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Watch out for a more buoyant core inflation

Wednesday, 23 March 2016

- **Headline inflation fell for the 16th straight month by 0.8% yoy (-0.1% mom nsa)**, which beat market consensus forecast for -0.7% yoy (+0.2% mom nsa) but was milder than our forecast for -1.1% yoy (+0.3% mom nsa). This marked the lowest yoy print since November 2015, due to the drag from housing & utilities (-4.1% yoy amid softening rentals), private road transport (-3.9% yoy as COE premiums fell) and communications (-0.9% yoy). These factors are likely to continue to sustain in the coming months, and we tip the headline inflation to revert to positive yoy territory only in 4Q16.
- **However, core inflation accelerated from +0.4% yoy in Jan to +0.5% yoy in Feb**, which is higher than our call for +0.3% yoy and market consensus of +0.3% yoy. This came amid higher food prices which accelerated from 1.7% yoy in January to 2.0% yoy in February due to more expensive prepared meals, including restaurant, hawker and fast food, especially during the CNY festive season.
- **So far, services inflation has been relatively stable for the year-to-date.** Service inflation rose 0.5% in February, the same as January, as more costly domestic services cost (namely maid salaries and government levies and other domestic house cleaning services etc) offset a moderate increase in holiday expenses. The official view remains that wages are on the ascent this year, but at a more moderate pace than 2015, and the pass-through to consumer prices will remain constrained by the subdued growth environment.
- **Given the recovery in crude oil prices and the likely uptick in food prices due to the higher agri-prices in the later part of the year, do be on the lookout for some stabilization in the headline CPI prints (likely from 3Q16) and potentially for core inflation as well.** In addition, the disinflationary effects of oil and budgetary and other one-off measures will also fade. Note the MAS-MTI statement removed the phrase that "global oil prices have fallen significantly since mid-October" but retained the view that they are "expected to average lower for the whole of 2016 compared to last year", whilst the rest of the official inflation outlook was very similar to the January one.
- **Our full-year headline and core inflation forecasts remain at -0.4% yoy and +1.0% yoy respectively**, vis-à-vis the official forecasts for -1.0%-0% and 0.5-1.5%.

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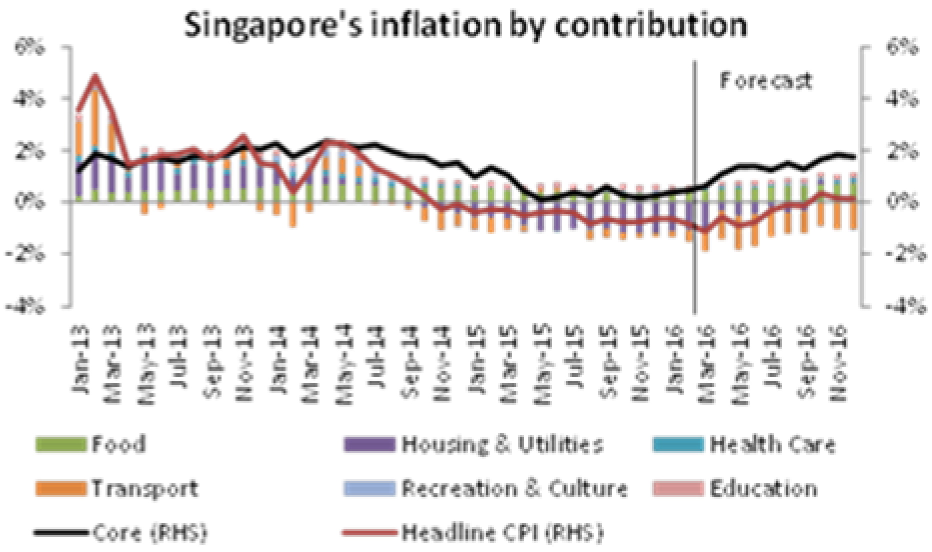

Source: CEIC, OCBC Bank