Philippines: Inflation slides to six-month low

Cost-push inflation is likely to dissipate further in coming months so we'll be revising our forecasts for central bank policy

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5.1%

December inflation

lowest in six months

Lower than expected

Supply side bottlenecks mitigated

Price pressures eased further in December with the CPI-heavy food items forcing the headline number below 6% for the first time since July. December 2018 prices posted a 5.1% gain from the same month in 2017, falling below the market consensus for a 5.6% gain. Meanwhile, core inflation reversed to post slower growth of 4.7% compared to the previous month's 5.1%, allaying fears of deeply-rooted inflation pressures.

The three heavyweight subsectors all showed a deceleration in price gains. Food items in

December 2018 posted a 6.7% increase in prices, down from 8.0% in the previous month as the 4Q harvest season and imports of grains helped normalise supply conditions. Transport costs were another major source of deceleration with inflation more than halving, showing a 4.0% gain, the slowest pace of inflation seen since January 2017. Lastly, utilities also saw a slowing trend with price gains of 4.1% versus November's 4.2%.

Most other subsectors also showed slower annual growth with alcoholic beverages, furnishing, recreation and restaurants & miscellaneous services all lower while only four subsectors showed faster inflation.

With more imported grains currently on delivery over the next few weeks, the rice tarrification bill set for signing and energy prices depressed, risks to the inflation outlook appear tilted to the downside and expectations now more anchored. In light of these developments, we will be revising lower our inflation outlook for both 2019 and 2020.

BSP afforded opportunity to reverse hike cycle with inflation trending back to target

With inflation trending back to the Bangko Sentral ng Pilipinas' (BSP) target of 2-4%, the case for the BSP to reverse its stance as early as 2Q19 has increased considerably. On top of BSP's widely-anticipated 200 basis point cut to reserve requirements scheduled for the year, the BSP will likely slash borrowing costs as early as the 9 May meeting to help bolster slowing growth momentum with its price stability mandate safeguarded. With the market anticipating a less aggressive Federal Reserve rate hike cycle in 2019, BSP may be afforded a window to walk back its own aggressive rate hike salvo from 2018.

With the stars aligning for decelerating inflation, a more dovish Fed and possibly slowing growth momentum, the chances for a BSP two-pronged easing in 1H has increased significantly. With our inflation forecasts likely to be lowered given recent price trends, we will be revisiting our forecast for BSP policy in 2019 as well.