The Impact of Global Commodity Prices on Inflation in Malaysia

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The broad-based commodity price shocks in the 2000s – a main source of inflation worldwide – underpin the importance for policymakers to understand the relationship between commodity prices and inflation. This paper studies the empirical relationship in Malaysia during the rapid rise and large swings in global commodity prices using data from 2000 to 2012. The contribution of this paper is twofold. First we ask, what is the connection between global commodity prices and headline inflation? Our results indicate that global commodity prices, especially food, have a positive pass-through to inflation. We find that global prices Granger-cause domestic inflation and the size of the pass-through is relatively small. This raises the second question, what is the impact of commodity price shocks on the dynamics of inflation? Our results suggest that the increase in prices did not lead to second-round effects on inflation. Specifically, we find headline reverting to core inflation while the converse does not hold. However, the relationship between global commodity prices and inflation was not evident in the 1990s, suggesting that the relationship is perhaps not an empirical regularity and may change in different sample periods.

Key Words: Headline and core inflation, pass-through, inflation dynamics, second-round effects