

# Why inflation must be addressed even if it's 'just' 3%

Inflation is a globally feared word nowadays, even in Malaysia, which is so used to prices hardly changing. The government, of course, has been very active in implementing price ceilings and even subsidising several "essential" goods. This is so entrenched in Malaysia's economy that trying to remove them or even retargeting them is akin to pulling out one's back molars — without anaesthetic!

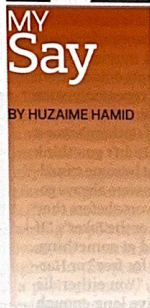
However, composing the Consumer Price Index (CPI) with such price-controlled, price-capped, subsidised or even "unit-limited" (meaning you can only buy a limited number of such items) impositions poses huge dangers. The CPI is meant to indicate how prices move in a time period. Having such price-controlled items (a collective term we will use henceforth) in its composition means simultaneously that part of the CPI will not move while the rest will move in bigger proportions than the overall number has.

Now, this is opening the Pandora's Box in trying to understand what is happening. You see, if one goes to the Department of Statistics to see how it calculates the CPI, you will see a very confusing picture. Instead of organising items being measured individually, you'll see these 12 categories:

1. Food and non-alcoholic beverages
2. Alcoholic beverages and tobacco
3. Clothing and footwear
4. Housing, water, electricity, gas and other fuels
5. Furnishings, household equipment and routine household maintenance
6. Health
7. Transport
8. Communication
9. Recreation services and culture
10. Education
11. Restaurants and hotels
12. Miscellaneous goods and services

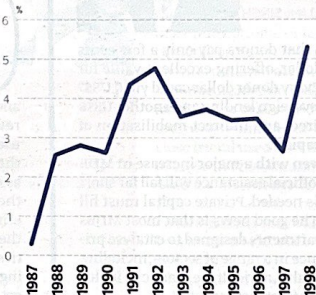
So, if you are wondering why the price of chilli just shot up 100% but the price increase is not being acknowledged in the CPI, then good luck finding it in the CPI components. It might not even be there.

Now, another thing one has to know is the weightages of these components. We could not find the weightages in Malaysia, although in the US (according to Investopedia), the top three weights



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## Malaysian inflation from 1987 to 1998



go to housing (34.7%), commodities (21.4%) and food (13.4%). That immediately shows that the categories do not go by equal weights. In fact, the rest of the weights are 6.9% to 4.8% — pretty low. It does not take an Albert Einstein to note that if your component has a small weight, then for an individual item therein to register an impact on the whole, the movement has to be huge.

Factually, there is a large number of items that are measured for the CPI. The US uses something like 80,000 items. So, a hike in chilli prices can actually be "invisible" unless brought to the public's attention.

Let's see why we said Malaysia must act against inflation even at 3%, a laughably small number compared with the rate Europe and the US incurred earlier this year (10% or so).

Our interest was piqued by a finding in our recent research paper, "Steps Towards A Financial Crisis", of Malaysia's CPI hitting "only" 5% or so in 1998 during the Asian financial crisis when the ringgit fell about 50% against the US dollar.

Thailand's, South Korea's and Indonesia's CPI in 1998 were 8%, 7.5% and 82.4% respectively. They, along with Malaysia, were at the epicentre of the Asian financial crisis. In a later publication in 2015, Bank Negara Malaysia noted that Malaysia's low inflation (specifically its Inflation Cost Pass-Through [ICPT] mechanism) was low because of the existence of price-controlled items.

So how does this work? Casting around among several economists, we found that they believed the percentage of price-controlled goods in Malaysia's CPI composition to be around 20% to 25%. Here's the rub: Several items like oil have an impact far beyond their own price rise — the increase would affect the prices of all items that are transported. If oil prices are controlled, then "true" inflation is not being measured properly, yet prices of other items — imported goods for instance — will show the oil price hikes that are not being measured in Malaysia. These impacts have to be considered, and herein we include them as "price-controlled" items.

The low weightages of some items and categories can actually "hide" what is being incurred by the public in their daily expenditures too.

Mathematically, if a portion is being price-controlled, then for the whole CPI to register an X% number, the non-price-controlled portion has to rise by the percentages shown in the table to enable the CPI to rise to that level.

HEADLINE CPI RISE (%)	PERCENTAGE OF COMPONENTS PRICE-CONTROLLED (%)	ACTUAL PERCENTAGE RISE OF NON-PRICE-CONTROLLED PORTION (%)
5	20	6.2
	40	8.3
	60	12.5
10	20	12.5
	40	16.7
	60	25.0

As one can see from the table, the non-price-controlled portions would rise far beyond the price-controlled portion in order for the CPI to show a certain number. This is probably why there is a public outcry when prices rise, even with a "low" CPI number.

Thus, Malaysia has to be ever vigilant about inflation. Saying "Eh? Why act? It's only at 3%" is not good enough. Price controls, including subsidies, are not only costly but warp the actual inflation picture, skewing the economic responses that need to be or could be taken to ensure things can be brought back to normal as soon as possible. This, of course, says nothing about the impact that incorrect CPI numbers have on real gross domestic product numbers or on bond prices. This is a structural issue that needs to be corrected. ■

**Huzaime Hamid is chairman and CEO of Ingenium Advisors, Malaysia's financial macroeconomics advisory**