

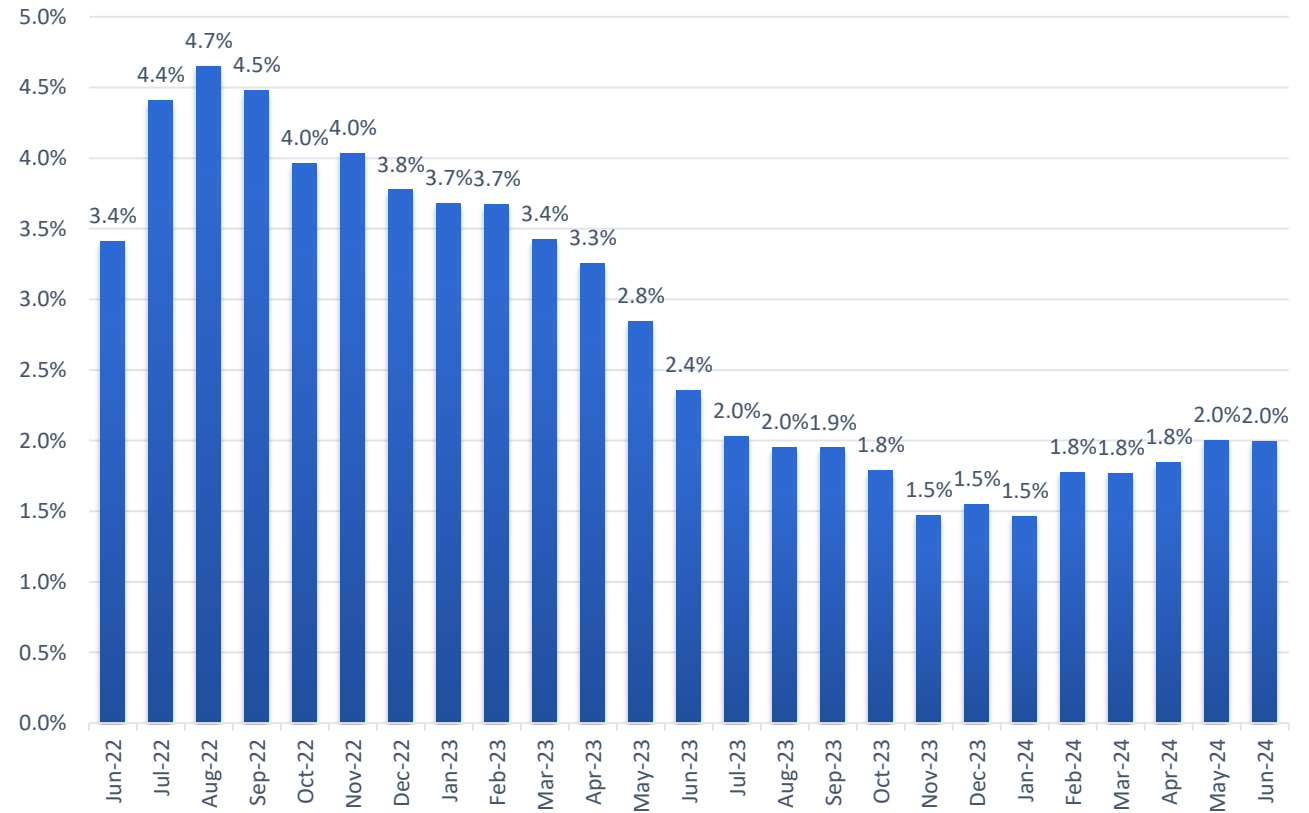
# Why inflation rate is still at 2.0%?

This was the common reaction when the Department of Statistics Malaysia (DOSM) announced the June Consumer Price Index (CPI) on July 24, 2024. The headline CPI stood at 2.0% year-on-year for June (unchanged from May: 2.0%), which was notably below the consensus estimates of 2.2% (BMMB: 2.1%) as surveyed by Bloomberg.

To provide some context, the government implemented a fuel subsidy rationalization on June 10, 2024, resulting in diesel prices increasing from RM2.15 per liter to RM3.35 per liter, a 55.8% hike. This measure was aimed at restoring fiscal discipline and ensuring that financial aid, including subsidies, benefits the appropriate target groups.

There was a sense of disbelief when the number was first announced. Therefore, we feel it is necessary to explain why the CPI remained stable despite the significant diesel price hike.

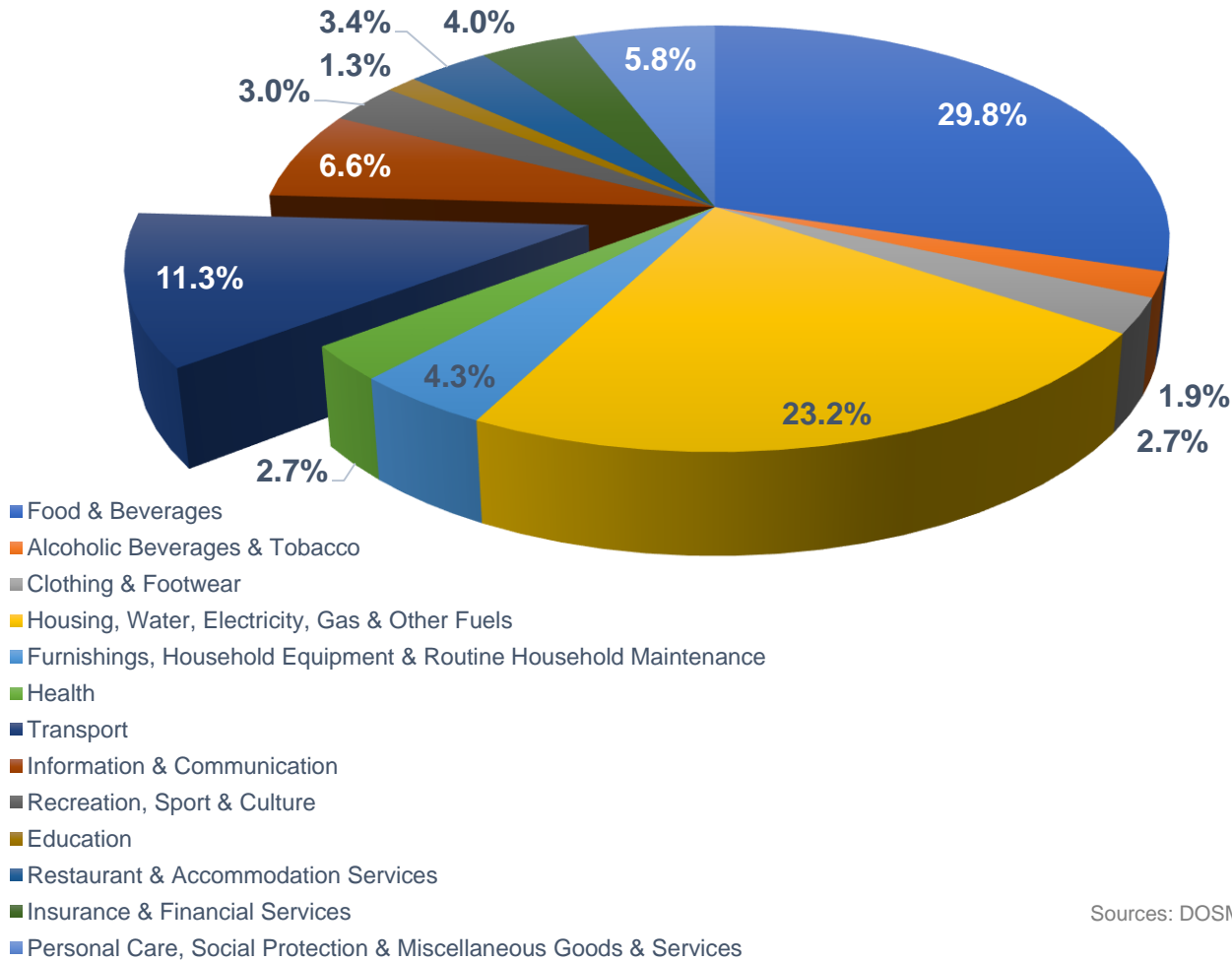
Malaysia's inflation rate



Sources: Bloomberg & CEIC

# Diesel only account for 0.2% in CPI weight.

Composition of Consumer Price Index



Diesel prices are included in the Transport category within the CPI framework, which collectively accounts for 11.3% of the total CPI weight.

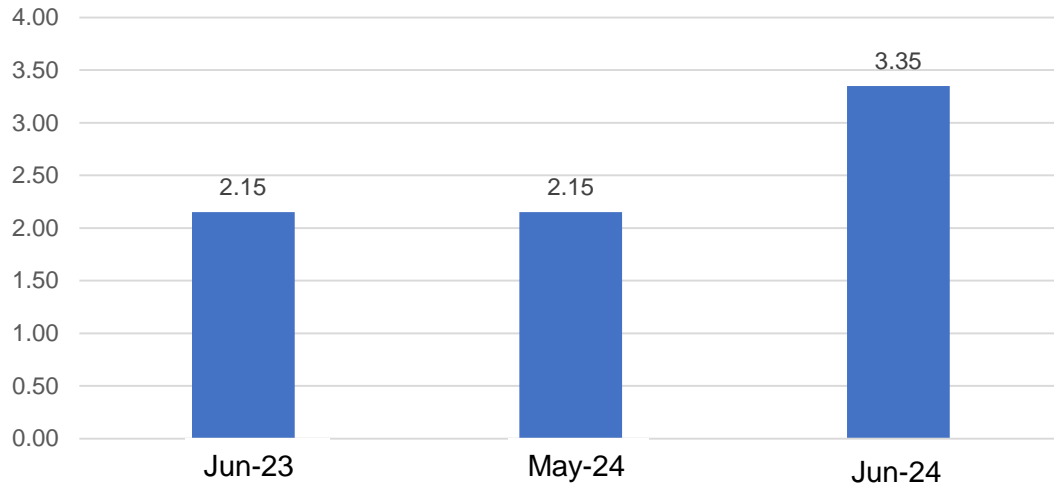
Within the Transport category, diesel is grouped under the subcategory of Fuels & Lubricants for Personal Transport Equipment, **where diesel only accounts for 0.2% of the total CPI weight.**

This is the primary reason why the sharp increase in diesel prices doesn't significantly impact the overall CPI, as its share is minimal.

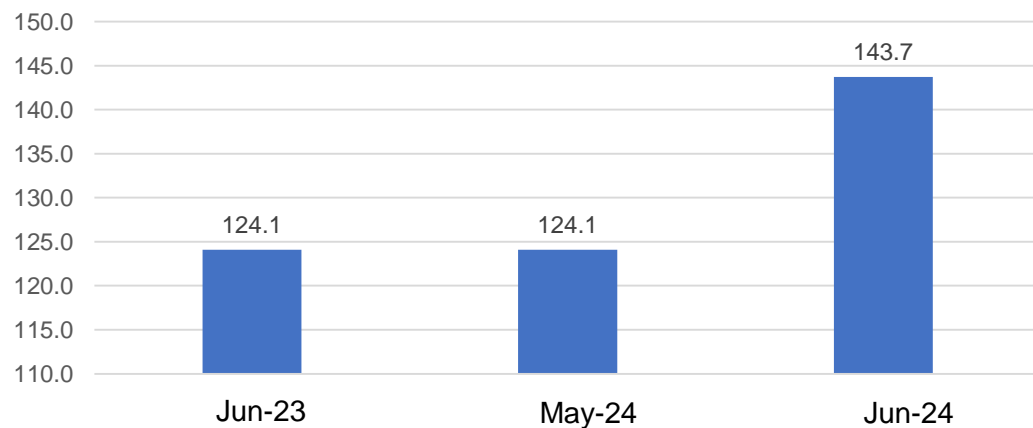
Sources: DOSM & CEIC

# Illustration to the impact of Diesel price hike

Diesel prices in RM per liter



CPI sub-index for Diesel



Scenarios	A	B	C	D	E
	Jun-24	Weight	A x B	CPI	Inflation
1. CPI - Diesel Index (with RM1.20 increment)	143.7	0.20%	0.29	133.00	2.0%
2. CPI - Diesel Index (with no increment)	124.1	0.20%	0.25	132.96	2.0%

In scenario 1, the CPI reported by DOSM stands at 133.0 points (Column D), factoring in the RM1.20 per liter hike in diesel prices on June 10. This results in a diesel sub-index of 143.7 points (Column A), reflecting a 15.8% year-on-year inflation for diesel. However, since diesel accounts for only 0.2% (Column B) of the CPI, it contributes just 0.29 (Column C) points to the overall CPI, leading to an overall inflation rate of 2.0% (Column E).

In scenario 2, assuming there was no diesel price hike, the overall CPI (Column D) would be 132.96 points. This represents just a 0.04-point difference between Scenario 1 and Scenario 2, and the overall inflation rate would still be 2.0% due to the minimal share of diesel in the CPI weight.

Sources: DOSM, CEIC & BMMB's Economics

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# In a nutshell, it's the weight that led to stable inflation rate

Based on the illustration, it's evident that the minimal weight has contributed to the stability of the inflation rate in June. However, we must not overlook potential inflationary pressures as the economic landscape evolves throughout the year. It's possible that businesses are offloading old stock purchased before the diesel price hike, allowing them to temporarily maintain their current prices. This strategy could be aimed at capturing more market share by offering better deals, as consumers are likely to favor sellers with more competitive pricing.

Given this context, the pricing behavior among businesses and firms is crucial in shaping the inflation outlook for the year. Additionally, the relationship between wages and prices is significant, as higher inflation expectations could lead to demands for higher wages. This, in turn, might prompt businesses to increase their prices to maintain profit margins. Consequently, there is a strong likelihood that Bank Negara Malaysia (BNM) will keep the Overnight Policy Rate (OPR) at 3.00%, especially as consumers and businesses anticipate an eventual increase in RON95 prices. It's important to note that the **CPI sub-index for petroleum prices is at 5.5%**, which is significantly higher than that for diesel. Therefore, the upward adjustment in RON95 prices is expected to be more substantial compared to diesel.