

Philippines: BSP tightening could be sooner

The Governor of the Philippine central bank (BSP) seems to have turned cautious over second-round effects of tax reform on inflation

Philippine Central bank stamp



Possible second-round effects of tax-reform related price increases raise caution

BSP Governor Espenilla has turned more cautious recently in terms of monetary policy due to possible second round effects from higher excise taxes on oil products and sweetened beverages. These taxes form part of the tax reform package that was recently signed into law last month. The tax reform cuts individual income tax rates but also raises excise taxes to not only cover government's losses from the income tax cut but also raise additional revenues for government's infrastructure and social service spending programs. The incremental government revenues of P90bn come from the excise tax component of the package. BSP, government and economists believe that the direct impact of the excise taxes would be between 0.4ppt to 1ppt increase on inflation. BSP in the past view the inflation impact as transitory which would not require a monetary policy response. But second-round effects are looming and could threaten the inflation target range of 2% to 4%. Second-round effects are possible increases in minimum fares for public transport and a possible domino effect on wages. We estimate that a 25% increase in minimum transport fares could raise inflation by as much as 1ppt on CPI. There are already petition to the

regulatory agency for a 25% to a 50% hike in minimum fares. Labor unions are preparing to also seek an increase in minimum daily wages. The likely wage petition seeks to raise wages especially for minimum wage earners who do not benefit from the reform's income tax cuts.

3.4%

BSP 2018 inflation forecast

BSP to review the forecast at February 8 policy rate meeting

Higher chances of monetary policy tightening in March or in 2Q

BSP would likely come out with a revised inflation forecast at the next policy rate meeting on February 8. A higher inflation forecast may pre-sage a tightening move by BSP. We believe that inflation forecast revision would reflect BSP's assessment of second-round effects. BSP currently forecasts 3.4% average inflation for 2018 which incorporates direct inflation impact of the excise tax increases of the tax reform program. We currently forecast an average of 3.7% inflation rate for 2018 with some upside risks depending on the extent of minimum fare adjustments. We still need to incorporate minimum wage increases to our inflation forecast. Public transport regulators are likely to rule on the fare hike petitions by March or April. Tri-partite regional wage boards are likely to evaluate wage hike petitions in 2Q. We believe that the possibility of BSP raising its policy rate at the March 22 meeting has increased. However, our base case is for a policy rate hike in 2Q. The first BSP policy rate meeting in 2Q is on May 10. In the meantime, we believe that BSP would likely prepare the market for a tightening move at the February 8 meeting.