inflation." She was also quoted as saying that the country could tolerate higher inflation if this was temporary.

Bank Negara reported in November that the average inflation rate for third-quarter 2013 had increased to 2.2% – the highest since the 2012 fourth-quarter, due to higher inflation in transport and food. This came after inflation rose to 2.6% in September – the highest in 2013, after the fuel price increase. So, many are asking: Will inflation in 2014 be a "temporary" spike as Zeti said it would, or will it be the start of a prolonged spiral, upwards?

One factor that may add fuel to inflation is the substantial pay rise of state and federal people's representatives. It started in May when Sarawak agreed to triple the pay of its assemblymen, including the chief minister, deputy chief minister, senior minister, state assembly speaker, ministers, assistant ministers, assembly deputy speaker, and political secretaries. Then, Selangor followed when its legislative assembly passed a 268% pay rise for the menteri besar, speaker, deputy speaker and assemblymen. Next came Penang with a proposal to raise salaries and allowances, and Johor has also indicated it would follow suit. Then, salaries and meeting allowances of federal lawmakers are also expected to more than double under a proposal submitted last week.

All these certainly do not go down well with the average consumer, who is bracing for higher retail prices and whose income has been stagnant for some time. Statistics Department records show the average Malaysian household income rose from RM4,025 in 2009 to RM5,000 in 2012 – only a 7.2% increase. So, were the cash handouts, including the people's aid programme BR1M, which started in the weeks leading to the general election, a move to ensure that increased consumer demand would balance out the cost-push factors? It is possible that the limited scope of households getting the substantial salary increases may not justify a substantial increase in the demand-pull factors to result in higher inflation.

Many say it is likely the bulk of the increased earnings may end up chasing property, audio-visual consumer products, and home electrical appliances, thus causing prices of these products to rise. This is bad enough for the ordinary consumer, and may even widen the gap between the haves and have-nots. FocusM

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Third Eye

BY **PY CHIN**

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Consumers are worried that the higher power tariffs to be imposed from Jan 1 could spark another surge in inflation