From the Desk of the
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HOUSEHOLD BORROWING SET TO WEAKEN AS LIVING COSTS SURGE

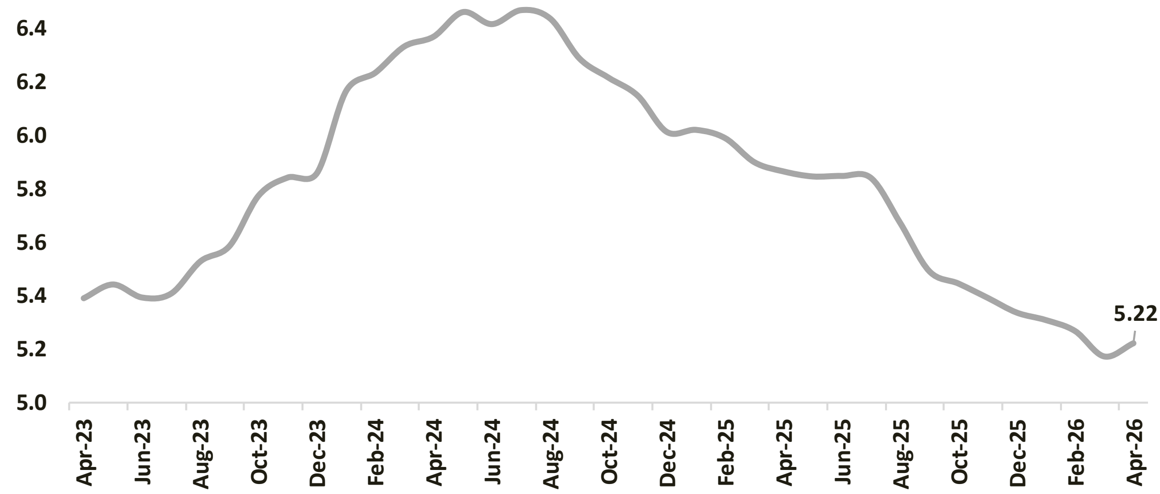
- Household financing forms the backbone of Malaysia's banking system, accounting for more than half of total loans outstanding. As of end-2025, household debt stood at RM1.67 trillion, with a debt-to GDP ratio of 84.8%. Housing and vehicle financing dominate, reflecting households' reliance on credit to fund major purchases or big-ticket items which are often considered essential needs.

- While debt servicing capacity remains broadly manageable, rising living costs and tighter budgets are set to weaken borrowing appetite. This dynamic pose risks not only to household balance sheets but also to private consumption, which anchors Malaysia's overall economic growth.

Household Financing Eases as Consumers Turn Cautious

- Household financing in the banking system continued its downtrend over the past year, despite improving only slightly to 5.22% y-o-y in April from 5.17% y-o-y in March. Elevated living costs and cautious household sentiment amid expectations of slower economic performance have contributed to a softer household financing growth in recent months, a trend visible across most household loan purpose segments. Household debt remains primarily concentrated in housing and car financing, which together account for over 75% of total household financing.

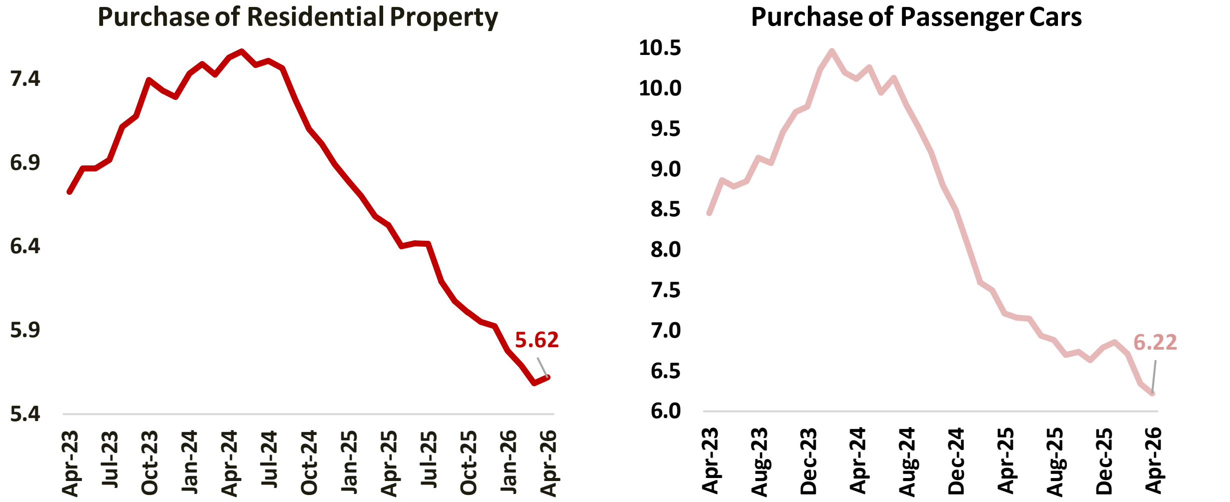
Chart 1: Household Financing (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- Residential property financing growth has continued to decelerate, reflecting households' reluctance to commit long-term debt amid high living costs and tighter lending standards. The growing preference for rent over home ownership has also contributed to the moderation growth in housing financing. The slowdown highlights how affordability pressures are already dampening homebuyer sentiment even before the U.S.-Iran conflicts emerged.

Chart 2: Key Purposes of Household Financing (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- Likewise, passenger car financing growth has softened as households grow more cautious about taking on large discretionary commitments. Rising living costs, higher vehicle maintenance expenses, and tighter lending standards have weighed on demand, while lifestyle shifts among younger consumers such as greater reliance on public transport and e-hailing services have further dampened appetite for car ownership. Elevated fuel costs following earlier subsidy rationalization have also added to household operating expenses, reinforcing the slowdown in vehicle financing.

- Diesel subsidies were removed in Peninsular Malaysia in June 2024, while the subsidised RON95 petrol quota was reduced from 300 to 200 litres/month effective April 1, 2026. Under this measure, households pay RM1.99/litre only for the first 200 litres, with subsequent purchases priced at market rates. The adjustment was introduced to guarantee supply and manage demand prudently amid heightened global energy price pressures from ongoing U.S.-Iran tensions.

- Meanwhile, diesel prices for consumers will be lowered starting July 1, with the subsidised rate reduced to RM2.10 per litre from RM2.15 currently. At present, diesel is sold at the unsubsidised price of RM4.07 per litre in Peninsular Malaysia and RM2.15 per litre in Sabah and Sarawak. The nationwide adjustment to subsidised diesel prices will be implemented through a MyKad-based targeting mechanism, similar to the Budi Madani RON95 (Budi95) system. While this measure provides some cost relief, its overall impact on CPI is expected to be limited given diesel's relatively small weight in the consumption basket. Nonetheless, earlier increases in fuel costs may have already filtered through to broader price pressures.

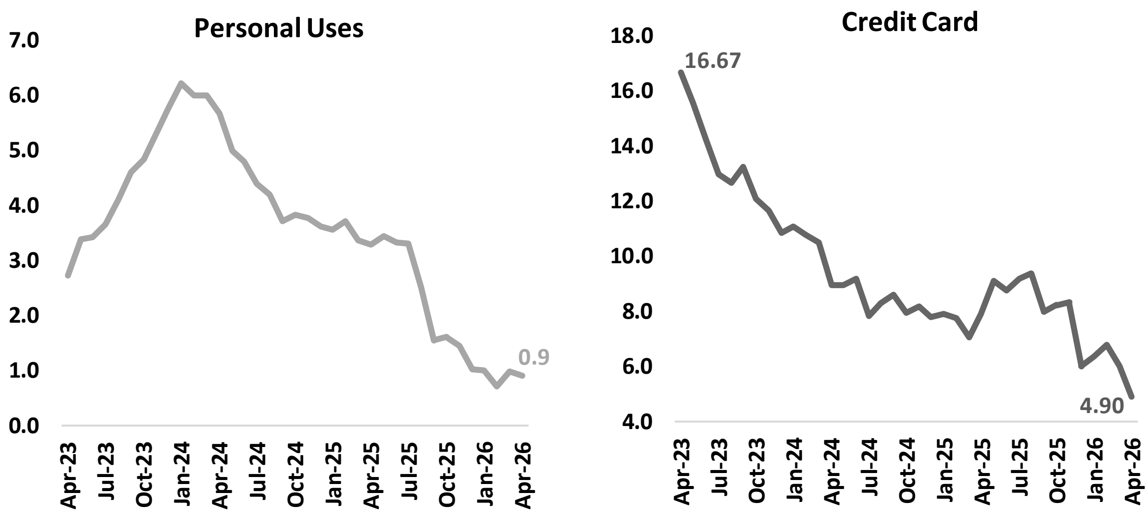
- Although this measure offers targeted support, frequent changes in subsidy policies have left consumers cautious. In an environment where global oil prices remain volatile amid war-related disruptions and geopolitical uncertainty, households are expected to remain prudent, leading to modest demand for vehicle financing despite the latest subsidy relief.

Buy Now Pay Later (BNPL): Emerging as an Alternative for Short-Term Financing?

- Financing growth for personal uses and credit cards has also mirrored the slowdown seen in housing and cars financing. Personal financing has remained sluggish, recording growth below 1.5% since November last year, with borrowing for consumer durable goods posting double-digit declines for nine consecutive months. A significant moderation was also observed in other personal loans.

- Meanwhile, credit card financing eased further in April, expanding by only 4.9% y-o-y, compared with 16.7% recorded exactly three years earlier. The downward trend partly reflects the rising popularity of Buy Now Pay Later (BNPL) schemes, which have gained traction among younger consumers and gig workers seeking flexible repayment options without stringent applications requirements.

Chart 3: Personal and Credit Card Financing (y-o-y, %)

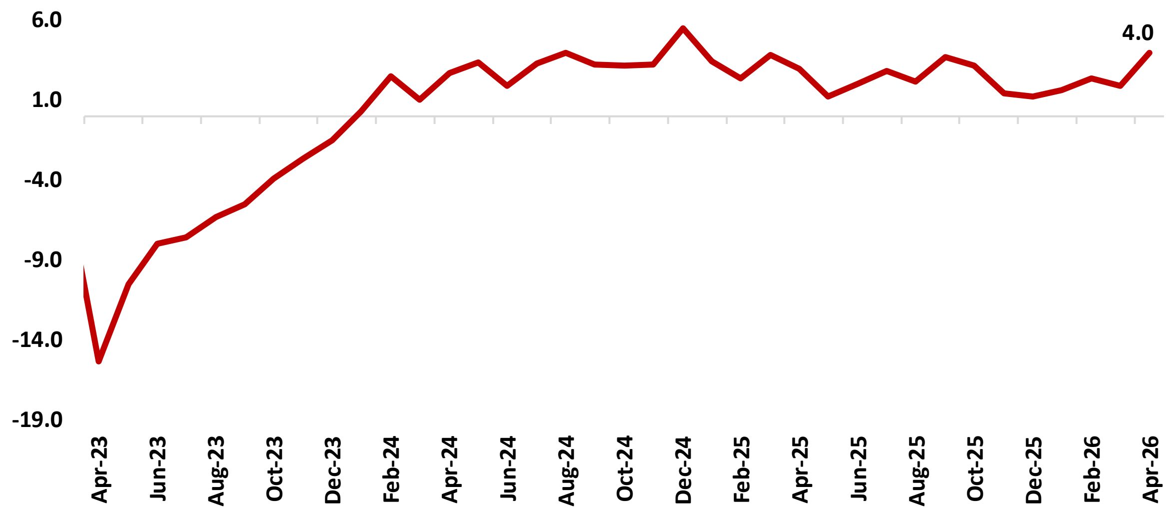


Sources: BNM, CEIC, Bank Islam

- While traditional lending models continue to rely on fixed salaries, CCRIS records, stable employment histories, and formal documentation, BNPL provides instant approvals, zero-interest instalments, and app-based convenience. This makes BNPL an increasingly attractive alternative to traditional credit cards.

- Furthermore, the acceleration in saving deposits to 4.0% in April (Mar 26: 1.9%), the highest since December 2024, illustrates how households prefer to safeguard their money during periods of uncertainty, while simultaneously showing a shift towards short-term financing via BNPL.

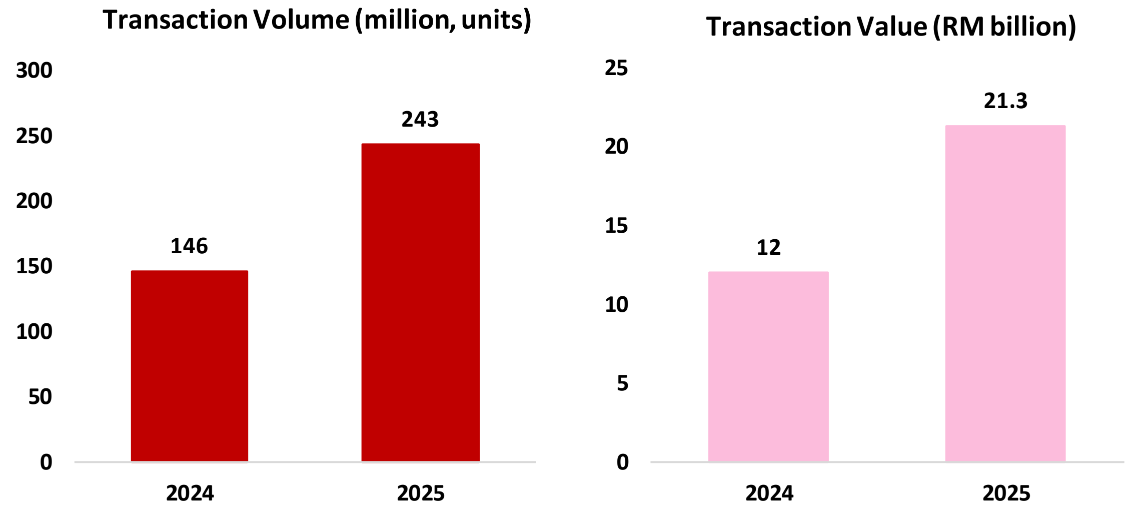
Chart 4: Saving Deposits (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- According to Ministry of Finance (MoF), BNPL transactions in Malaysia surged to 243 million, with a total value of RM21.3 billion in 2025, representing a 66% increase in transaction volume and a 78% rise in value compared with 2024, when 146 million transactions worth RM12.0 billion were recorded.

Chart 5: Transaction Performance of Buy Now Pay Later (BNPL)



Sources: MOF, Bank Islam

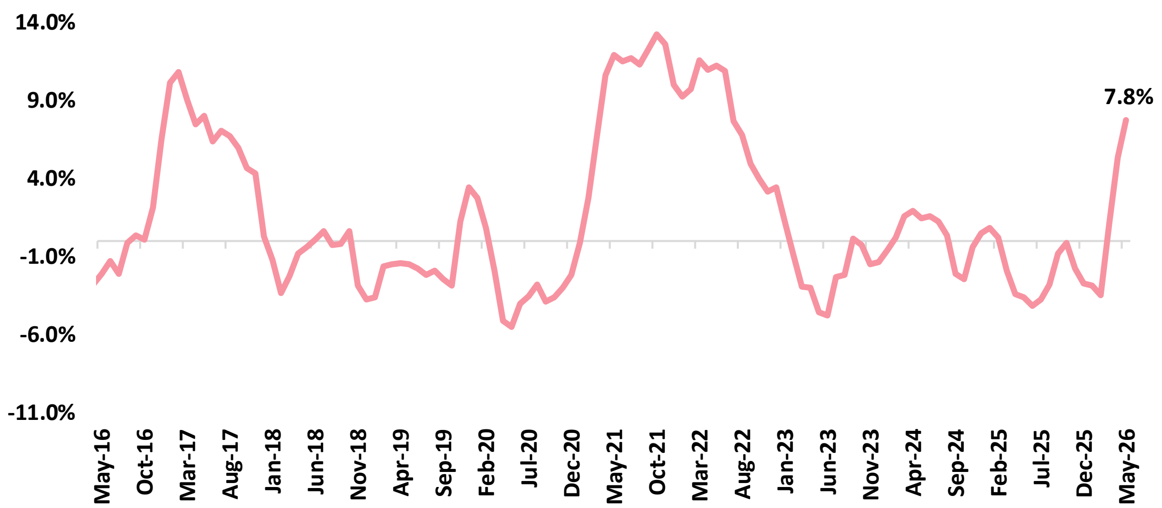
- BNPL usage has increasingly shifted from discretionary spending towards everyday essentials, underscoring its growing role as a parallel financing channel that is reshaping household borrowing behaviour. According to the Deputy Finance Minister, BNPL is now commonly used for basic expenditures such as food, groceries, transportation, and services, with an average transaction value of approximately RM91. Notably, individuals aged 30 and below account for around 40% of total transactions, highlighting its strong adoption among younger consumers.

- Findings from the Consumer Credit Oversight Board Task Force further indicate that more than 70% of active BNPL users are from the B40 income group. This suggests that BNPL is increasingly being used as a short-term cash flow management tool rather than purely for discretionary purchases.

Rising Input Costs to Drive Second-Round Inflation Risks

- Malaysia's Producer Price Index (PPI) reached its highest level in almost 4 years (Jun 22: +10.95), picking up to 7.8% in May (Apr: 5.4%). The jump reflects intensifying cost pressures from surging energy prices amid U.S-Iran tensions. YTD (May 2026), diesel prices soared 70.4%, while RON95 and RON97 climbed 55.1% y-o-y and 52.2% y-o-y, respectively, translating into higher domestic fuel costs and rising production expenses across sectors.

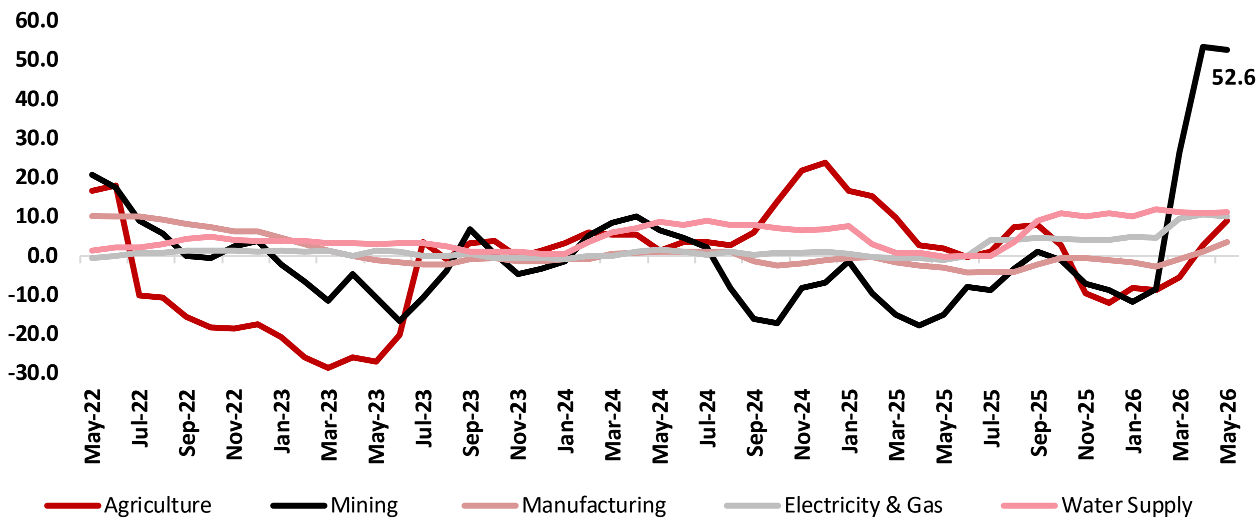
Chart 6: Producer Price Index (PPI) (y-o-y, %)



Sources: DOSM, CEIC, Bank Islam

- Sectoral costs gains were broad-based in May 2026, with mining rising 52.6% (Apr 26: 53.4%), manufacturing accelerating to 3.5% (Apr 26: +1.1%), and agriculture rebounding to 8.9% (Apr 26: +2.7%) after several months of deflation. Meanwhile, electricity & gas (+10.0%; Apr 26: +10.6%), and water supply (+11.2%; Apr 26: 10.8%) sustained double-digit increases, highlighting persistent cost pressures across key sectors.

Chart 7: PPI by Sector (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- Rising fertilizer prices have directly increased production costs in crop and animal production, as fertilizer is a key input for planting and feed. The rebound in costs shown in Table 1 (May 26: +9.1%; Apr 26:1.7%) reflects how higher input prices are translating into higher farm-gate costs, which in turn expected to push up food prices. Since food carries a large weight in Malaysia's Consumer Price Index (CPI) basket, this intensifies the cost-of-living burden on households, eroding disposable income.

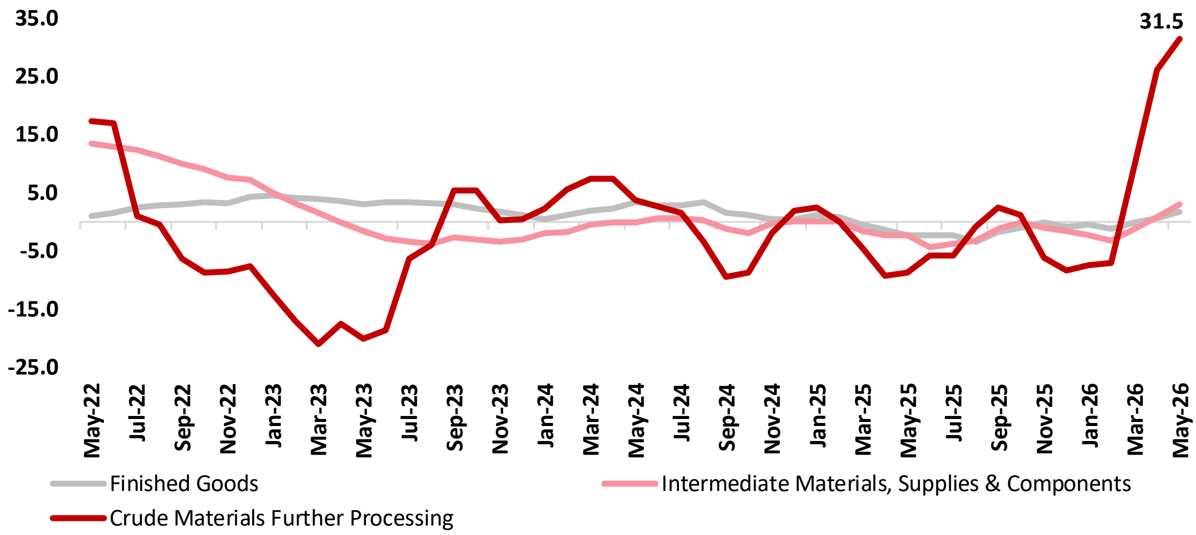
Table 1: Heatmap – PPI Breakdown by Sector

Component/Sub-component	Weight	Jan-26	Feb-26	Mar-26	Apr-26	May-26
Producer Price Index	**100.0**	**-2.9**	**-3.4**	**1.1**	**5.4**	**7.8**
Agriculture	**6.7**	**-8.3**	**-8.7**	**-5.6**	**2.7**	**8.9**
Crop & Animal Production, Hunting & Related Serv Activities	5.7	-10.1	-10.6	-7.5	1.7	9.1
Forestry & Logging	0.4	-1.4	-0.5	-0.7	1.5	-0.2
Fishing & Aquaculture	0.6	8.8	8.5	13.8	14.7	13.0
Mining	**7.9**	**-11.7**	**-8.5**	**26.5**	**53.4**	**52.6**
Manufacturing	**81.6**	**-1.7**	**-2.7**	**-0.8**	**1.1**	**3.5**
Food Product	14.5	-4.2	-5.2	-2.8	-0.3	2.2
Beverages	0.7	2.6	3.4	5.7	4.3	5.1
Tobacco Products	0.3	12.5	12.8	10.2	9.7	5.9
Textiles	0.6	-0.9	0.0	1.0	-0.7	-1.4
Wearing Apparel	0.6	-2.7	0.7	-0.1	-0.3	-0.6
Leather and Related Products	0.1	-2.3	-1.0	0.6	1.4	4.0
Wood & Wood Products	1.7	-3.0	-3.6	-3.7	-3.4	-3.7
Paper & Paper Products	1.2	1.7	1.1	2.9	2.7	3.3

Printing & Reproduction of Recorded Media	0.7	-0.6	-0.1	-0.2	-0.8	-0.7
Coke & Refined Petroleum Products	10.0	-5.8	-10.6	-3.8	3.0	12.3
Chemicals & Chemical Products	6.7	-4.1	-5.7	-4.4	-2.0	0.4
Basic Pharmaceutical Products & Preparation	0.3	-1.1	-3.3	-4.2	-4.2	-4.2
Rubber & Plastic Products	4.7	-2.8	-2.5	-1.2	1.6	2.4
Non Metallic Mineral Products	2.9	2.3	3.6	3.4	3.5	3.3
Basic Metals	3.1	-1.4	-1.5	-0.8	-0.8	0.1
Fabricated Metal Products excl Machinery & Equip	3.6	-0.4	0.2	0.5	1.3	1.3
Computer, Electronic & Optical Products	18.8	2.4	1.5	3.2	3.8	5.7
Electrical Equipment	2.6	-2.7	-2.6	-2.1	-1.9	-0.9
Machinery & Equipment	2.1	-1.7	-1.3	-1.6	-1.6	-1.2
Motor Vehicles, Trailers & Semi Trailers	4.0	1.7	1.1	0.2	2.2	2.5
Other Transport Equipment	1.4	-6.2	-6.6	-4.8	-2.0	-2.6
Furniture	0.9	0.6	-0.1	-1.8	-1.9	-2.6
Electricity & Gas	**3.4**	**4.9**	**4.7**	**9.6**	**10.6**	**10.0**
Water Supply	**0.3**	**10.2**	**11.9**	**11.3**	**10.8**	**11.2**

Sources: DOSM, CEIC, Bank Islam

Chart 8: PPI by Stage of Processing (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- By stage of production, crude materials for further processing skyrocketed further to 31.5% (Apr 26: +26.1%), while intermediate inputs and finished goods accelerated 3.0% (Apr 26: 0.8%) and 1.7% (Apr 26: +0.7%), highlighting broad-based cost escalation feeding into factory-level inflation.

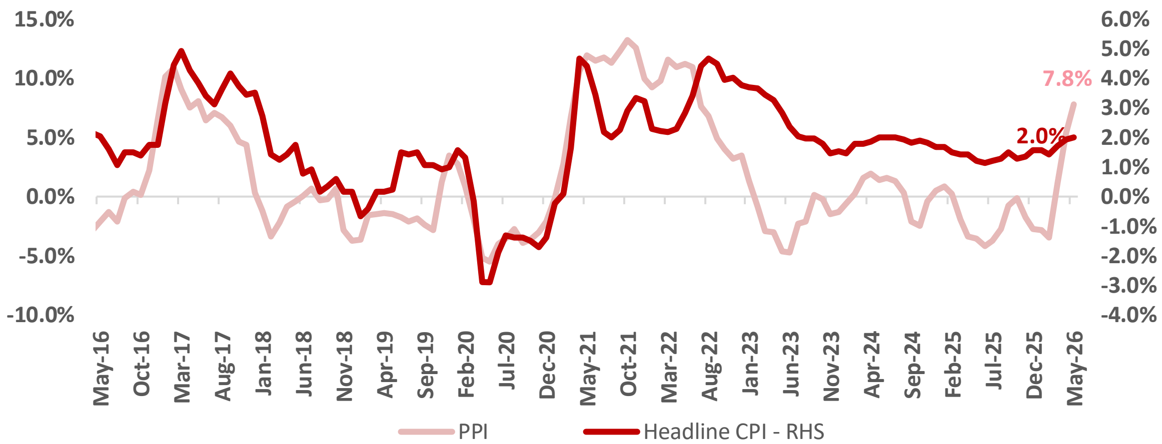
Table 2: Heatmap – PPI Breakdown by Processing Stage

Component/Sub-component	Weight	Jan-26	Feb-26	Mar-26	Apr-26	May-26
Producer Price Index	**100.0**	-2.9	-3.4	1.1	5.4	7.8
Crude Materials for Further Processing	**16.4**	-7.5	-7.0	9.8	26.1	31.5
Foodstuffs and Feedstuffs	3.2	4.5	4.4	5.5	4.3	4.3
Non-food Materials	13.2	-10.0	-9.5	10.7	31.2	38.1
Intermediate Materials Supplies and Components	**56.1**	-2.3	-3.1	-1.3	0.8	3.0
Materials and Components for Manufacturing	29.6	-3.5	-4.2	-2.5	-0.5	1.6
Materials and Components for Construction	2.9	5.8	5.9	5.9	5.9	5.3
Processed Fuels and Lubricants	11.9	-6.3	-9.3	-4.8	-0.7	3.7
Containers	0.6	3.0	2.1	2.3	2.4	3.6
Supplies	11.2	2.7	2.8	3.5	4.4	5.7
Finished Goods	**27.5**	-0.6	-1.1	-0.1	0.7	1.7
Finished Consumer Foods	3.5	0.5	0.5	0.7	-0.1	0.9
Finished Consumer Goods Excluding Foods	8.0	-0.4	0.3	0.6	0.7	1.3
Capital Equipment	16.0	-0.9	-2.3	-0.6	0.8	2.1

Sources: DOSM, CEIC, Bank Islam

- Rising production costs are exerting second-round inflationary pressures on consumers. Historically, movements in the Consumer Price Index (CPI) have closely tracked the Producer Price Index (PPI), except during periods of government intervention such as food price controls or fuel subsidies. If elevated oil prices continue to raise operating expenses and compress business margins, firms are likely to pass these costs on to consumers, resulting in higher living costs in the period ahead.

Chart 9: CPI vs PPI (y-o-y, %)



Sources: DOSM, CEIC, Bank Islam

- The inflation heatmap (Table 3) shows food-away-from-home prices remaining elevated at 2.5% in May, reflecting higher delivery and transport costs. At the same time, the transport index stayed above 3.5% for the second consecutive months, driven by the operation of personal transport equipment and persistently high public transport services. The lagged effect of rising input costs is expected to become more visible in food prices in the coming months, with food and beverages carrying a 29.8% weight in the CPI basket.

Table 3: Heatmap for Selected Component/Subcomponent

Sub-component	Weight	Jan-26	Feb-26	Mar-26	Apr-26	May-26
Food and Beverages (FB)	**29.8**	1.5	1.3	1.1	1.2	1.4
Food	**29.0**	1.5	1.3	1.1	1.2	1.4
Food Away from Home	13.4	2.5	2.4	2.3	2.6	2.5
Food at Home	15.6	0.6	0.3	0.1	0.0	0.3
Transport	**11.3**	-0.7	-0.7	1.6	4.1	3.8
Purchase of Vehicles	*1.6*	0.2	-0.4	-0.5	-0.2	-0.2
Operation of Personal Transport Equipment	*8.9*	-1.0	-1.2	1.5	4.8	4.2
Public Transport Services	*0.7*	0.8	3.8	7.0	7.0	6.8
Transport Services of Goods	*0.1*	-1.4	-1.9	-1.9	-1.3	-1.3

Sources: DOSM, CEIC, Bank Islam

- Nevertheless, continued fuel subsidies on RON95 and diesel, together with food price controls, may partially mitigate the impact of cost shocks on overall inflation stemming from the earlier surge in energy prices triggered by the U.S.-Iran conflict. Should the conflict fade and the Strait of Hormuz remain open, global oil prices could trend downward, easing some cost pressures.

- Even so, both CPI and PPI are expected to stay higher than last year's levels, as earlier energy-related increases have already filtered through supply chains and lifted production costs. Against this backdrop, households are likely to remain cautious, with modest demand for financing reflecting persistent uncertainty and the frequent adjustments in government subsidy measures.

BNM to Hike OPR on Inflationary Pressures? Implications For Household Financing

- Modest core inflation, lingering around 2.0%, reduces the urgency for rate hikes, as underlying demand pressures appear contained. However, headline inflation recorded its highest growth in almost 2 years, rising 2.0% in May.

- The likelihood of persistently high headline inflation in the months ahead, driven by energy and food costs could further erode household purchasing power, leading to more cautious financing demand as consumers adjust to higher living costs.

- This situation presents a policy dilemma for BNM: raising the OPR could further dampen economic growth, while keeping rates unchanged risks allowing inflation expectations to become less anchored if supply-side pressures persist amid U.S.-Iran tensions.

- Unlike the post-pandemic period in 2022, current inflationary pressures appear to be more supply-driven than demand-led, limiting the need for monetary tightening. For now, we maintain our view that BNM will keep the OPR unchanged at 2.75% throughout this year, supported by modest core inflation and existing price control and subsidies measures.

- Nevertheless, a prolonged rise in headline inflation could still trigger rate hikes if inflation climbs beyond acceptable thresholds. In such a scenario, higher borrowing costs would likely further dampen household financing demand, as households face increased monthly repayments on existing loans and tighter affordability for new credit.

- Rising interest rates typically reduce the appeal of large-ticket financing such as housing and vehicles, while also discouraging personal loans and credit card usage. Banks may respond by tightening lending standards to manage repayment risks, compounding the slowdown in credit growth.

- At the same time, households already burdened by elevated living costs and food inflation would become more cautious, prioritising essential spending over discretionary borrowing. This combination of higher debt servicing costs, reduced affordability, and cautious sentiment underscores the likelihood of a more pronounced moderation in household financing growth should policy rates rise further.

Household Financing Quality to Deteriorate Under Cost-of-Living Strain?

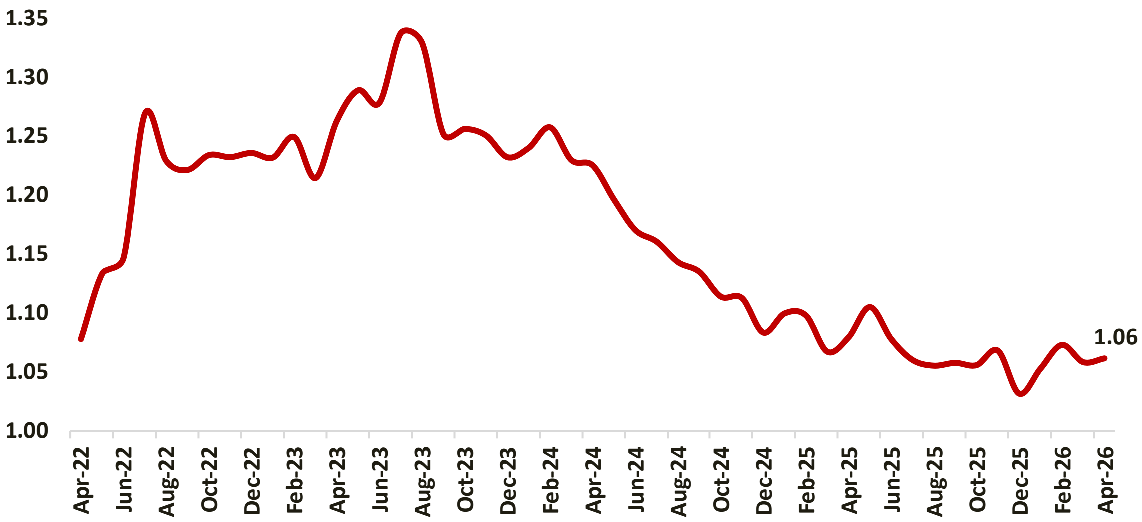
- Recent trends suggest household asset quality is beginning to show signs of strain, reflecting a weakening ability to service credit. Passenger car financing shows the clearest upward trend in GIFR over the past four years, though its level remains below other household segments.

- Additionally, personal financing and credit card segments' GIFR have also turned higher, pointing to rising stress among more discretionary forms of borrowing. However, the ratio for residential property financing has remained relatively stable, indicating more resilient repayment behavior in this segment.

- Looking ahead, impaired financing is expected to climb if inflationary pressures persist, with personal financing, credit card, and passenger car financing most exposed to repayment stress. Residential property financing should remain comparatively stable, as housing is prioritized as an essential need.

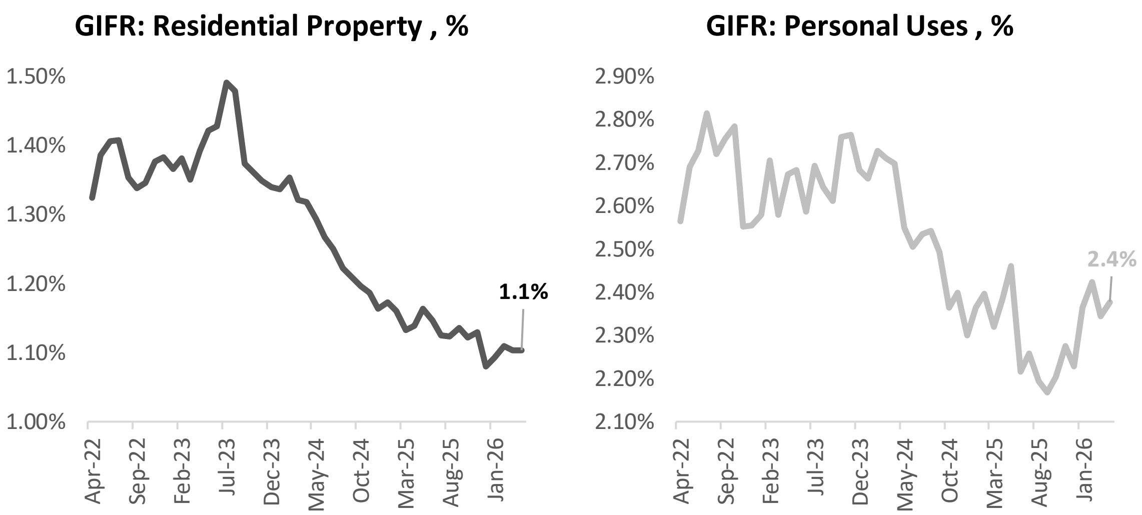
- Overall household financing asset quality is set to weaken, with risks intensifying if U.S.-Iran tensions trigger a renewed spike in energy costs. Such a shock would amplify food and transport inflation, erode repayment capacity, and deepen household stress as the cost of living continues to rise.

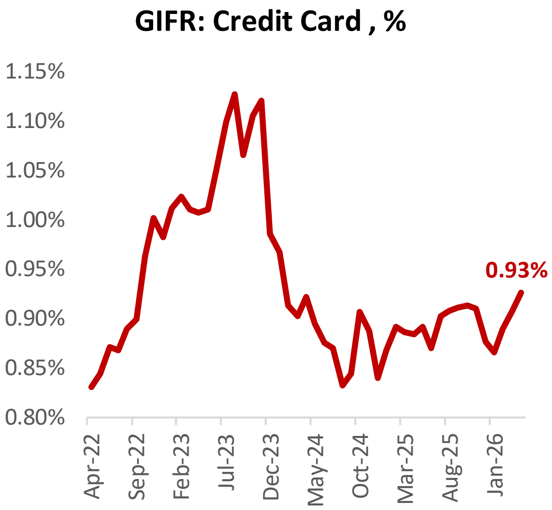
Chart 10: Households Gross Impaired Financing Ratio (GIFR), %

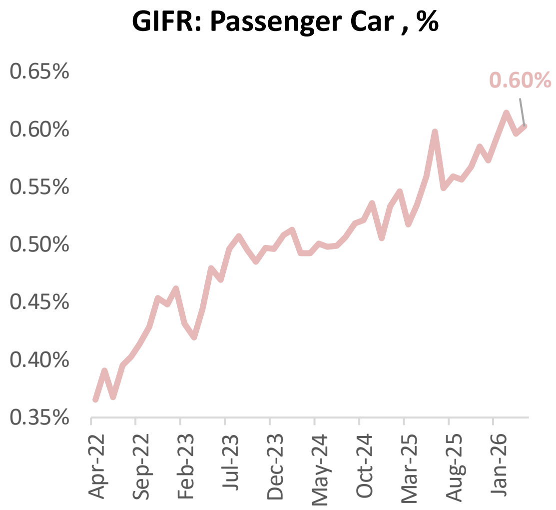


Sources: DOSM, CEIC, Bank Islam

Chart 11: GIFR of Households Breakdown, %





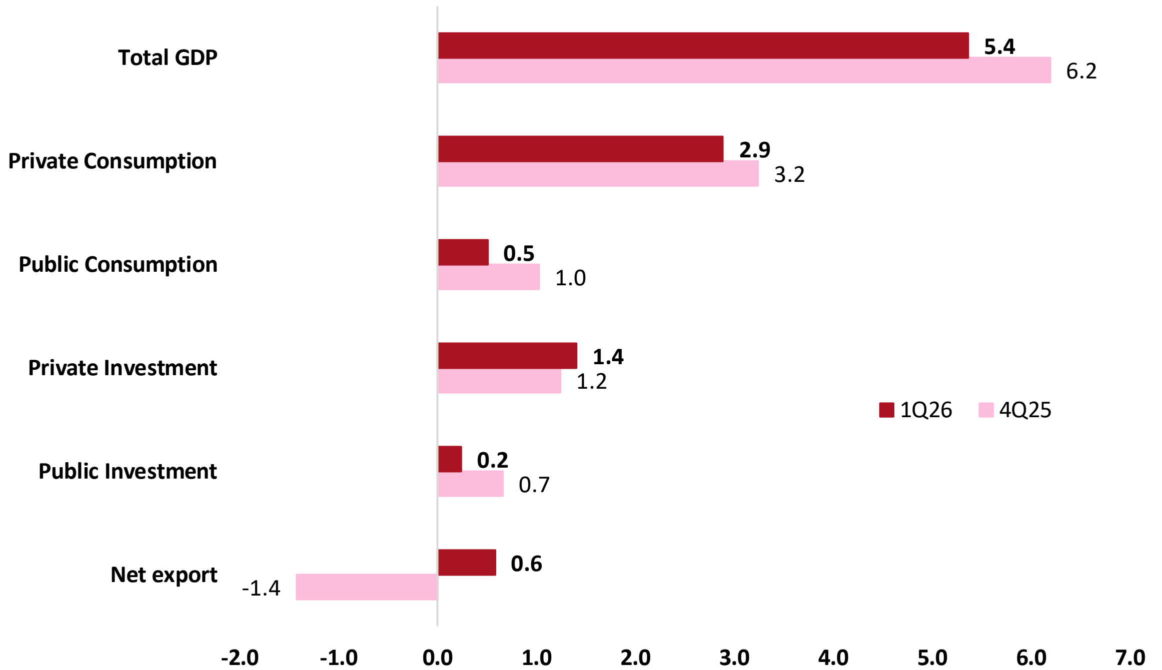


Sources: BNM, CEIC, Bank Islam

Impact on Malaysian Economy

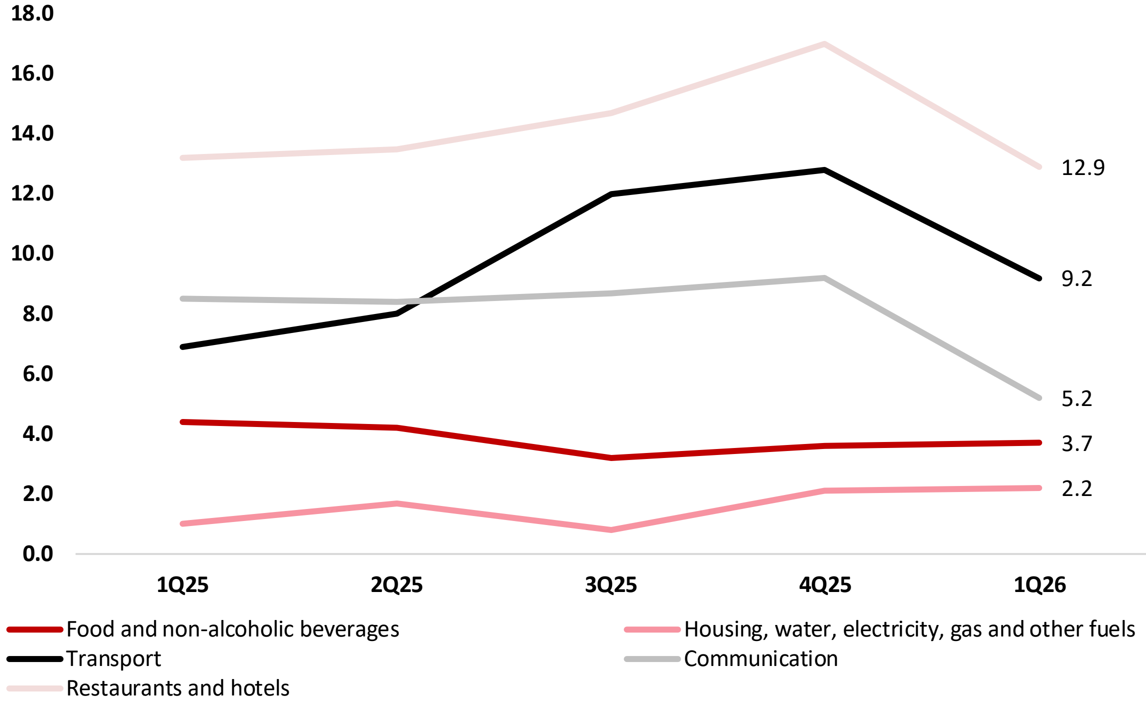
- Private consumption, which accounts for 62% of GDP, moderated to 4.7% y-o-y in 1Q26, its weakest growth since 3Q24. Although it remained the key driver of growth, its contribution eased to 2.9 ppt, reflecting softer spending on transport, communication, and restaurants & hotels amid rising energy prices triggered by the U.S.-Iran conflict.

Chart 12: GDP by Type of Expenditure: PPT Contribution to GDP Growth



Sources: BNM, CEIC, Bank Islam

Chart 13: Private Consumption by Segment (y-o-y, %)



Sources: BNM, CEIC, Bank Islam

- As household financing growth is expected to moderate amidst higher living costs and geopolitical uncertainties, private consumption is likely to weaken further. Tighter bank lending in response to rising repayment risks will compound the slowdown, constraining access to credit.

- With financing less supportive, households are expected to reduce discretionary spending and defer major purchases, reinforcing the moderation in consumption growth. Elevated uncertainty over income prospects will also dampen demand for housing, car, and personal financing. Without stronger credit expansion, households will have limited ability to bring forward future spending.

- Given private consumption's significant share of GDP, a sustained moderation in household financing could have broader implications for overall economic growth.