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Insight - Addressing the rising living cost issue urgently

In a recent discussion on global inflation and its impact on Malaysia chaired by Minister in the Prime Minister's Department (Economy)Datuk Seri Mustapa Mohamed, the rising inflation and its impact on both businesses as well as the rakyat is a major concern for the government.(File pic)

INFLATION is hitting everyone hard globally, and Malaysians are no exception. From businesses to households and even the government, no one can escape the squeeze from the current spike in inflation.

In recent months, people have had to cough up more than what they spent a few years ago to maintain a similar lifestyle or just to survive. This can be interpreted as a higher cost of living due to the surge in inflation.

While the terms "cost of living" and "inflation" are closely related and used interchangeably, they are different in various ways.

Cost of living, in general, reflects a household's expenditure on goods and services that are necessary to maintain a certain standard of living. In a very broad term, cost of living means that the a household's spending needs to be maintained at a constant standard of living.Meanwhile, the consumer price index (CPI) is not an ideal measure of changes in the cost of living. It is a measure of the price of a fixed basket of goods and services, with an unchanged composition and quality over time.

This approach is relatively practical and gives the CPI certain properties that make it attractive as a target for monetary policy.

In the case of Malaysia, the basket constitutes subsidised items that help keep the CPI lower than many other countries.

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Being an open economy, as reflected by 131% of the gross domestic product, the country is vulnerable to external shocks.

Today's inflation and rising living cost could be attributed to cost-driven factors as opposed to demand pull.

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Since the pandemic began, the government, businesses and the rakyat have been struggling to deal with the rising cost of living and inflation.

Still reeling from the Covid-19 impact, we now have the impact from the Ukraine crisis accompanied by the sanctions on Russia. Adding to that, China's zero-Covid policy continues to weigh on global supply chain disruptions that have made access difficult.

Labour shortages have held back businesses, which are already struggling to clear backlogged orders, from taking up new orders. The shortage of workers has pushed up wages and salaries besides the minimum wage of RM1,500.

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It also led to the “pinching” of workers as companies threw in higher wages. This is happening not only in factories or oil palm plantations, but also in food outlets and “mamak” restaurants.

Further fuelling the increase in living cost and inflation is higher import cost. The weak ringgit, not just against the US dollar but also in several other cross rates, is seen to be adding pressure on inflation mainly coming from the supply side due to high import bills.

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A 20kg bag of wheat flour jumped by 77% to RM75.Meanwhile, wages have jumped between 25% and 33% due to the pinching of workers despite a minimum wage of RM1,500. This may be a simple basis but it clearly shows the apparent rise in today’s living cost that comes from higher cost push pressures rather than demand pull.

Given that much of the inflation stems from the cost side as opposed to demand, it remains unclear if the cost segment of inflation will ease or worsen from the overnight policy rate (OPR) hike. A total of 50 basis points (bps) have been raised by Bank Negara to 2.25% with the aim of cooling inflation and normalising the policy rate.

Despite the hike in the OPR, the ringgit's performance weakened. It depreciated by 6.7% to 4.45 from the start of the year. It could possibly mean that the OPR hike is not so much to address the global interest rates differential.

Rising OPR and the falling ringgit would be a double whammy to businesses, especially importers.

People will certainly have to dig deeper into their pockets for their loan repayments. A simple calculation of a 25bps hike in the OPR on a RM500,000 loan with a new base rate at 3.85% for a period of 30 years would see the borrower paying an extra RM71.04 in the monthly payment. While the quantum of the repayment may be seen as small, but with a total of 50 bps hike thus far, it will translate to RM142.08 a month.

With the basic living cost based on the example of teh tarik and roti canai price that has increased 61%, can the borrowers withstand more rate hikes and a continuously weakening ringgit that will only add to import bills and risk transfer pricing?

Challenging environment

While the simple reality is that inflation will always be here and everyone must be prepared for it, this is easier said than done in today's challenging environment.

And it is more so when we are just emerging from the Covid pandemic and now with uncertainties in the global environment.

Thus, it is important to understand how inflation affects everyone.

The clear downside of what is happening right now – where inflation is driven largely but not exclusively by commodity prices (like oil) – is that people are getting poorer. And their quality of life will deteriorate, most likely.

This situation can have knock-on effects. From a behavioural perspective, consumers may change what they buy to help foot the bill on rising costs.

Given that our inflation is leaning more towards cost push, it is inevitable that businesses will experience margin compression even after a partial transfer pricing to consumers.

Of course, this can be risky. An outright pullback can feed into a business slowdown or shutdown. It heightens the pressure of a recession or a "recession sentiment".

Hence inflation poses a "clear and present danger" to our economy.

We know that inflation is a global phenomenon. Aggressive rate hikes by global central banks to contain the more cost-driven inflation could risk tilting the global economy into recession. As an open economy, we remain vulnerable to the ongoing global uncertainties. We are also experiencing challenges to institute fiscal reforms.

Concerted efforts

We need a good and well-coordinated concerted efforts by the government (fiscal and monetary policy; enforcement to avoid profiteering; ensuring adequate supply); producers (improve cost efficiency); businesses (avoid hoarding; fair price practices; avoid smuggling); workers (raise productivity); and consumers (change our lifestyle; implement the Green Book; and zero waste management).

Equally important is the government improving its communication with the business community as well as the rakyat. This was also pointed out by the Minister of Economy.

While structural reforms are important, the urgent need now is to address the rising cost of living and inflation pressure that could risk more businesses winding up or sinking into bankruptcies.

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