

Philippines might face higher inflation in 2018

The tax reforms offer upside risk to the BSP's 3.4% inflation forecast for 2018. We reiterate our forecast for a total of 50bp BSP policy rate hikes this year



3.2% Inflation rate in 2017

As expected

In-line December CPI inflation

As widely expected, Philippine consumer price inflation in December was unchanged at November's 3.3% year-on-year. Full-year 2017 average inflation rate accelerated to 3.2% from 1.8% the previous year, in line with consensus as well as with Bangko Sentral ng Pilipina's (BSP) forecasts. The data has little significance for financial markets as the focus is more toward any inflationary impact of tax reforms this year.

Tax reforms likely to push inflation higher in 2018

The implementation of the recently approved tax reform package is raising second-round price pressures. The Tax Reform for Acceleration and Inclusion (TRAIN) cuts income taxes but raises excise taxes for fuel, sweetened beverages and low cost vehicles among others. Excise taxes for fuel increases by six Philippine Peso (PHP) per litre over three years. Of this, a PHP 2.5/litre hike in the first year implies a 6-8% increase in diesel and gasoline prices.

Positive net revenue gains from TRAIN

Prices for sweetened beverages are expected to rise by 20-50%. These taxes will more than offset revenue losses from lower income tax rates. TRAIN generates an additional PHP 82bn of revenues for the government. The government has planned to utilize added revenues for infrastructure programmes and enhanced social expenditures, including financing safety nets.

3.4%

BSP's inflation forecast for 2018

The risk will be on the upside

Direct impact on consumer prices

The direct price impact of higher excise taxes is expected to be 0.8-1.2ppt. According to government estimates the direct impact on CPI inflation will be 0.4-0.7ppt. The BSP regards these price pressures as transitory and thus warranting no monetary policy response. The BSP expects 2018 inflation to average at 3.4%, which we consider to be at upside risk with our 3.7% forecast.

Demand for higher wages and transport fares

The BSP is worried about second round effects of tax reforms on consumer prices. Labor unions and public transportation associations are preparing petitions for wage and fare adjustments. Transport associations including GRAB are preparing to file petitions to increase fares by 10-50%. Based on our estimate a 20% increase in minimum public transportation fares adds 1-1.5ppt to CPI inflation. Labor unions are also preparing petitions to raise minimum wages. Approvals for these petitions is expected in March or in the second quarter of the year. If approved, this could push inflation higher, possibly exceeding the BSP's medium-term target range of 2-4%.

ING forecast of BSP policy in 2018

The likelihood of an earlier BSP monetary tightening increases with the second-round inflation impact of TRAIN if signals from regulatory agencies point to more moderate requirements. We reiterate our forecast of two 25bp BSP policy rate hikes in the second and fourth quarters of 2018.