

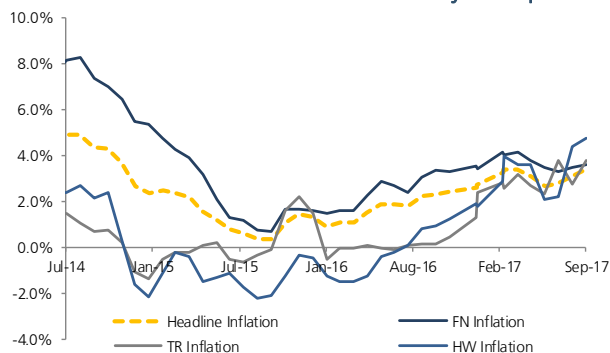
Inflation Update

September 2017

FMSBC Research | Oct. 5, 2017

Headline inflation rose to 3.4% in September — ahead of 3.1% consensus estimate and well-within Bangko Sentral ng Pilipinas' (BSP) monthly estimate of 2.8%-3.6%. Core inflation, which excludes volatile food and energy items, stood at 3.3% (est: 3.1%). Jan-Sept inflation remained at 3.1%, within BSP's full year target of 2%-4%.

Headline Inflation vs. Select Commodity Groups



Source: Philippine Statistical Authority, First Metro Sec

Food and Non Alcoholic Beverages (FN) index drove overall headline inflation with 3.6% y-o-y increase (Sept-16: 3.1%) still due to lean month season and with four typhoons hitting the country last month. Agricultural and coastal areas in Luzon and Visayas were mostly hit, resulting to supply disruptions for fish and some agricultural produce.

- Prices of Fish (Sept-17: 10%), Oils and Fats (Sept-17: 5.9%), Fruits (Sept-17: 5.1%) and Vegetables (Sept-17: 4.3%) led FN index's inflation, while more stable prices were observed in other agricultural produce such as Bread and Cereals (Sept-17: 1.6%), Rice (Sept-17: 1.4%), and other Food Products, not elsewhere classified (Sept-17: 1%).
- Post-bird flu outbreak, Meat prices stabilized at 3.6% for Sept-17, from 4% in Aug-17.

Inflation Y-o-Y Growth rates

| Commodity Group | Aug-17 | Sep-17 |
|---|-------------|-------------|
| Food and Non-Alcoholic Beverages (FN) | 3.5% | 3.6% |
| Alcoholic Beverages and Tobacco (AT) | 6.3% | 6.4% |
| Clothing and Footwear (CF) | 1.9% | 2.0% |
| Housing, Water, Electricity, Gas, and Other Fuels (HW) | 2.8% | 3.8% |
| Furnishing, Household Equipment and Routine Maintenance of the House (FH) | 1.8% | 1.8% |
| Health (HT) | 2.4% | 2.3% |
| Transport (TR) | 4.4% | 4.8% |
| Communication (CO) | 0.3% | 0.3% |
| Recreation and Culture (RC) | 1.4% | 1.4% |
| Education (ED) | 2.3% | 2.3% |
| Restaurants and Miscellaneous Goods and Services (RS) | 2.2% | 2.4% |
| Headline Inflation | 3.1% | 3.4% |

Source: Philippine Statistics Authority, First Metro Securities

Housing, Water, Electricity, Gas, and Other Fuels (HW) inched higher by 1ppt m-o-m to 3.8% (Aug-16: 0.1%) given increase in LPG prices, and slight increases in electricity rates.

- LPG prices adjusted upwards by P2.74/kg for the month of September following the increase in LPG Contract Prices to US\$494/MT (+10.3% y-o-y) from US\$448/MT in August. The increase in prices was due to limited supply in Asia, tight spot market in the Middle East, and delays in US stock loadings due to Hurricane Harvey. Year-to-date, LPG prices have observed a net increase of P5.68/kg as of Sept-17.
- Electricity rates in the Meralco franchise area increased by P0.8642/kWh, bringing the overall rate to P9.2491/kWh (Aug-17: P8.3849/kWh). Current rates have normalised to pre-refund levels, following the end of Meralco's three-month refund of over-recovery on pass-through charges from Jan-14 to Dec-16, worth P6.9bn. Note that electricity generation charges also increased during the month as higher demand in the Luzon grid pushed spot prices higher.

Transport index (TR) increased sharply by 4.8% y-o-y (Sept-16: 0.2%) mainly due to the increase in oil prices in the world market, with Dubai Crude Oil gaining 9.4% in September, settling above US\$51/bl. Likewise, robust regional demand further strengthened following the end of the rainy season and the lifting of seasonal fishing ban in the China Seas.

- Year-to-date, consequent adjustments for retail pump prices saw a net increase of P3.64/L for gasoline and P3.85/L for diesel as of mid-September 2017.

On a month-on-month basis, consumer prices increased by 0.47% for September 2017. Top increases were registered by the HW index (Sept-17: 0.9%), TR index (Sept-17: 0.6%), and FN index (Sept-17: 0.5%), followed by Alcoholic Beverages and Tobacco (Sept-17: 0.3%) and Restaurants and Miscellaneous Goods (Sept-17: 0.3%).

Inflation Outlook

- We expect FN index to normalise moving forward as the lean month season ends in October.
- We anticipate increase in the HW index mainly due to Metropolitan Waterworks and Sewerage System (MWSS)'s approval of the P0.11 and P0.24 per cubic meter increases in Maynilad Water Services Inc.'s and Manila Water Co. Inc.'s respective foreign currency differential adjustment (FCDA) accounts for 4Q17. Adjusted rates will be effective on October 13. Further increases in international LPG Contract Prices should likewise contribute to the subindex, as local retailers have already implemented a P4.9/kg increase starting October.
- Increases in the TR index are expected as producers from OPEC and Russia continue to mull extension of crude oil output cut deals, as well as further increase in cuts by 1ppt.
- We believe that key policy rates will remain stable this year as the inflation environment continues to be manageable over the Bangko Sentral ng Pilipinas (BSP)'s policy horizon. We stay watchful, however, as the Comprehensive Tax Reform Program (CTRP)'s traction in the Senate could expedite the program's inflationary effects once passed by 4Q17.
- As for the Philippine peso, we expect it to stabilize moving forward as cash remittances remain resilient given stronger growth in the European Union, Russian Federation, and the United States and despite lingering political uncertainties in the Middle East. Recall that the peso recently slid to 11-year low with US\$1:P51.494 last Aug-17. BSP expects cash remittances to hit a record US\$28bn by end-FY17 while World Bank sees remittance flows to hit US\$32.8bn amid global economic recovery.