

ECONOMIC UPDATE

INSAP Expects High Cost of Living in the Coming Months

Edwin Oh Chun Kit and Dr Khairul Rafiz

Understanding CPI from a consumer lens

The Consumer Price Index, which is a key economic indicator that acts like a magnifying glass which allows us to deep dive into trends reflecting average change in cost of purchasing a specific basket of goods and service over a period of time. Why is this important in terms of our daily live consumption?

This is because when CPI goes up, it means that the cost of our items (think groceries, clothes, medical expenditure) is going up. This phenomenon in economic terms is known as inflation. In simple terms, this would feel like your paycheck shrinking even when your salary has not actually changed. In contrast if CPI goes down, this is like finding out you have a special discount card in your wallet as goods or services you often consume becomes cheaper.

So, the CPI is not just another economic statistic. This is a window, looking into our own purchasing power where it acts as a signal of how much one person's hard-earned money can buy.

Malaysia: Stable CPI?

INSAP has found that as per latest available data (January 2024), Malaysia's inflation rate has held steady at 1.5% since November 2023¹ which on the surface would essentially provide an impression that prices of goods and service we use in our daily lives are still provided at similar selling prices. However, don't let these numbers fool you.

While this steady rate might sound manageable at first glance, like a single price tag on a grocery item, it doesn't tell the whole story. Remember, this 1.5% is just an average across a wide basket of goods and services. Just like a grocery list, it can vary wildly depending on your needs and preferences, so too can the impact of inflation on your wallet.

¹ Consumer Price Index, January 2024 <https://newss.statistics.gov.my/newss-portalx/ep/epFreeDownloadContentSearch.seam?cid=58205>

We view the current 1.5% as a temporary lull rate as we anticipate that the Consumer Price Index (CPI) will break this mark in the near future, moving upwards resulting in a faster pick-up of prices. This view is based on several factors, mainly including: (1) The expansion of the Sales and Services Tax (SST) coverage² and a 2% increase in the rate for certain categories (from 6% to 8%). While items like food, beverages, and telecommunications are excluded³, this tax increase could have a ripple effect on other goods and services and (2) The lagging impact of previous tariff hikes and the implementation of the 10% Low-Value Goods (LVG) tax earlier this year. These measures may take some time to fully show their effect on prices.

INSAP also digs deeper into available data where we find that many essential items you need every day is creeping up in price, even while the overall inflation rate appears stable.

Food

INSAP found that prices continued the general upward trend in January 2024, rising 0.3% from December 2023 driven mainly by the increase in prices of vegetables and meat. This marks eight out of the past nine months with price increases, with only a brief dip of 0.3% observed in November 2023. On average, food and beverage prices have increased by 0.2% per month over this nine-month period (May 2023 - January 2024). Within the food and beverage category, vegetables⁴ prices exhibited the most significant month-on-month rise in January 2024, increasing by 2.1%.

So, what does this mean for you? While the average monthly increase might seem like a sprinkle of salt into the ocean. Remember, these small rises can quickly turn into a full-blown basket of added costs, especially for everyday essentials.

Fish and other seafood prices experienced a slight decrease of 0.4% in the same period. Notably, throughout 2023, fish and seafood prices exhibited the most frequent month-on-month decreases compared to other food and beverage subgroups. Does this mean that it is cheaper to consume seafood?

² <https://www.thestar.com.my/news/nation/2024/02/27/service-tax-for-logistics-and-digital-services-gazetted>

³ https://www.malaysianbar.org.my/cms/upload_files/document/Circular%20No%20067-2024.pdf

⁴ Also includes tubers, plantains, cooking bananas & pulses

Amidst the scorching heatwave in Malaysia, local fishermen have expressed that this benefited them with an ample supply of all types of local fish, squid and prawns sourced from nearby farms and fishermen.⁵ However, if this prolongs there could be a negative side of things as well. While the hotter condition provides this temporary surge in catches (particularly of farm-raised and near-shore species), the hot weather would lead to coral bleaching which weakens and even kills coral reefs.⁶ These underwater structures are vital for demersal fish like snapper and grouper, providing them with food, shelter, and breeding grounds. If the reefs get bleached, these demersal fish populations would be negatively impacted which then would eventually increase prices of these fish (cod, grouper, red snapper, halibut) in a long run despite potentially lower prices initially.

On the other hand, pelagic fish like tuna, which reside closer to the surface, has a possibility to react in another way to the heatwave by migrating to deeper, cooler waters. This redistribution in a long run could force fishermen to travel further and potentially adjust their fishing methods to reach these fish, impacting their overall catch. When supply falls, prices (and CPI) will rise.

Also, reported troubles in the local fishing industry⁷ might prompt more seafood imports. For instance, The Japan External Trade Organization (Jetro) is expecting an increase in Japanese seafood exports to Malaysia this year in view of the boom in the tourism industry and the weak yen.⁸ Given these imports are usually more expensive, this would not provide significant competition in terms of price to the local market. This means it would not be a major factor in driving down or stabilizing overall seafood prices.

As for ready-made food and other food products, this category experienced consistent month-on-month price increases throughout 2023, highlighting a unique trend within the broader food and beverage sector. This particular trend could be potentially driven by rising raw ingredients and production costs.

⁵ <https://www.straitstimes.com/asia/se-asia/vegetable-fish-vendors-in-malaysia-enjoy-great-yield-with-prolonged-dry-spell>

⁶ <https://www.channelnewsasia.com/podcasts/fishing-malaysia-dwindling-supply-cna-correspondent-podcast-4119331>

⁷ <https://www.channelnewsasia.com/asia/malaysia-fishing-industry-fishermen-food-climate-change-sustainability-4056331>

⁸ <https://www.freemalaysiatoday.com/category/business/2024/02/11/japans-seafood-exports-to-malaysia-expected-to-increase-in-2024/>

Housing, Water, Electricity, Gas and Other Fuels.

The CPI has experienced an uptick of 0.4% in January 2024 from the previous month. This basket only experienced stagnancy or increase in 2023, raising concerns about potential long-term inflationary pressures within this specific category.

Our analysis suggests a potential increase in retail fuel prices is likely with the implementation of the targeted fuel subsidy program in the latter half of the year. This program, expected to roll out as early as the second half of 2024⁹, could contribute to an overall inflation rate. To mitigate the potential impact on consumers, the government is considering a managed-float price mechanism for RON95, coupled with targeted cash assistance to eligible individuals identified through the Central Database Hub or also known as PADU.¹⁰

While the targeted fuel subsidy aims to soften the blow, rising retail fuel prices could still have a negative cascading effect. We could see a rise in the cost of living (CPI) for this basket due to increased transportation and production costs especially for those groups whom are not covered along with the potential introduction of market volatility

In addition to the increases in water¹¹ and electricity¹², tariffs observed in 2024 while the CPI for water supply and miscellaneous dwelling-related services rose by 7.4%, with sewage collection experiencing a more significant increase of 58.7%. These significant increases are likely to exert further upward pressure on the CPI in the coming months, as INSAP anticipates continued increases on a month-on-month basis.

Health

The Consumer Price Index (CPI) for health has been steadily climbing, with a 0.15% increase in January 2024 alone driven mainly by increase in prices by health supplements, medical diagnostic products and treatment devices (for personal uses). As Malaysia rapidly

⁹ <https://www.thestar.com.my/news/nation/2023/11/28/targeted-fuel-subsidy-to-roll-out-mid-2024>

¹⁰ <https://www.freemalaysiatoday.com/category/business/2024/02/23/economists-forecast-2024-headline-inflation-to-rise-2-5-3-3/>

¹¹ <https://www.thestar.com.my/opinion/letters/2024/01/18/poor-timing-for-water-tariff-hike-says-insap>

¹² <https://www.thestar.com.my/news/nation/2023/12/23/price-of-electricity-to-go-up>

ages, projected to reach "aged nation" status by 2040, rising healthcare costs pose a significant threat to the country's future.

On a side note, the recent decline in the value of the Malaysian Ringgit carries a hidden risk for Malaysia's healthcare system, despite the Health Minister, Dzulkefly Ahmad's assurances that current medicine procurement is shielded by "locked-in" prices.¹³ While this "locked-in" pricing strategy offers temporary relief, it's crucial to acknowledge its limitations and develop long-term solutions to address the potential challenges arising from the ringgit's decline. When these "locked-in" prices eventually expire, the full impact of the ringgit's depreciation will be felt, potentially leading to significant price hikes and a sudden heavy financial burden on these group of consumers.

The extent of these locked-in prices remains unclear, potentially covering only a specific portion of medicines or a limited timeframe. Additionally, future procurements would not benefit from this arrangement, leaving them susceptible to future price hikes linked to the weakened ringgit which is projected to slide further. This could lead to increased government spending, straining the healthcare budget and impacting other vital areas, in a long-term run.

Look beyond the CPI

While the headline CPI may appear stable at a glance, a closer look reveals a more concerning reality. Essential items like food, water, and healthcare are experiencing consistent price increases, painting a clearer picture of the rising cost of living for Malaysians. With the implementation of new taxes, subsidy adjustments, and the potential impact of a weakening ringgit, the situation is likely to further escalate in the coming months.

In light of these concerns, the government needs to prioritize policies that mitigate the impact of rising inflation on vulnerable groups. More importantly, there is an urgent need for monitoring the direct and indirect spillover impacts from the new taxes over a longer period of time. With consistent and transparent monitoring, the administration would be in greater position to be able to implement temporary intervention and control measures. Fostering economic diversification is also crucial to decrease dependence on imported

¹³ <https://www.msn.com/en-my/health/other/govt-has-locked-in-cost-of-medicines-from-overseas-says-dzul/ar-BB1iO6gQ>

goods, especially essential items like food and energy. This could involve supporting domestic agricultural production, investing in renewable energy development, and promoting import substitution initiatives.

Bridging the gap between perceived and actual inflation

There is always a fine line between perception and reality in economics. One of those important questions is whether the official CPI inflation represents the real shift in the cost of living. The general public's experiences indicate that the cost of living has increased more than the relatively modest CPI inflation over the last two years. As a result, there is doubt about the CPI's accuracy in predicting changes in the national cost of living. Public scepticism on the CPI has grown as their own experiences point to a higher cost of living increase.

However, the public's view of inflation could be biased, measures of perceived inflation were greater than CPI inflation because of the biases, particularly during periods of increasing inflationary pressures. Expectations about future inflation are a major factor in driving inflation, as those views about consumption and investment have an impact on current prices and wages. Concerns about inflation could become entrenched, heightened by the price increase, making it much more important to think carefully about how the government should educate people about it.

“Perception is real, even when it is not reality” a quote by Maltese physician and commentator Edward de Bono that aptly describes our situation. To heal the disconnect between the cost of living and the reported CPI inflation, the government should employ a multifaceted strategy that takes into account both communication and resolving underlying problems to close the gap between perceived and actual inflation in Malaysia, ignoring or being defensive over public grouses which only worsens disconnection.

In addition to the orthodox methods of increasing openness, public education, and consistent communication through various channels and platforms, the government should begin by acknowledging that although official statistics are important, people's perceptions of inflation may differ based on their individual spending habits and experiences. Being honest when addressing these concerns and offering plausible justifications for the

disparity is advised. Utilize real-world examples and focus on specific goods and services that most affect Malaysians, such as groceries or daily expenses. This makes it easier for consumers to relate to the facts and comprehend how it affects them personally. Rather than downplaying, dismissing, or being defensive, the government, policymakers, and pertinent agencies should acknowledge the "feel" of inflation and concentrate on relatable examples.

It is also imperative that the government address underlying factors behind inflation, and chief among them is to communicate realistic expectations about future inflation and the government's plan to address it. This helps to avoid public panic and build trust in economic policies. As per our observation, there is more room for improvement for the government to better manage public expectations on controlling the inflationary phenomenon. By effectively communicating and addressing the root causes of inflation, the government can bridge the gap between perceived and actual inflation and ensure the public has a clear understanding of the inflationary environment and economic situation.

Inflation uncovers deeper issues in Malaysia

Malaysia's recent inflation surge has ordinary citizens feeling the pinch at the grocery store and beyond. While rising costs for everyday goods are a concern, economists see this as a symptom of deeper problems within the Malaysian economy.

One key factor is reliance on imports. Malaysia brings in a substantial amount of its food and other necessities. When global prices climb or the Malaysian Ringgit weakens, the cost of these imports increases. The pandemic and ongoing geopolitical tensions have also played a role, disrupted supply chains and caused shortages that push prices higher. Additionally, if the Malaysian economy isn't becoming more productive, it may struggle to keep pace with rising costs. Even government policies, like subsidies, can have unintended consequences, fueling inflation.

The government's response will be crucial. They have a toolbox of monetary and fiscal policy options to try and curb inflation. However, external factors like the war in Ukraine and global commodity prices will also play a part. For Malaysians, this period of inflation highlights the need for a more resilient and productive domestic economy. The coming

months will be telling, as we see how the government addresses these challenges and Malaysians navigate this period of rising costs.

Rising prices test Malaysia's social safety net

Malaysians are feeling the pinch of inflation, with rising prices for everyday goods straining household budgets. This economic pressure is putting the country's social safety net to a critical test.

Low-income families like B40 and those who rely on government assistance programs are particularly vulnerable. As the cost of essentials like food and shelter climbs, existing support systems may struggle to keep pace. The government may face tough choices about allocating resources, potentially leaving some in need behind.

This situation underscores the critical role of a robust social safety net in programs such as Bantuan Sara Hidup (BSH), Bantuan Awal Persekolahan (BAP) and Bantuan Warga Emas (BWE), Bantuan Orang Kurang Upaya (OKU), and some other contributory programs where employees and employers make mandatory contributions with benefits such as pensions, healthcare and employment injury compensation such as EPF, SOCSO and SESSS. Strengthening these programs and ensuring they reach those who need them most will be crucial in weathering the current economic challenging time.

In addition, Malaysia's social safety net has shown its worth, but gaps remain. Many who need help fall outside the programs, and rising inflation risks leave even those covered struggling to make ends meet. Targeting the right people efficiently is crucial, but so is ensuring adequate benefits. While funding these programs is a strain, the alternative of neglecting vulnerable Malaysians during challenging economic times could be far costlier in the long run. It's time for the government to address these challenges head-on to ensure a robust safety net that protects all Malaysians.

Targeted policies aimed at addressing the root causes of inflation while providing specific support to vulnerable populations are essential, the public rightfully expects more proactive and tangible actions to be taken by the government to improve the situation, but it leaves

much to be desired at this moment. By taking proactive measures, the government can navigate this period of rising prices while protecting the citizens' well-being.

Will rising inflation dampen PADU and Progressive Wage benefits?

The government's targeted subsidies (PADU) and Progressive Wage Model (PWM) aim to improve lives and wages. But will rising inflation dampen their impact? With gloomier days expected ahead following the recent SST hike, increase in water and electricity bills at the turn of the year and the dreadful cascading effect, Malaysians are increasingly concerned about the apparent solutions or targeted supports that the government has put forth to shield the people especially the poor and vulnerable from economic shocks and difficulties.

PADU provides aid to those who need it most. However, inflation can erode the value of these targeted subsidies over time. The government would need to adjust PADU payouts to ensure they maintain their purchasing power. While PWM promises gradual wage increases based on skills and experience. These hikes could help offset inflation's pressure, but the key is how fast wages rise compared to inflation, which may open up another Pandora's box

PADU and PWM are steps towards a fairer economy, but they are at an early stage and need fine-tuning for inflationary times. The government's commitment to adjustments and proper execution will be crucial. Balancing wage increases with managing inflation is key to avoiding a wage-price spiral.

Consumers feel the pinch, but hope remains as Malaysia navigates economic headwinds

Malaysia's economy faces a bumpy road ahead. Rising prices and stricter financial regulations are expected to slow growth, potentially affecting job security. Consumers will likely feel the pinch with declining purchasing power. However, there's still a silver lining. Consumer spending has a significant impact on the economy, and informed choices can influence the market.

The Anwar administration, grappling with a challenging economic landscape inherited from 2023, it has focused on long-term solutions. The Madani Economy policy framework

emphasizes sustainability and responsible growth. Additionally, the National Energy Transition Roadmap (NETR) and the New Industrial Master Plan (NIMP2030) provide direction for businesses. Though not flashy, these plans aim for long-term stability.

Limited government funds restrict large-scale projects, but the Budget 2024 prioritizes fiscal responsibility through tax adjustments and subsidy reforms. These measures might be unpopular, but with the next general election only due in 2027, the government has a window to set Malaysia on a stronger financial footing for future prosperity.

//END