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EASING COST OF LIVING THROUGH SUSTAINABLE REFORMS

PART ONE: FISCAL REFORMS & IMMEDIATE COST PRESSURES

Chart 1: Government debt, % of GDP

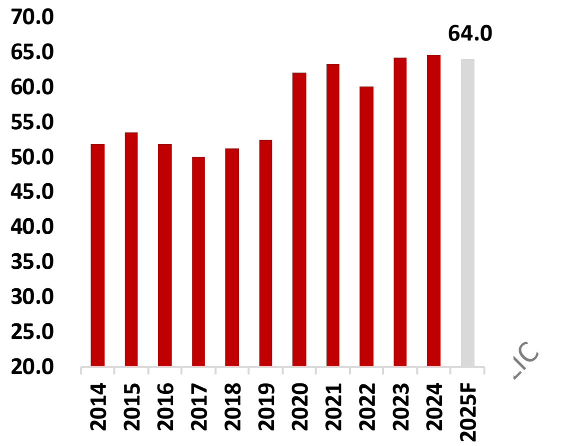
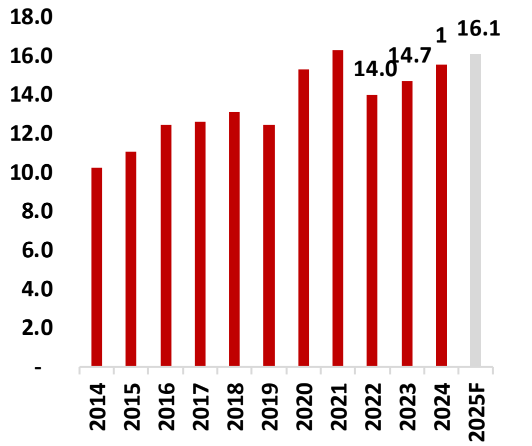


Chart 2: Debt Service Charges, % of Revenue



Sources: Ministry of Finance (MOF), CEIC Data, Bank Islam

- The government foresees 2025 debt-to-GDP to edge marginally lower at 64.0% (2024: 64.6%). As of 1Q2025, the debt-to-GDP level is at 61.3%, assuming the nominal GDP is at RM2.1 trillion as per Budget 2025.

- Additionally, the statutory debt-to-GDP ratio stood at 62.9% in 2024, remaining below the 65.0% ceiling, and is projected to decline further to 60.4% in 2025. However, the government anticipates that debt service charges (DSC) will rise to 16.1% of revenue in 2025 (2024: 15.8%), exceeding the administrative threshold of 15.0%. This reflects the continued reliance on deficit financing, although the overall fiscal shortfall is on a downward trajectory.

- Though still under control, rising debt service costs could crowd out essential development and welfare spending, limiting the government's capacity to fund long-term projects and social programs, suggesting limited room available for the government to service and take on additional debts.

Chart 3: Revenue, % of GDP

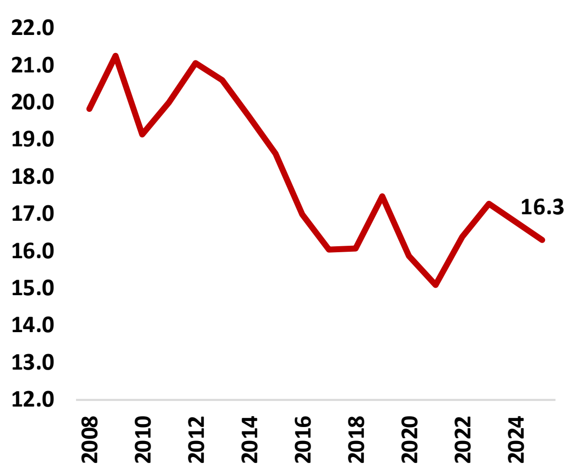
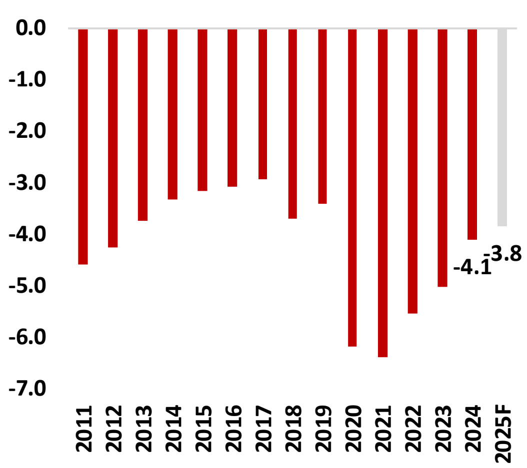


Chart 4: Fiscal Balance, % of GDP



Sources: Ministry of Finance (MOF), CEIC Data, Bank Islam

- Malaysia is indeed undergoing significant fiscal reform, driven by the need to strengthen its fiscal sustainability. This involves a multi-pronged approach that includes subsidy rationalisation and the broadening of the Sales and Services Tax (SST).

- **Sales Tax at 5%:** Select items, including construction materials, some foodstuffs, petroleum oils, and (from July 2025) additional imported goods like certain fruits and premium seafood, are now subject to 5% after the latest update.

- **Sales Tax at 10%:** The standard rate for most taxable goods and imports. Luxury and non-essential items, such as high-end bicycles, essential oils, and antique artworks, may fall into this category, especially with the 2025 changes.

- **Service Tax at 8%:** Effective from March 2024, the rate applies to most services, excluding food & beverage, telecommunication, parking, and logistics services.

- **Service Tax at 6%:** For food & beverage, telecommunication, parking, logistics, and (from July 2025) specific new categories like construction and private healthcare (for foreigners) and private education (for international students).

- **Zero-rated and Exempted Goods:** Essential goods such as rice, chicken, beef, vegetables, eggs, local fish, books, medicines, and basic building materials remain exempt or zero-rated, ensuring affordability for the public.

Table 1: SST vs. GST

Feature	SST	GST
Tax Structure	Single-stage tax: Sales tax is imposed on goods at the manufacturing or import stage. Service tax is charged by service providers.	Multi-stage tax: Applied at every stage of the supply chain (from manufacturer to retailer to consumer).
Input Tax Credit	No input tax credit: Businesses cannot claim back tax paid on their inputs, which can lead to a "cascading effect" where tax is paid multiple times throughout the supply chain and ultimately passed on to the consumer.	Input tax credit available: Businesses can reclaim GST paid on their purchases (input tax), ensuring that tax is only applied to the value added at each stage. This generally leads to greater transparency.
Tax Base	Narrower tax base: Applied only to specific goods and services. Many essential items are exempted	Broader tax base: Applied to almost all goods and services, with some zero-rated or exempt items
Rates	Sales Tax: 5% or 10%. Service Tax: 6% or 8% (depending on the service).	Standard rate was 6% for most goods and services.
Revenue	Generally, generates **less revenue** for the government due to its narrower base and single-stage application. Revenue: 2025E: RM51.7 billion (revised from RM46.7 billion) 2026F : Additional RM 10 billion	Generally, generates **more revenue** due to its broader base and multi-stage application. Revenue: 2016: RM55.7 billion 2017: RM60.5 billion

Sources: DOSM, Bank Islam

- While SST is simpler and generally considered less intrusive, its lack of an input tax credit mechanism can lead to hidden costs for businesses, which may then be passed on to consumers. GST, despite its complexity and unpopularity, is generally seen as a more efficient and transparent tax system for revenue collection.

Chart 5: USD/MYR vs. Import Prices

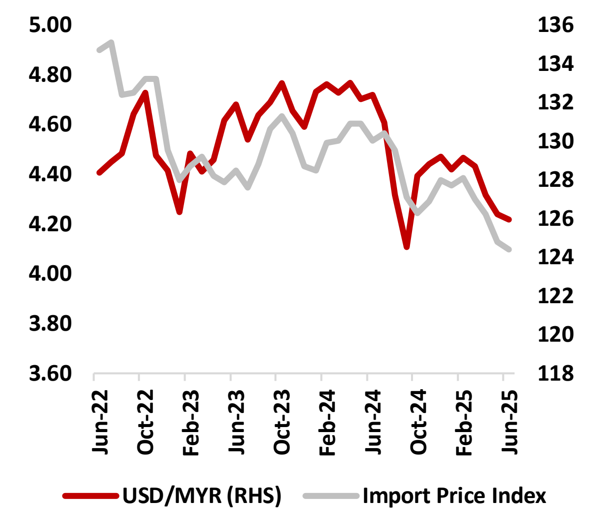
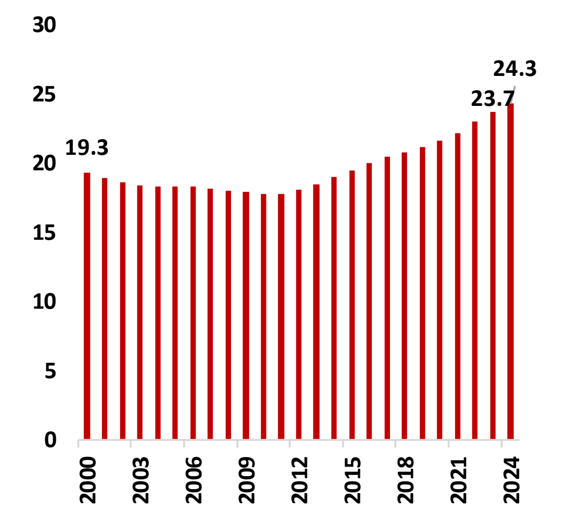


Chart 6: Malaysia - Prevalence of Stunting Height for Age of Children Under 5, %



Sources: Ministry of Finance (MOF), CEIC Data, Bank Islam

- **Impact on Imported Goods:** The expansion of the SST to cover more imported goods, including selected fruits, will directly raise their prices. As many of these imports have limited local substitutes, the increased cost is likely to be passed on to consumers. This impact could be further amplified by a weakening Ringgit, which would make imported goods even more expensive in local currency terms.

- **Businesses Passing on Costs:** Businesses facing higher operating costs, whether from changes in the SST or rising fuel prices due to subsidy rationalization, are likely to pass these increases on to consumers. This is especially evident in sectors such as food away from home, where costs related to ingredients, transportation, and utilities are directly affected.

- **High Food Expenditure:** Low-income households are most vulnerable because a significant portion of their total spending (often more than 50%) is allocated to food. Any increase in food prices directly and severely impacts their ability to afford nutritious meals, leading to stunted children.

- **Limited Buffers:** Low-income households typically have minimal financial buffers to absorb price shocks, making them highly susceptible to increased living costs

Table 2: Government's Mitigating Measures and Fiscal Implications

Measure	Detail	Additional Spending
Direct Cash Transfers : Sumbangan Asas Rahmah (SARA) for all	• RM100 one-off cash aid for all Malaysian adults (18+), benefitting approximately 22 million people	RM2.0 billion
RON95 Price Reduction to RM1.99/litre	• Eligible for Malaysian and may benefit around 18 million vehicle users • More targeted approach by excluding foreigners to ensure subsidies reach those in need	RM1.2 billion
Jualan Rahmah MADANI funding doubled to RM600 billion	• Expansion of affordable goods initiatives by doubling the fund from RM300 million to RM600 million. • Covers all 600 state constituencies, with more product varieties.	RM0.3 billion
Toll rates remain unchanged	• The government has postponed toll hikes on 10 highways this year, including SDE, LPT2, SKVE, LLB, and MEX.	RM0.5 billion

Sources: MOF, Bank Islam

PART TWO: EXPLORING SUSTAINABLE SOLUTIONS TO EASE THE COST OF LIVING

1. Agricultural Reform to Enhance Food Security and Curb Food Inflation Risk

- Malaysia has been importing food and agricultural commodities for many years to meet domestic consumption needs. As a net food importer, the country has become increasingly dependent on imported items like rice, vegetables, beef/mutton, dairy, and onions.

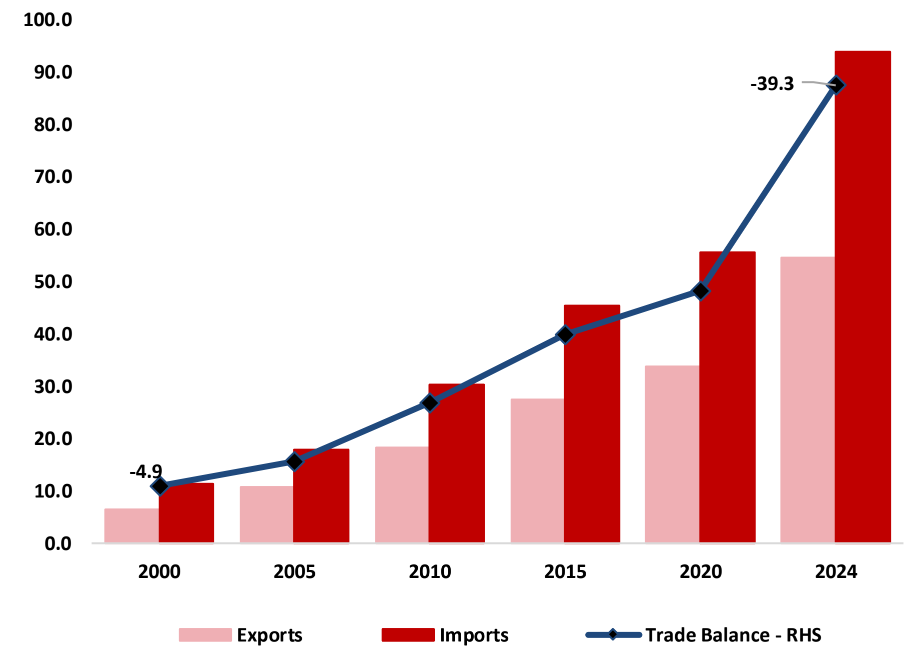
- In 2024, the food trade deficit stood at RM39.3 billion, a nearly eightfold increase from the RM4.9 billion recorded in 2000. Notably, the deficit has risen sharply since the COVID-19 pandemic, with the figure surpassing RM20 billion beginning in 2020.

- This dependence exposes Malaysia to external shocks such as global supply chain disruptions during lockdowns, currency depreciations with an extremely weakening ringgit, and rising international food prices driven by lower supply resulting from food trade protectionism and climate-related risks in food-exporting countries.

- Investing in local food production can improve food resilience and affordability over the long term and limit rising costs of food caused by the external factors. This includes:
  - expanding land or using barren land for food farming
  - providing targeted incentives and financing for local farmers and agribusinesses
  - improving irrigation and infrastructure to increase farming efficiency
  - supporting contract farming and vertical integration to connect farmers with markets

- Strengthening domestic production reduces reliance on imports, shields consumers from volatile prices, and enhances national food security.

Chart 7: Food Import & Export Value (RM'billion)



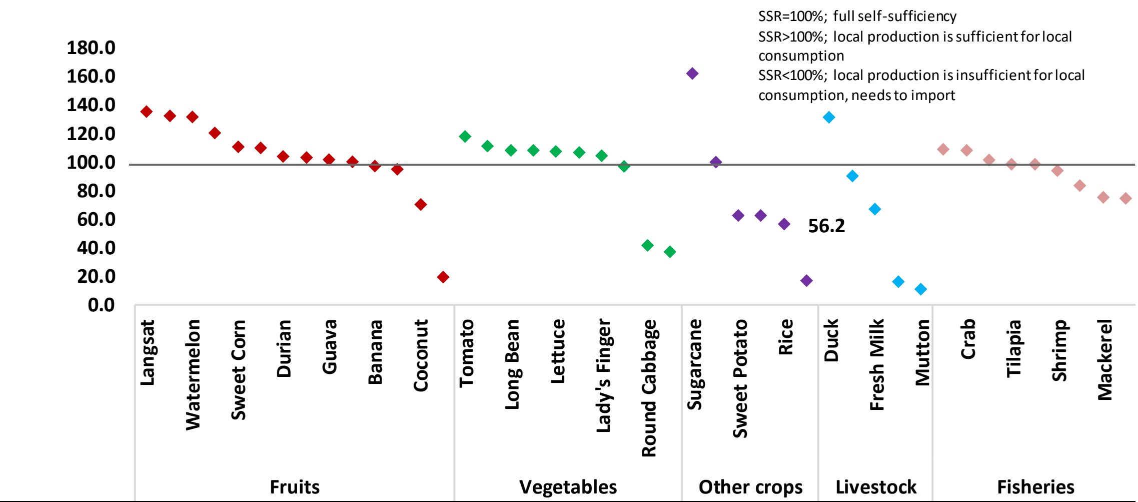
Sources: DOSM, MAFI, Bank Islam

- Malaysia's self-sufficiency ratio (SSR) for critical food items remain below optimal levels as demand is more than supply. For example, the SSR for rice is only around 56%, while most crops, livestock, and some fisheries are below 100%, indicating that local production is insufficient for domestic consumption and imported commodities are needed to meet local demand.

- This means the country still relies heavily on imports for many food staples. Improving SSR is suggested to be a strategic national priority. Therefore, efforts should include:
  - Identifying food items with low SSR but high import value, and focusing resources to boost production
  - Improving yield per hectare through better seed quality, pest control, and technology
  - Reducing post-harvest losses through better storage, cold chain, and distribution logistics.

- Improving SSR not only improves food security but also reduces Malaysia's food import bill and dependence on the global market prices.

Chart 8: Self-Sufficiency Ratio of Commodities in 2023



Sources: DOSM - Supply and Utilization Accounts Selected Agricultural Commodities, 2019-2023

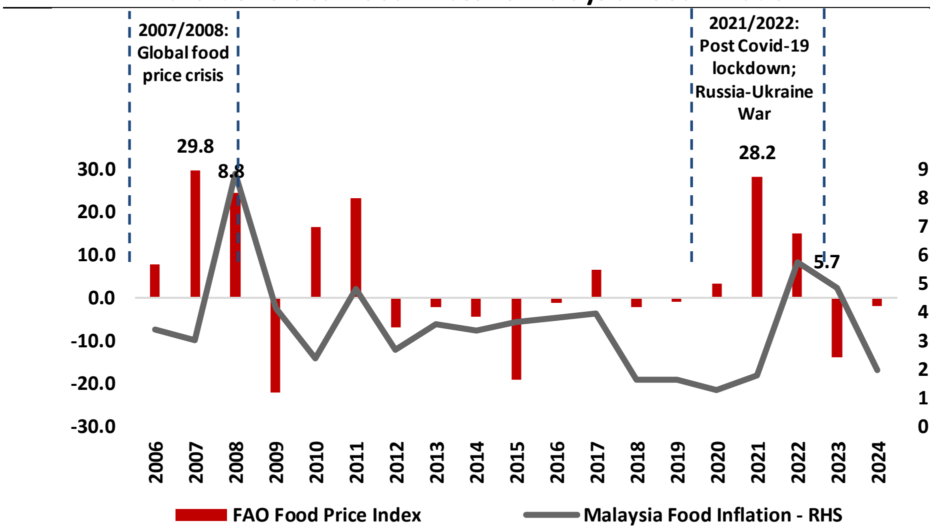
- Malaysia has experienced significant spikes in food prices during global crises, particularly when food-exporting countries implemented protectionist policies. These countries often prioritised domestic needs by imposing export bans, which in turn triggered price surges in food-importing nations like Malaysia.

- **2007-2008: Global Food Crisis**. Combination factors ranging from poor harvest, low cereal stocks, rising oil prices, export restrictions, and rising demand have led to this crisis. Major producers like India and Vietnam imposed export bans to safeguard domestic supply, exacerbating global shortages and driving prices sharply higher. As a result, global prices of key staples like rice, wheat, and corn surged, as reflected in the FAO Food Price Index, which rose by 29.8% in 2007. This global trend translated into elevated food inflation in Malaysia, which climbed to 8.8% in 2008.

- **2021-2022: COVID-19 and Russia-Ukraine War**. Global food inflation surged by 28.2% in 2021, driven by a strong post-pandemic demand recovery and further exacerbated by the Russia-Ukraine war in 2022. The conflict disrupted the global supply of wheat, corn, fertilizers, and sunflower oil, given both countries' major role in these markets. This combination of supply shocks and food export restrictions by countries further pushed up global oil prices. In response, Malaysia rolled out targeted subsidies, implemented ceiling prices on key items like chicken and eggs, and increased social assistance to cushion the impact on households. Food aid and cooking oil subsidies rose sharply to RM2.47 billion in 2022, a 135.5% increased from 2021. Due to this price control, Malaysia's food inflation only increase by 5.7% in 2022.

- This history shows that building self-reliance in food production is crucial to reduce dependence on imports, minimize exposure to external shocks, and stabilize local food prices. By strengthening domestic capacity and finding local substitutes for imported products, Malaysia can lessen its vulnerability to foreign policy decisions and ensure greater food security in the long term.

Chart 9: Global Food Prices vs Malaysia Food Inflation



Sources: FAO, DOSM, Bank Islam

- To ensure long-term sustainability and higher productivity, Malaysia should embrace the digital transformation of agriculture, as traditional farming methods are increasingly constrained by limitations in yield and resource efficiency.

- Policy measures may focus on:
  - Promoting smart agriculture, including the use of drones, IoT, AI-driven crop monitoring, and automated irrigation systems.
  - Encouraging young agropreneurs through digital platforms and training programs.
  - Offering more grants, tax incentives, or subsidies for adopting modern equipment.
  - Partnering with research institutions and private firms to drive agricultural innovation.

- Modern and digital farming can make agriculture more attractive to youngsters, profitable, and climate-resilient, paving the way for long-term food sustainability and preventing high cost of living from expensive food prices.

- The implementation of three main strategies to strengthen food security in the recent announcement of the 13th Malaysia Plan is crucial to ensure a more sustainable and resilient agrifood production, supply, and distribution chain.

- The document outlines plans to expand large-scale agriculture in the East Coast, Sabah, and Sarawak to strengthen domestic food supply and tap into export opportunities. In Kedah and Perlis, paddy production will be scaled up through private sector collaboration, with emphasis on improving infrastructure, upgrading irrigation systems, and adopting smart farming techniques. Additionally, initiatives such as the National Agrofood Empowerment, Nextgen

Agropreneur, and Pengganda 30 will involve young agropreneurs, promote industry collaboration, and focus on reducing food waste through zero-waste practices.

Table 3: Benefits from Agricultural Reforms

Benefit	Details
• **Price Stability**	• Reducing reliance on imports lowers exposure to exchange rate volatility and global food inflation
• **Lower Fiscal Pressure**	• Reducing the need for food subsidies and import costs
• **Food Security**	• A more self-reliant food system ensures better food access during crises or international supply shocks
• **Rural Development**	• Job creation and better income for local farmers and agri-workers in rural areas may boosting rural development and limit the high-cost living pressure
• **Environmental Gains**	• Smart farming reduces waste, optimizes resource use, and supports climate adaptation
• **Economic Resilience**	• A strong agriculture sector contributes to GDP and cushions external economic shocks. This may increase agriculture's share in GDP, by not only focusing on palm oil but also expanding to other crops and the fisheries industry.
Overall, by strengthening the nation's food system, Malaysia can build a more resilient, inclusive, and sustainable economy and, most importantly, reduce the burden of rising living costs from high imported food inflation in the long term.	

Source: Bank Islam

2. Attracting High-Complexity Investments

- Malaysia's labour market remains robust throughout 1H2025, as the unemployment rate settled at a decade-low of 3.0% in May, while the labour force participation rate (LFPR) reached a record high of 70.8% in the same month.

- While the current landscape suggests a healthy job environment that is supportive of domestic demand, consumers are still burdened by the increasing costs of living, which weigh heavier on their pockets against a backdrop of shrinking disposable income. This highlights the mismatch between the solid labour market data and the reality faced by the consumers.

- This disparity can be understood by looking closer at the breakdown of job market figures. Semi-skilled workers make up the majority share of employment (~56.5%), followed by skilled (~30.2%) and low-skilled (~13.3%) workers. Meanwhile, the unemployment rate for youth ages 15 to 30 years is 6.2% in May, more than double the national level.

- Evidently, they would be highly vulnerable to rising price pressures given their lower income levels, with the cost-of-living crisis disproportionately eroding their purchasing power compared to higher-income groups.

Chart 10: Unemployment Rate, %

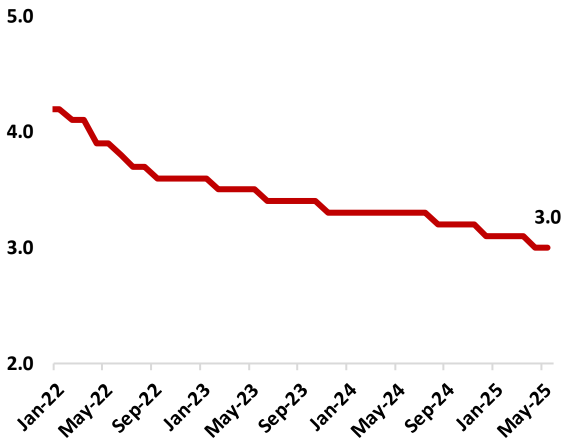
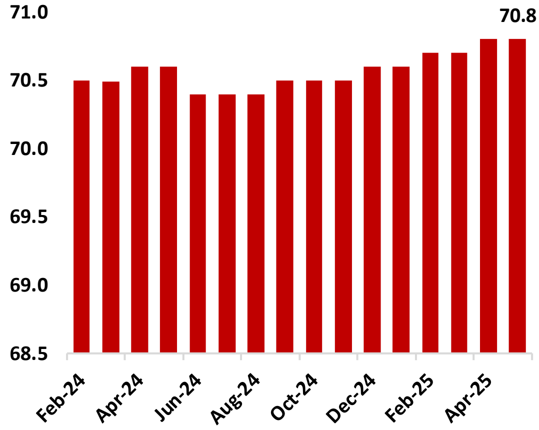


Chart 11: Labour Force Participation Rate, %



Sources: DOSM, CEIC Data, Bank Islam

Chart 12: Time-related Underemployment, person th

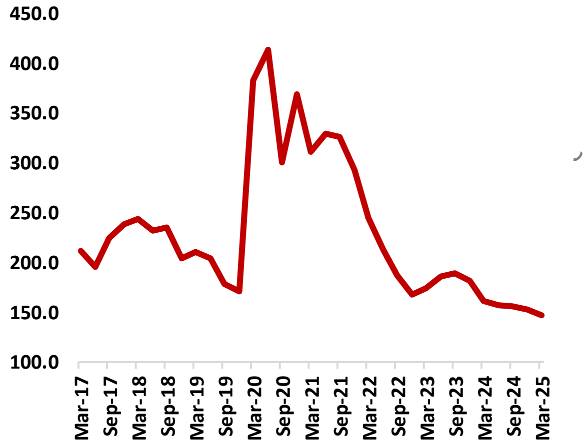
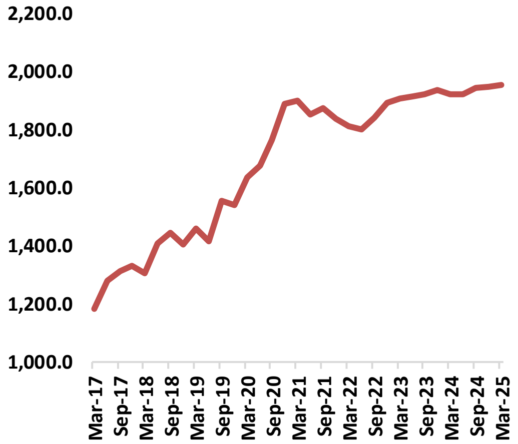


Chart 13: Skill-related Underemployment, person th



Sources: DOSM, CEIC Data, Bank Islam

- Furthermore, a significant portion of Malaysia's labour force remains underemployed, largely due to skill-mismatch or time-related constraints. According to the Department of Statistics Malaysia (DOSM), time-related underemployment is defined as the number of working individuals who worked less than 30 hours per week even though they were willing to work more often due to a lack of suitable job opportunities. In 1Q2025, more than 146.9K individuals fell into this category, of which the majority are youths between 15 and 24 (50.4K persons).

- Meanwhile, skill related underemployment is defined as the number of employed individuals with tertiary education but who were working in a semi-skilled or low-skilled job as classified under MASCO. In 1Q2025, almost 2.0 million employed individuals are categorized as underemployed under this umbrella.

- To ease the financial burden on consumers, it is crucial for the government to address these underemployment trends. Theoretically, these individuals should be earning more in line with their skill levels and willingness to work. If they were gainfully employed and fairly compensated, they would be better equipped to cope with the increasingly challenging economic environment.

Chart 14: Foreign Direct Investment (FDI): Net Flow, RM million

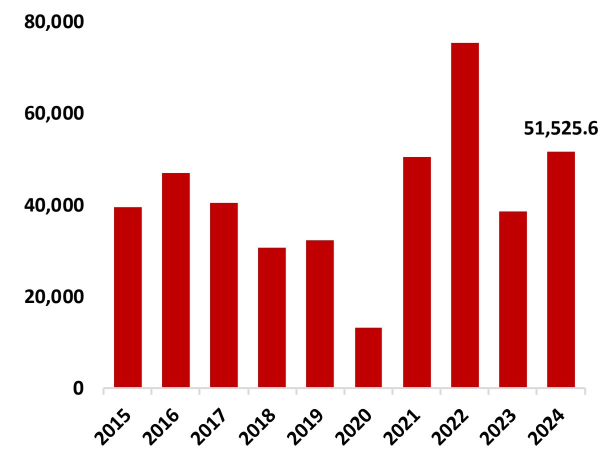
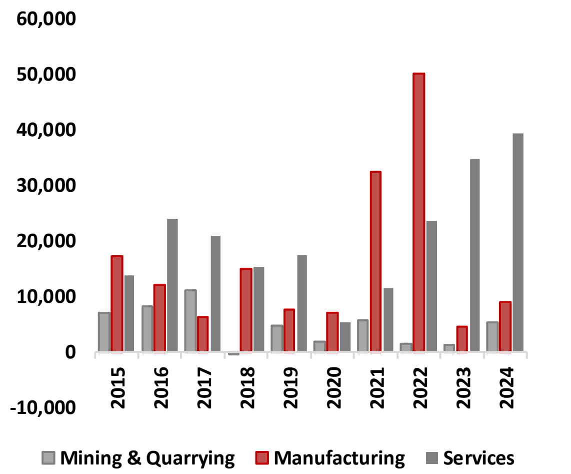


Chart 15: FDI by Sectors: NF, RM million



Sources: DOSM), CEIC Data, Bank Islam

- One way to tackle the issue would be encouraging foreign direct investments (FDI) and domestic direct investments (DDI) into the local market, as underlined in the New Industrial Master Plan (NIMP) 2030, National Energy Transition Roadmap (NETR) and other Madani policy documents.

- These frameworks highlight the government's targets and thrusts to attract high-value investments in areas encompassing sustainable and renewable industries alongside high-tech and high-value industries, which would be channeled into developing Malaysia's economic complexity.

- Such investments would accelerate technology adoption in Malaysia as well as develop the domestic tech landscape through the impartation of innovation and tech advancements. For instance, China had recently pledged to share its rare earth processing technology with Malaysia, enabling it to better leverage the potential of the local rare earth industry as another avenue for growth.

- Consequently, these investments would create high-skill and high-income job opportunities. These complex industries require a set of specialized talents as well as higher education and certification credentials, which will be compensated with better wages.

- Furthermore, these industries offer better career progression for employees, as they would have to participate in continuous upskilling to keep up with the evolving technology landscape, making their expertise and experience more valuable over the long run.

Chart 16: YTD Approved Investments, RM million

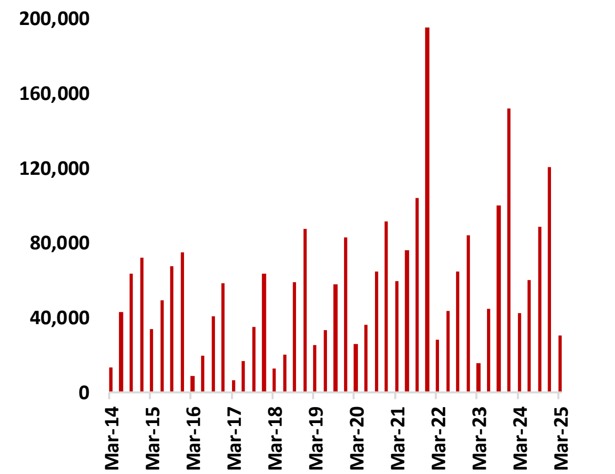
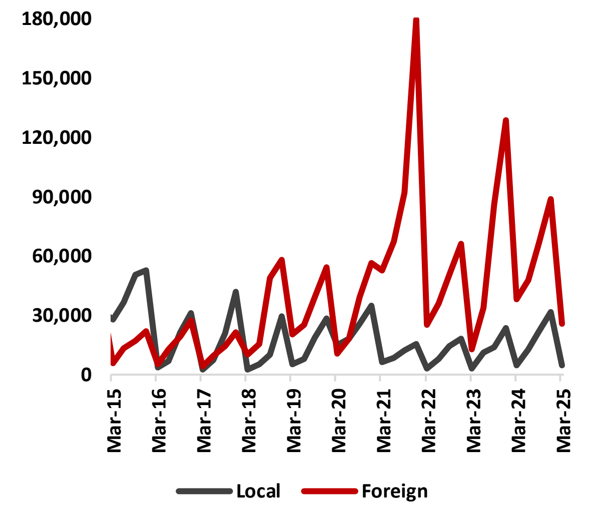


Chart 17: YTD Approved Investments, RM million



Sources: DOSM, CEIC Data, Bank Islam

- Latest data show that approved manufacturing investments totalled RM30.5 billion in 1Q2025, down from RM42.7 billion recorded in 1Q2024. The moderation likely reflects more cautious investor sentiment amid rising global protectionism and heightened volatility following Trump's ascension into office.

- Foreign investments contribute RM25.5 billion in 1Q2025, a step lower than RM37.9 billion in 1Q2024, while local investments make up RM4.9 billion of the total, slightly more than RM4.8 billion in 1Q2024.

- As such, these figures highlight the potential for higher investments into Malaysia beyond the uncertainties of the current time, as its economic outlook remains consistently resilient, lifted by strong fundamentals.

- The government should play a central role in enhancing the appeal of Malaysia's value proposition, leveraging its abundant land area, skilled human capital supply, and strategic position in the global value chain, to attract investment and boost investor confidence. Among measures that could be expanded further are:
  - Incentivizing investments into Malaysia through fiscal policies
  - Promoting Malaysia on the global scale through high-level trade missions, conventions, and expos
  - Facilitating partnerships and linkages between domestic firms and potential investors
  - Supporting the development of economic clusters such as the JS-SEZ, Kulim Industrial Corridor and Kerian Integrated Green Industrial Park

PART THREE: BUILDING LONG-TERM RESILIENCE AGAINST COST OF LIVING PRESSURES

- Developing sustainable and long-term solutions to ease the cost of living is essential to ensure Malaysians are not burdened by rising prices, particularly those driven by external factors. Well-designed strategies will also help strengthen the country's fiscal sustainability by reducing overreliance on subsidies and promoting a more balanced and resilient economy.

- Key suggestions on structural reform, such as enhancing food security and attracting high-complexity investments, are central to the effort in reducing cost of living. Boosting domestic food production through smart farming and modern agricultural practices can reduce dependence on imports, making Malaysia less vulnerable to global supply shocks, food protectionism, and commodity price swings.

- Additionally, advancing economic complexity by drawing in high-value investments will create better-paying jobs with more skilled workers and raise household incomes. Over time, this could allow wage growth to outpace inflation, providing Malaysians with greater purchasing power and economic security.

- Together, these reforms not only address cost-of-living pressures but also support a healthier fiscal position. The real challenge lies not in strategy design, but in consistent, well-coordinated execution to ensure lasting impact for future generations.