

Promoting Monetary Stability

The Monetary Policy Committee (MPC) formulates monetary policy in Malaysia to maintain price stability while taking into account broader economic and financial conditions. Meeting six times a year, the MPC assesses Malaysia's inflation and growth prospects to decide on the Overnight Policy Rate.

Monetary Policy in 2025

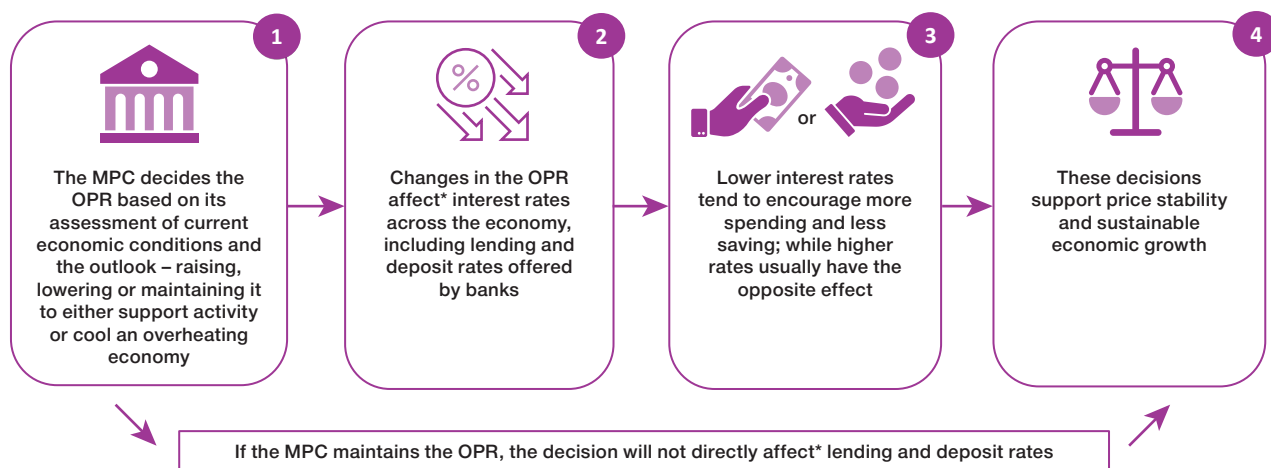
Introduction to Monetary Policy

Monetary policy¹ in Malaysia is set by BNM's Monetary Policy Committee (MPC) through the

central bank's key policy rate also known as the Overnight Policy Rate (OPR). A change in the OPR influences, among others, banks' lending and financing rates, as well as deposit rates. These changes affect how expensive or affordable loans are and how attractive it is to save – shaping households' and businesses' spending and saving decisions. In turn, this affects overall demand and the prices of goods and services in the economy.

In setting the OPR, the MPC assesses both current economic conditions and where the economy is heading. Its main goal is to keep inflation low and stable in support of sustainable growth. If economic activity is expected to slow, the MPC may lower the OPR to make borrowing cheaper and encourage spending. When prices rise too quickly, as demand is stronger than supply, the MPC may raise the OPR to slow spending and keep inflation under control. (See Diagram 1 for the illustration).

Diagram 1: How Monetary Policy Works Through the Economy



* This can still be subject to change depending on market dynamics, macroeconomic developments and banks' strategies.

Source: Bank Negara Malaysia

¹ More information on Malaysia's monetary policy and the MPC can be found in the 'Governance' chapter of this report and in the 'Monetary Stability' section of the BNM's website (<https://www.bnm.gov.my/monetary-stability>).

Global Economic and Financial Conditions

In making its monetary policy decisions, the MPC first considers what is happening in the global economy. This is important because Malaysia, as a small and open economy, is closely connected to other countries. Developments abroad can affect Malaysia’s economy in real and tangible ways – from the prices we pay to how we trade.

The global economy continued to expand in 2025 despite a highly challenging and uncertain external environment. When the United States (US) announced higher import tariffs in early 2025, it affected global trade flows and increased uncertainty around policy and growth outcomes.² Despite this, global trade turned out to be relatively resilient during the year. Firms accelerated shipments ahead of higher US tariffs, while strong artificial intelligence (AI)-related demand for technology goods provided an additional boost. As the year progressed, trade agreements reached between the US and a few of its trading partners eased some of the uncertainty. Many final tariff rates were set lower than initially expected,³ reducing pressures on global trade and sentiment. Alongside this, firm household spending, investment, as well as supportive fiscal and monetary policies across major economies lent support to global economic growth.

Global inflation continued to ease during the year. While demand and economic activity expanded, they did so at a pace that did not generate excessive inflationary pressures. At the same time, a higher supply of key commodities, like oil, pushed their prices down. This in turn lowered input costs⁴ for producers. Stronger currencies against the US dollar also helped keep inflation in check across most countries.

Broadly stable prices worldwide allowed major central banks to lower interest rates, supporting a further easing in global financial conditions. This easing continued despite bouts of financial market volatility arising from uncertainties over global trade and monetary policy,⁵ which peaked in April after the US administration announced reciprocal tariffs. However, as the year progressed, new trade agreements and greater clarity on the global trade outlook helped restore investor confidence.

² This was further exacerbated by the potential retaliatory responses by other major economies.
³ Based on BNM estimates, the US effective tariff rate (ETR), which takes into account reciprocal tariff rate, product tariff rate and tariff exemptions eased to around 17.4% towards the end of the year.
⁴ Input costs refer to the expenses incurred by a business or producer in acquiring the necessary resources, materials, and services to create a product or provide a service.
⁵ Uncertainty around global monetary policy in this context mainly reflects shifting expectations about the US Federal Reserve’s policy path.

In this environment, emerging market economies (EMEs) including Malaysia experienced capital inflows, and their currencies strengthened against the US dollar, particularly in the second half of 2025.

Domestic Economy

The Malaysian economy performed well in 2025 despite the challenging global environment. While global conditions provide an important backdrop, the MPC focuses primarily on domestic growth and inflation considerations in its monetary policy decisions.

As a highly open economy, Malaysia is exposed to external developments, and the MPC therefore assesses their impact on the outlook of domestic economic growth and inflation. The external sector⁶ was largely resilient throughout 2025. Exports were supported mainly by firm electrical and electronic (E&E) performance and strong inbound tourism.

Malaysia has a diversified export structure – in terms of trade partners and product segments. This helped cushion the impact of rising global trade barriers and weaker shipments to the US. Even as frontloading by US importers eased

Diagram 2: 2025 Key Domestic Figures at a Glance



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

⁶ The external sector refers to a country’s economic interactions with the rest of the world, including the buying and selling of goods and services, as well as cross-border investment flows.

in the second half of the year, E&E exports benefitted from strong global demand for AI-related technology goods. At the same time, higher flight connectivity, visa exemptions for selected countries,⁷ and promotional initiatives in the lead-up to Visit Malaysia 2026⁸ helped draw more tourists to Malaysia. As a result, Malaysia continued to experience a current account surplus in 2025, with export earnings exceeding spending on imports.

Amid the resilient external sector, domestic demand⁹ continued to be a key engine of growth. Better employment, wage growth and income-related measures throughout the year shaped household spending. These measures include the Civil Servant Salary Revision (CSSR) and minimum wage revision for the private sector, while targeted cash transfers, including Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA), provided further support.

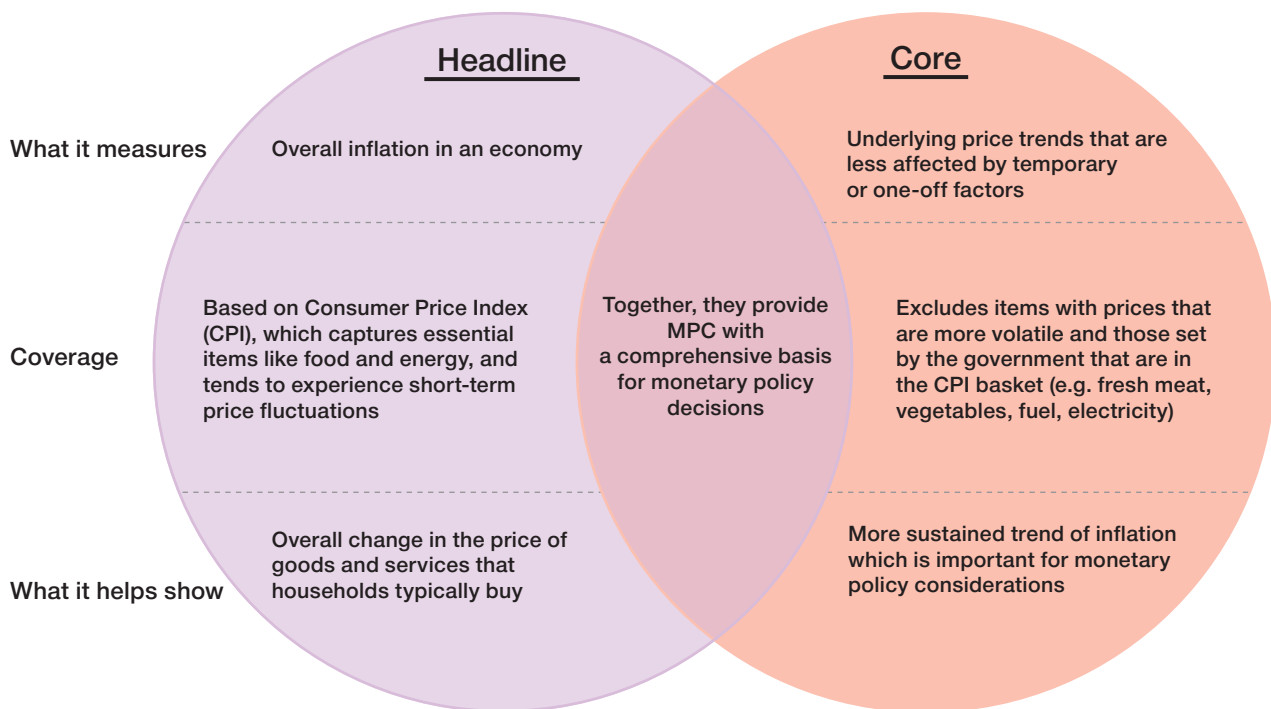
Investment activity continued to be an important driver of Malaysia’s growth. Multi-year projects by public and private sectors continued to

progress steadily, as initiatives under national masterplans were also rolled out.¹⁰ Investment approvals remained robust, reflecting continued confidence in Malaysia’s investment landscape. Many earlier-approved investments were also translated into real activities. Notably, 84.9% of manufacturing investment projects approved by the Malaysian Investment Development Authority (MIDA) between 2021 and 2025 have already progressed to various stages of implementation.¹¹ Sustained government spending and strategic capital investments by public corporations also lent support to public investment growth. Taken together, this reinforced overall investment momentum.

Domestic Inflation

In assessing inflation, the MPC looks at both headline and core inflation. (Refer to Diagram 3 for more information). Domestic inflation stayed broadly contained in 2025. Headline inflation moderated further to 1.4% as global cost conditions eased. While domestic policy adjustments – particularly the electricity tariff

Diagram 3: Headline and Core Inflation Comparison



Source: Bank Negara Malaysia and Department of Statistics, Malaysia

⁷ Malaysia’s visa-free entry scheme for travellers from China and India was originally introduced in December 2023. This initiative, which allows stays of up to 30 days, has been extended until 31 December 2026.
⁸ More information can be found on the official tourism website of Malaysia (<https://www.malaysia.travel/page/visit-malaysia-2026>).
⁹ Domestic demand refers to the total spending within a country by households, businesses, and the government.

¹⁰ These included among others, the New Industrial Master Plan (NIMP 2030) and National Energy Transition Roadmap (NETR).
¹¹ Source: Malaysian Investment Development Authority (MIDA). More information can be found on MIDA’s website (<https://www.mida.gov.my/why-malaysia/mida-insights/>).

restructuring and rationalisation of RON95 fuel subsidies – were initially expected to add temporary upward pressure on inflation, the overall impact turned disinflationary.¹² This reflected the policy design and implementation, whereby most households benefitted from lower electricity rates while eligible Malaysians faced lower retail fuel prices, consistent with the government’s intention to cushion households from the effects of these reforms.

Meanwhile, core inflation stayed stable and close to its long-term average of 2%, supported by steady domestic demand without undue price pressures. Overall, the contained inflation provided a stable environment for people and businesses to conduct economic activities without worrying about significant price changes.

Monetary Policy Developments

The MPC always looks ahead when making monetary policy decisions. This is because changes to the OPR do not affect economic activity and inflation right away.¹³ In 2025, the MPC made the pre-emptive decision to reduce the OPR by 25 basis points to 2.75% in July.¹⁴

While the domestic economy was on solid footing at the time, global developments posed greater downside risks to Malaysia’s growth outlook. By acting early, the MPC sought to ensure that policy support would already be in place if these risks materialise. If they did not, the costs of acting pre-emptively were limited, given that inflation remained contained.

Throughout the rest of the year, Malaysia’s economy continued to be supported by steady spending and investment. Inflation also stayed low, helped by contained global cost conditions and the absence of excessive demand pressures. In this environment, the MPC kept the OPR unchanged, as it viewed the current stance as appropriate and supportive of the economy. The preemptive cut is expected to continue providing additional support to the broader economy in 2026.

¹² Electricity costs fell for most households following tariff restructuring, which introduced lower domestic rates and rebates under the Energy Efficiency Incentive. The phased rollout of the BUDI95 programme, particularly the introduction of a lower subsidised price of RM1.99 per litre, for all eligible Malaysian citizens, contributed to lower inflation during the year.

¹³ In Malaysia, changes in the OPR transmit almost immediately to market and reference rates, including the Standardised Base Rate (SBR), Base Rate (BR) and Base Lending Rate (BLR). However, the effects on the broader economy take longer to materialise, as households’ and businesses’ consumption and investment decisions adjust gradually.

¹⁴ More information on Malaysia’s monetary policy decision-making process can be found in the ‘Monetary Stability’ section of the BNM’s website (<https://www.bnm.gov.my/monetary-stability>).

In addition to our monetary policy decisions, we reduced the Statutory Reserve Requirement (SRR) ratio from 2% to 1% in May. This provided banks with greater flexibility to manage liquidity in the face of financial market volatility.¹⁵ Throughout the year, our monetary operations focused on maintaining sufficient liquidity in the domestic banking system to support financial intermediation.

The Ringgit Exchange Rate

Malaysia adopts a flexible exchange rate regime.¹⁶ This means the ringgit is determined based on the supply and demand for our currency, with foreign exchange movements influenced by both global and domestic factors. Global factors include monetary policy in major economies and changes in commodity prices. Domestic factors include Malaysia’s growth and inflation outlook, and overall market sentiment.

In the first half of 2025, the ringgit strengthened. The appreciation was driven by global investor interest in emerging market economies (EME) assets amid trade-related uncertainties. This continued into the second half of the year, supported by easier global monetary policy. This included the US Federal Reserve, which lowered its policy rate three times since September 2025.

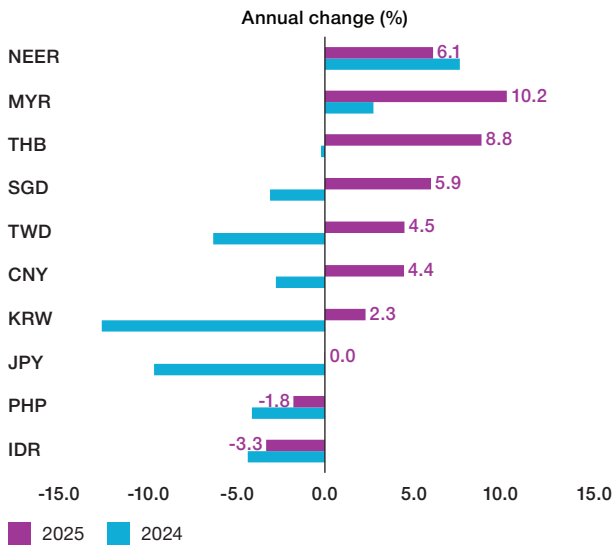
Global monetary easing supported the ringgit in two ways. First, as interest rates abroad fell, the gap between their interest rates and Malaysia’s became smaller. Foreign investors therefore earned less from holding assets in their respective countries than before, making investments in Malaysian assets more attractive. Second, easier global financial conditions also improved risk sentiment. This encouraged investors to seek better returns in emerging markets, including Malaysia. As these inflows rose, demand for the ringgit increased, helping to support its value.

In addition to these global factors, the ringgit’s performance was also supported by positive sentiment surrounding Malaysia’s favourable economic outlook. Ongoing structural reforms against a backdrop of political stability further strengthened investor confidence. These developments enhanced Malaysia’s appeal as an investment destination. By end-2025, the ringgit recorded the largest appreciation among regional currencies against the US dollar (Chart 1).

¹⁵ More information on the SRR can be found in the ‘Monetary Operations’ section of the BNM’s website (<https://www.bnm.gov.my/statutory-reserve-requirement-srr->).

¹⁶ More information on the ringgit can be found in the ‘Ringgit Exchange Rate Policy’ section of the BNM’s website (<https://www.bnm.gov.my/monetary-stability/ringgit>).

Chart 1: Performance of Selected Currencies Against the US Dollar and Ringgit Nominal Effective Exchange Rate (NEER)



Note: Positive figures indicate an appreciation of currencies against the US dollar. NEER shows the value of the ringgit against a trade-weighted basket of Malaysia’s major trading partners’ currencies.

Source: Bank Negara Malaysia

Throughout the year, BNM supported the smooth functioning of the foreign exchange market through our liquidity and foreign currency operations. By buying or selling the ringgit when necessary, our objective is to maintain two-way liquidity in the market, especially during periods of stress. These actions helped ease pressures on the currency and kept the market operating smoothly. Such operations also prevented sudden, excessive swings in the ringgit, which could disrupt activities like exports and investments. Additionally, ongoing coordinated efforts by the Government and BNM to encourage more consistent repatriation and conversion of foreign earnings by corporates and investors continues to support more balanced two-way flows in the domestic financial market, including through the Qualified Resident Investor (QRI) programme.¹⁷

Through ongoing initiatives under the Financial Markets Committee (FMC) and regular engagement sessions with large corporates, BNM pursued efforts to deepen the foreign exchange

market further, enabling banks and businesses to meet their funding and foreign exchange needs more effectively. At the same time, BNM continued to promote access to hedging instruments¹⁸ to help businesses better manage their foreign exchange risks.

Research and Analysis

BNM undertakes research on both short- and long-term economic developments, with a focus on understanding their implications for the Malaysian economy. These analyses inform the MPC’s deliberations and support the Bank’s broader economic policy advocacy.

Against heightened uncertainty this year, BNM’s research efforts focused on assessing how global developments and domestic policy moves could shape Malaysia’s economic outlook. This was not a straightforward task. Global shocks often spread through many interconnected channels, affecting growth and inflation in different ways. As a small and open economy, we are especially sensitive to these ripple effects.

An important focus during the year was the impact of trade-related developments, particularly the reciprocal tariffs imposed by the US. We closely examined how these tariffs were shaping global trade flows, investment decisions and business behaviour. This allowed the MPC to differentiate between short-term trade-related disruptions versus more lasting implications for growth. We also undertook a careful review of domestic growth conditions and updated Malaysia’s growth forecast for the year.¹⁹

We examined the economics of data centre investments, in line with Malaysia’s rising position as a regional data centre hub. Beyond their direct contribution to GDP, our research shows that data centres also have the potential to create spillover gains across the supply chain, including higher demand for construction, utilities, professional services, and digital infrastructure, as well as the creation of higher-paying jobs. Realising these benefits will depend on having the right policies in place to strengthen forward and backward linkages, while managing key risks.²⁰

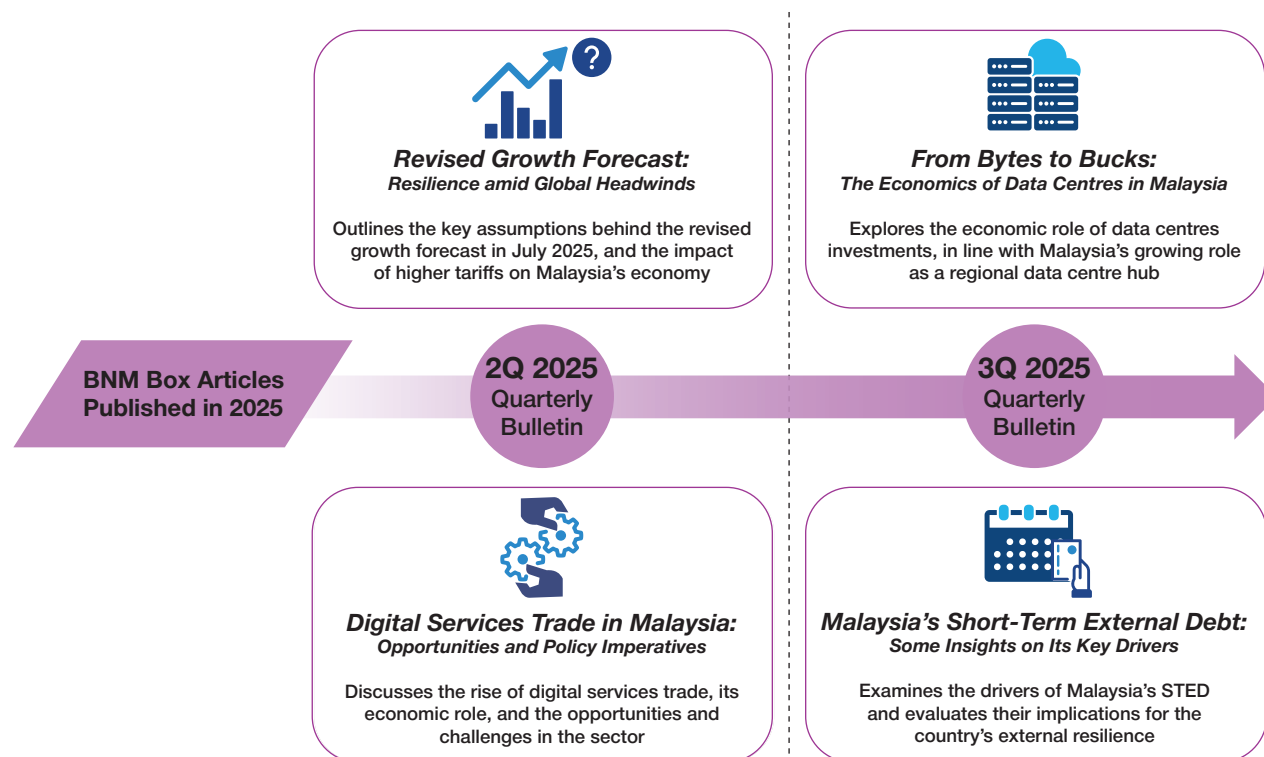
¹⁷ More information on the Qualified Resident Investor (QRI) programme can be found in the ‘Foreign Exchange Policy’ section of the BNM’s website (<https://www.bnm.gov.my/fep/flexibilities/qri>).

¹⁸ BNM introduced the dynamic hedging programme in December 2016 to allow greater flexibility for registered institutional investors to actively manage their invested assets’ foreign exchange exposure. More information can be found on the Financial Markets Investor Portal (FMIP): (<https://financialmarkets.bnm.gov.my/frequently-asked-questions>).

¹⁹ Further analysis can be found in the BNM’s Second Quarter of 2025 Quarterly Bulletin White Box Article titled ‘Revised Growth Forecast: Resilience amid Global Headwinds’.

²⁰ Further analysis can be found in the BNM’s Third Quarter of 2025 Quarterly Bulletin White Box Article titled ‘From Bytes to Bucks: The Economics of Data Centres in Malaysia’.

Diagram 4: BNM Box Articles Published in 2025



Source: Bank Negara Malaysia

Digital services trade is becoming an increasingly important contributor to Malaysia's external sector. This led us to assess its growing role, alongside the opportunities and policy priorities needed to unlock the full potential of the digital economy. Our study shows that Malaysia has a strong base to grow its digital services industry. This includes good ICT infrastructure, supportive government policies, a vibrant tech sector, and a competitive talent pool. More work, however, is needed to shape the next stage of growth. Key priorities include focusing on high-value, low-latency industries, strengthening Malaysia's startup and intellectual property ecosystem, and developing a larger pool of digital talent.²¹

We also assessed the resilience of Malaysia's external sector by examining both the growth and composition of short-term external debt. While the study showed that short-term external debt has been rising, this reflects Malaysia's deeper integration into the global economy, supported by the active participation of banks and private

firms in cross-border activities such as interbank borrowing and trade credit. Importantly, the debt profile is favourable, helping to contain related vulnerabilities. Overall, Malaysia's external sector continues to be a key pillar of economic strength, providing a strong buffer against external shocks. This resilience is underpinned by sound economic fundamentals and robust policy safeguards.²²

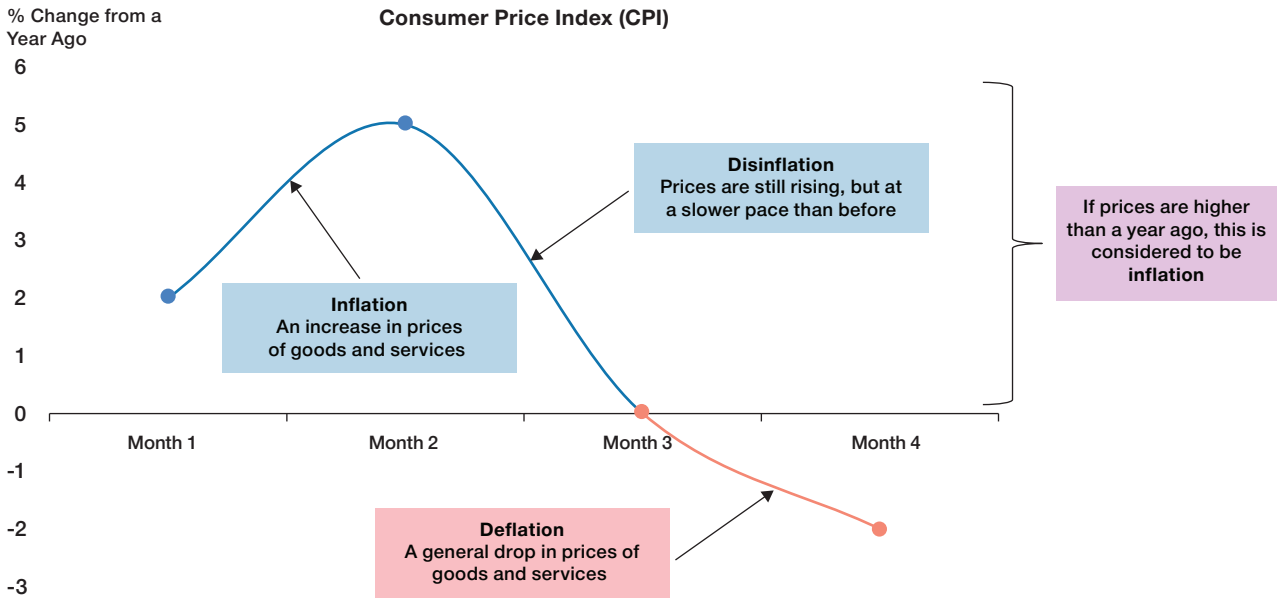
Another area of research was to understand how domestic policy changes introduced during the year would affect inflation. As broad-based disinflation occurred across many economies, BNM developed an internal framework to distinguish between disinflation and deflation²³ (see Chart 2 for the illustration). This framework helped guide the MPC to respond appropriately without overreacting to short-term movements in prices. Overall, the assessments showed that deflation is not a material risk for Malaysia, reflecting healthy demand conditions, resilient labour markets, and a stable inflation outlook among firms and households.

²¹ Further analysis can be found in the BNM's Second Quarter of 2025 Quarterly Bulletin Box Article titled 'Digital Services Trade in Malaysia: Opportunities and Policy Imperatives'.

²² Further analysis can be found in the BNM's Third Quarter of 2025 Quarterly Bulletin Box Article titled 'Malaysia's Short-Term External Debt: Some Insights on Its Key Drivers'.

²³ For further discussion on cost of living and why households' experiences may differ from headline inflation, see the Featured Article 'Beyond the Headline: Inflation Through the Eyes of Households' in this chapter.

Chart 2: An Example of Inflation, Disinflation and Deflation



Source: Bank Negara Malaysia

The Tun Ismail Ali Centre of Excellence in Monetary and Financial Economics (TIACOE) was officially launched during the year as a BNM-endowed research centre under the stewardship of the Asia School of Business (ASB).²⁴ TIACOE complements BNM’s internal research efforts, serving as a platform for fellows and affiliates of ASB, central bankers, scholars and graduate students to conduct research in the field of monetary and financial economics. Following its set up in August, research grants were awarded to recipients working on projects in monetary policy as well as in liquidity dynamics within Islamic Finance.²⁵

Beyond research, as the financial and economic advisor to the Government, BNM continued to actively participate in several inter-agency policy groups focusing on Malaysia’s economic priorities. These included areas like the cost of living, labour, public finance, investments and social protection. For example, we provided input on the policy design and payment mechanism for BUDI95, helping ensure that subsidies were delivered to the *rakyat* in a targeted manner while minimising leakages.

Throughout these engagements, our policy advice remained grounded by a sound understanding of the economy. We looked carefully at how policies may affect domestic inflation and growth, and the daily lives of households and businesses. Our aim remains to safeguard macroeconomic stability and protect the welfare of all Malaysians.

Communications and Outreach

Throughout 2025, BNM stayed closely engaged with its key stakeholders, including analysts, financial market participants, the media and the Malaysian public. Through these engagements, we explained our monetary policy decisions and major economic developments, such as growth, inflation, and movements in the ringgit. This helped deepen understanding of BNM’s role and ensured we are responsive to issues that matter in an uncertain global environment.

We spent some time during the year improving the way we communicate monetary

²⁴ The Tun Ismail Ali Chair (TIAC) was established at the University of Malaya in 2000 with the aim of strengthening academic excellence in monetary and financial economics. It was conceived as a tribute to Tun Ismail Ali, the first Malaysian Governor of Bank Negara Malaysia and its longest-serving Governor. Over time, the initiative has evolved into the Tun Ismail Ali Centre of Excellence, now under the stewardship of the Asia School of Business.

²⁵ For more information on these grants, please visit the Asia School of Business, Tun Ismail Ali Centre of Excellence in Monetary & Financial Economics research grants webpage: (<https://asb.edu.my/research-office/tun-ismail-ali-coe>).

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policy decisions. To enhance transparency, BNM introduced its first post-MPC media interview series, aimed at better educating the public on the MPC's considerations behind its policy decisions and the global and domestic conditions shaping them. To broaden outreach on monetary policy, BNM continued to leverage a range of channels, including social media, media interviews, speeches, publications, press conferences, and targeted workshops and briefings.²⁶

In engaging with analysts, we held regular briefings after each MPC meeting. In these sessions, we provided further clarity on our policy decisions and the assessments behind them. These sessions are designed to be interactive where analysts can pose questions and provide feedback to BNM. We also held monetary policy workshops for the public and media. These workshops provided deeper insights into our policy approach and provided space for interactive discussions to address misconceptions and information gaps. This includes how inflation

is measured, drivers of the ringgit, and the role of monetary policy in an economy.

Going Forward

We expect the global environment to remain uncertain, with many moving parts shaping domestic economic conditions. Despite this, Malaysia's economy is projected to remain on a firm footing, supported by resilient domestic demand. We expect inflation to stay moderate, keeping price changes steady and predictable.

As developments abroad can influence conditions at home, the MPC will continue to monitor global trends closely. In charting a steady path forward, the MPC will remain focused, alert to emerging risks, and vigilant to factors that may affect Malaysia's growth and inflation prospects. Above all, the MPC remains committed to keeping inflation low and stable in support of sustainable economic growth.



Governor speaking at the press conference for the second quarter Quarterly Bulletin release

²⁶ More information on the BNM's public engagements throughout the year can be found in the 'Engaging Malaysians' chapter of this Annual Report.

Beyond the Headline: Inflation through the Eyes of Households

Introduction

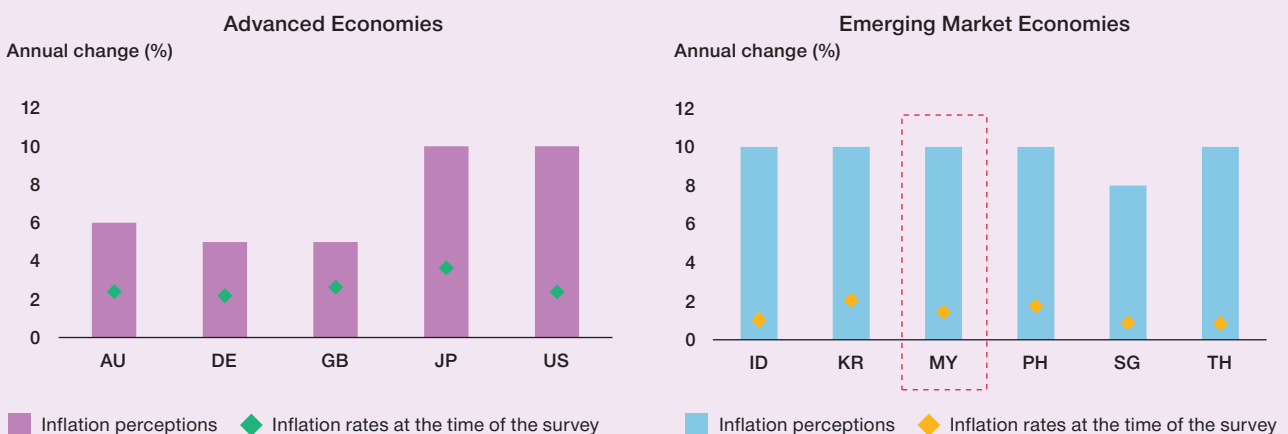
Inflation in Malaysia has eased to its lowest level in five years. In 2025, headline inflation, measured as the year-on-year growth in the Consumer Price Index (CPI), averaged 1.4%.¹ But, high cost of living remains a major concern for many households. This partly reflects how inflation is measured in official statistics compared with people’s day-to-day experiences. In this article, we explore why this experience can feel different from the headline inflation figures – a pattern seen in Malaysia and many other countries around the world.

It is natural for inflation to be viewed in a way that reflects people’s own experiences or opinions

Media headlines and everyday conversations about prices tend to draw on people’s own experiences, especially when it comes to familiar vegetables like *sawi* or everyday meals such as *nasi lemak* and *roti canai*. These day-to-day observations naturally shape how many Malaysians perceive inflation.

Evidence from around the world, including Malaysia, shows that people often perceive inflation to be higher than what official figures report. This is especially the case after periods of sharp price increases, such as those that followed the COVID-19 pandemic (Chart 1) (Weber et al. (2021); Anesti et al. (2024)). This is understandable, as households feel the price changes directly in their daily spending.

Chart 1: Household Inflation Perceptions* Are Elevated Above Prevailing Inflation Rates



* Household inflation perceptions typically refer to how households perceive the magnitude of past price changes. In contrast, inflation expectations refer to the magnitude of future price changes expected by households (European Central Bank Economic Bulletin, 2021).

Note: AU = Australia, DE = Germany, GB = Great Britain, JP = Japan, US = United States, ID = Indonesia, KR = Korea, MY = Malaysia, PH = Philippines, SG = Singapore, TH = Thailand

Source: Adapted from ‘A global survey of household perceptions and expectations’ (Bank for International Settlements (BIS), 2025). The BIS conducted a cross-country survey in March–April 2025 examining households’ inflation perceptions and expectations, finding that households in all surveyed economies consistently perceived inflation over the past 12 months to be higher than official published rates

¹ Inflation is measured by the Consumer Price Index (CPI), which is published by Department of Statistics, Malaysia (DOSM) monthly. For further information, please refer to the white box article on ‘Inflation, the Cost of Living and the Living Wage’ in BNM’s Annual Report 2018.

Households tend to form their views on inflation and price changes in two main ways.

First, **households’ impressions of prices are largely influenced by the items they buy frequently**, such as staple food and beverages. This tendency, also known as frequency bias, means that regularly bought items weigh more heavily on their perception of inflation. To better reflect this experience, economists use indicators such as the **Everyday Price Index (EPI)**, which assigns greater weight to frequently purchased items in the CPI. By emphasising these regular purchases, the EPI captures price changes that more closely mirror households’ day-to-day experiences.

Second, **households’ perceptions are also shaped by how price changes are remembered**. Price increases tend to leave a stronger and more lasting impression than price declines, even when both occur. This behavioural pattern, known as memory bias, is captured in the **Perceived Price Index (PePI)**. The PePI is similar to the EPI but includes only items that have recorded price increases, while excluding those that have fallen in price.² As a result, the PePI often shows a higher rate of inflation than both the CPI and the EPI, reflecting the stronger impression that price hikes leave on households.

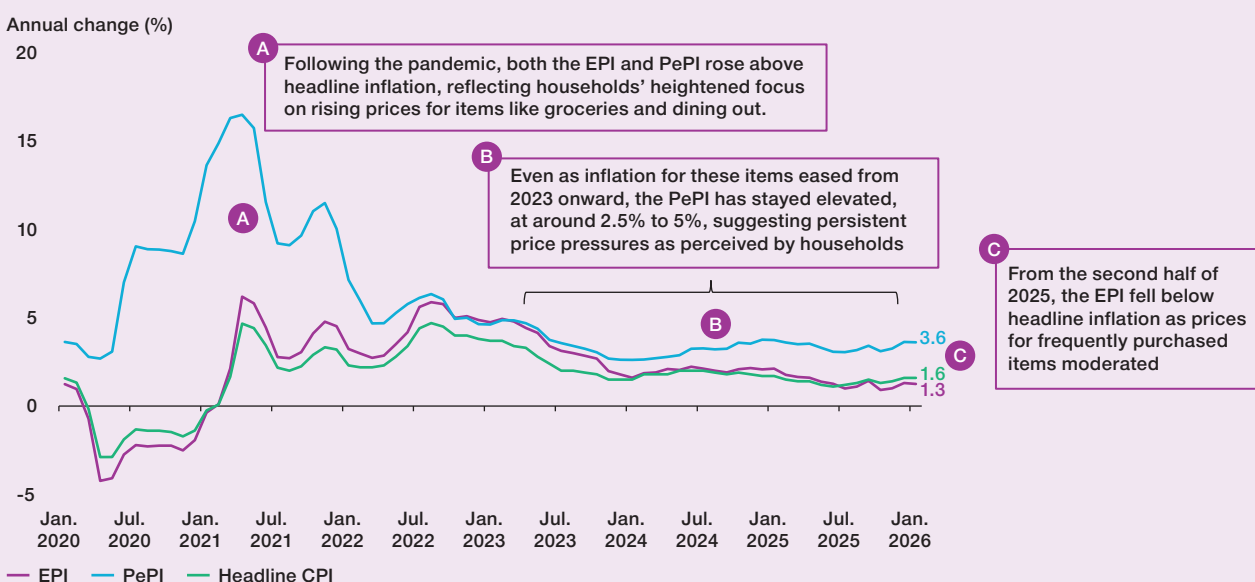
Recent trends in the data illustrate this clearly. Prices of everyday items such as fresh food, petrol and utilities have eased, helped by softer global commodity prices and recent policy reforms (Table 1).³ As a result, the EPI has fallen below headline inflation. Even so, the PePI has stayed high (Chart 2). This suggests that many households still feel inflation is elevated because earlier price increases continued to stand out more than the more recent price declines.

Table 1: Price Movements for Selected Items (2025 vs. 2024)

Price increases	Price declines	Prices stable (mainly price-administered items)
<ul style="list-style-type: none"> Eating out: 4.1% (2024: 3.6%) Water bills: 5.5% (2024: 28%) Rent: 2.0% (2024: 1.7%) 	<ul style="list-style-type: none"> Vegetables: -4.4% (2024: 2.5%) Electricity: -3.4% (2024: 1.6%) Petrol: -0.9% (2024: -0.2%) 	<ul style="list-style-type: none"> Toll facilities Government hospital fees

Source: Department of Statistics, Malaysia

Chart 2: Malaysia’s CPI, EPI and PePI



Note: EPI and PePI are constructed by Bank Negara Malaysia using DOSM price data.

Source: Department of Statistics, Malaysia and Bank Negara Malaysia estimates

² For more information, please refer to the box article ‘Inflation: Perception vs. Reality’ in BNM’s First Quarter of 2017 Quarterly Bulletin.
³ For example, policies include fuel subsidy rationalisation under BUDI95 and electricity tariff revision.

So why do we still rely on the CPI?

The CPI is designed to measure overall inflation across the entire economy. It is built on a broad and representative basket of goods and services that reflects the spending patterns of the average household. To capture this full picture, the CPI includes not only everyday essentials but also items that are purchased less frequently, such as computers and household appliances.

Because of this wider coverage, and its consistent methodology across countries, the CPI provides the most complete and internationally comparable measure of inflation. This is why it remains the primary indicator used to assess inflation trends and guide policy decisions.

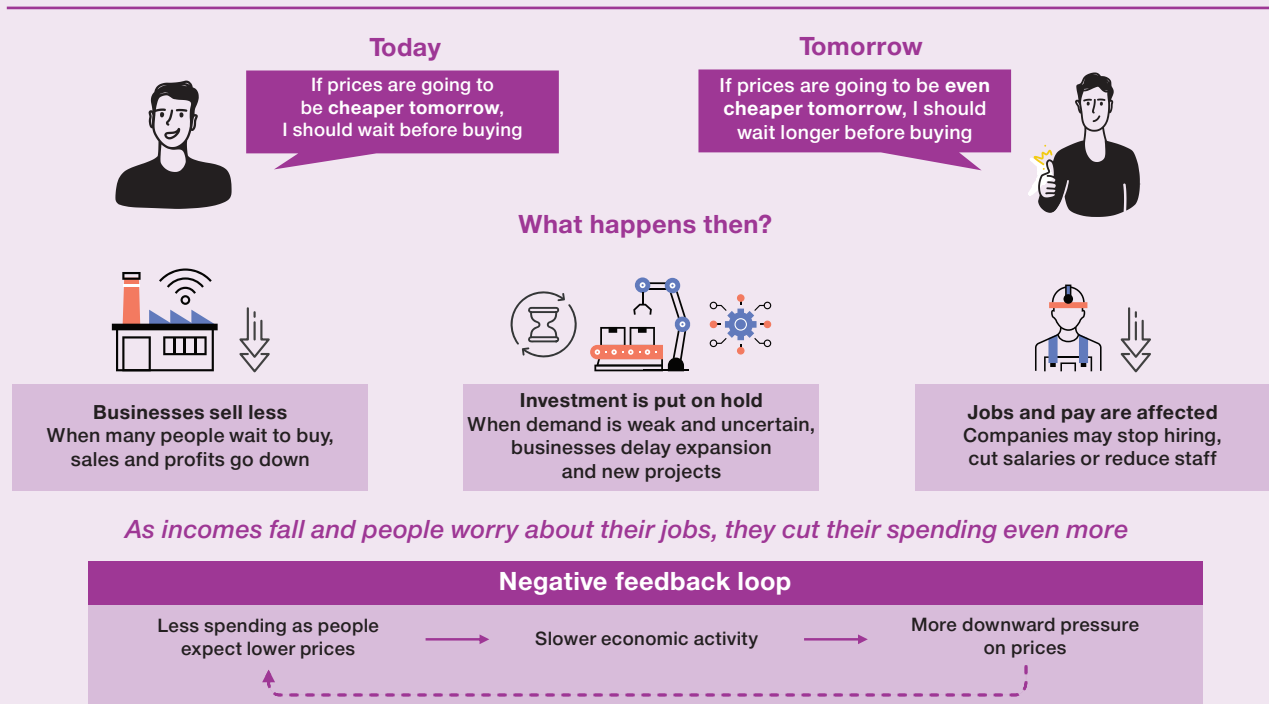
At the same time, to gain a more holistic understanding of inflation as felt by households, some economists also examine the EPI and PePI. Each of these indicators highlights a different angle of how people experience price changes in their daily lives. Taken together, the CPI, EPI and PePI provide a deeper and more nuanced picture – balancing lived experience with the broader economic perspective.

Inflation measures price growth, not price levels

Inflation measures how **fast** prices are rising, not how high prices already are. Many people think about inflation by comparing today’s prices with what they were before, sometimes from years ago. When everyday expenses feel high, it is natural to wish that prices could return to those earlier, more familiar levels. These past price points often serve as a reference for how households assess whether their purchasing power has improved or weakened.

But for *prices to fall back* to earlier levels would mean deflation. While deflation may sound appealing at first, especially when living costs feel high, it can create deeper problems in the economy. If people expect prices to keep falling, they may delay spending in the hope of getting a better deal later. When this behaviour becomes widespread, it can weaken demand, reduce business revenues, and lead to job losses and delayed investment, setting off a cycle of weaker economic activity (Diagram 1).

Diagram 1: When Falling Prices Create Bigger Problems



Source: Bank Negara Malaysia

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Prices play an important role in the economy. They signal changes in supply and demand to enable a more efficient allocation of resources. In some cases, price increases are a natural and necessary part of this process. For example, when the demand for a product is more than available supply, prices may rise until they reach a point where buyers' willingness to pay matches what sellers are willing to provide. This was seen during the COVID-19 pandemic when global demand for rubber gloves far exceeded available supply, causing average selling prices to more than double. In other cases, price changes could partly reflect better quality or features – for example, getting a phone with a better camera or longer battery life. In these situations, people may be paying more not just because of higher costs, but because they are receiving a better product in return.

For some essential goods, the Government may step in and sometimes cap prices through subsidies or price controls to ease short-term price pressures. However, such measures are costly for the Government. In addition, if such caps stay in place for too long, they can also distort supply and demand. For instance, in the case of price controls, producers may struggle to stay profitable when the cost of producing a product rises above its fixed selling price. In turn, they may cut back on production, or focus production towards exports markets offering higher prices, leading to supply shortages – commonly known as the 'empty shelves phenomenon'.

Purchasing power depends on prices, as well as wages

As the central bank, one of Bank Negara Malaysia's (BNM) key objectives is to ensure low and stable inflation. This is important as stable and predictable prices allow households and businesses to better plan their spending, saving and investment decisions. In turn, this helps to support economic activity and growth.

Preserving households' purchasing power, however, depends not only on prices, but also on incomes. Namely, when price increases are slow and predictable, households can maintain their purchasing power as long as wages rise alongside prices. In such conditions, steady inflation allows incomes time to adjust, helping households cope with higher prices and plan their spending with greater confidence.

Recent developments in Malaysia help illustrate this dynamic. In 2025, overall prices increased by 1.4% while nominal wages per worker grew by 1.7%,⁴ bolstered by policy support and firm economic activity. However, a closer look at how wage and price levels have evolved since before the pandemic shows why many households still feel the strain. From 2019 to 2024, the headline CPI increased by 9.3%, while nominal wages per worker grew by just 7.2%. In other words, this means that the average person must work more hours to afford the same basket of goods. This is clearly illustrated in the case of food: as food prices rose faster than wages in recent years, households must now work longer just to meet their usual food expenses (Chart 3).

Chart 3: Working Hours Needed to Afford Monthly Food Expenditure*



* Based on gross median income and average spending on food, with the assumption of nine working hours/day and five working days/week.

Source: Bank Negara Malaysia estimates using data from Household Income and Expenditure Surveys 2019 and 2024, Department of Statistics, Malaysia

⁴ Nominal wages per worker refers to the wages of workers in the private-sector manufacturing and services industries.

Recent income measures, such as revisions to the minimum wage,⁵ have helped to ease the burden of more than five million workers in Malaysia. Over the longer term, however, deeper structural reforms are needed to address the root causes of subdued wage growth in Malaysia.

First, there is a need to create more high-skilled and high-paying jobs. In 2025, high-skilled jobs made up only 26% of new positions, lower than the 5-year (2020–24) average of 30%. This decline reflects Malaysia's slow transition from low to high value-added industries, muted adoption of technology and low research and development (R&D) investment. To address these gaps, reforms that promote industrial upgrading and support firms' transition into more complex, high-value production are essential. In this vein, initiatives such as the National Industrial Masterplan (NIMP2030) and the National Investment Aspirations (NIA) aim to attract higher quality investments, promote technology-intensive production and generate more high-skilled jobs.

At the same time, supply-side reforms are equally important to ensure the workforce can meet rising skill demands. Persistent skills mismatches and limited support for upskilling and reskilling continue to limit workers' access to better-paying opportunities. Elevating education and training systems, deepening industry linkages and expanding opportunities for lifelong learning will be critical.

Overall, a comprehensive reform agenda is needed to address persistent gaps in the labour market, raise productivity and create more opportunities for better-paying jobs.⁶ Without addressing these underlying conditions, wage growth could continue to lag price increases, leading to an erosion in living standards over the long term.⁷

Conclusion: Perceptions and Policy

At the end of the day, inflation is not just about numbers. Household experiences shape perceptions and expectations of inflation, influencing key economic decisions such as consumption, savings and wage expectations. These, in turn, impact firms' price-setting behaviour and create broader ripple effects on the economy. When expectations of high inflation become widespread, they can also influence inflation itself. In extreme cases, if people expect prices to rise faster than usual, their behaviour can end up keeping inflation high for longer and affect a wider range of goods and services.⁸

In pursuit of low and stable inflation, BNM's main tool is monetary policy. When inflation is high, BNM adjusts monetary policy to manage overall demand in the economy, slowing the pace of price increases. The aim is to ensure low and stable inflation, rather than an environment of deflation, which could harm the economy. However, monetary policy alone cannot fully preserve purchasing power, as households' wellbeing is also shaped by wage growth, productivity and broader cost of living trends.

Even with moderate inflation, many households continue to grapple with higher living costs amid slow wage growth. To secure better living standards and strengthen purchasing power, income growth needs to outpace increases in prices. When expenses rise faster than incomes, even small price increases can feel significant to households, shaping how affordable things seem and how they view the broader economy.

Ultimately, strengthening households' purchasing power requires a holistic and coordinated policy strategy. This entails complementing monetary policy with targeted fiscal support for vulnerable groups and implementing structural reforms that boost incomes and productivity. By tackling both price and wage dynamics, policymakers can safeguard purchasing power and support sustainable economic growth over the long term.

⁵ In 2025, Malaysia's minimum wage was raised to RM1,700 from RM1,500.

⁶ At this juncture, ongoing efforts by the Government to strengthen education and skills development include reforms to technical and vocational education (TVET) and expanded industry-linked training initiatives.

⁷ For more information on policies addressing labour market challenges and wage growth, please refer to the box article 'Sustaining the Engine: The Evolving Drivers behind Malaysia's Private Consumption Growth' in BNM's Economic and Monetary Review 2025 and the feature article 'Curbing Inflation, Easing Costs: The Policy Perspective' in BNM's Annual Report 2024.

⁸ During the post-pandemic reopening of the economy, many people expected prices to rise faster than usual given the environment of pent-up demand and supply disruptions. In turn, as costs rose, businesses were able to increase prices more easily without losing customers, contributing to broad-based inflation which peaked at 4.7% in August 2022.

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