

Easing inflationary environment, but no clarion call for an inter-meeting policy easing

Tuesday, July 23, 2019

Highlights

- **Headline inflation moderated to 0.6% yoy in June, down from 0.9% yoy in May.** The main contributors to the softer headline CPI print were lower private road transport (due to a smaller increase in car prices and falling petrol prices), services (due to more gradual hikes in holiday expenses and airfares, coupled with a bigger decline in telecommunication services fees) and retail (attributable to a larger fall in telcom equipment, medical products and goods for recreation & entertainment) inflation, as well as more affordable electricity & gas (due to the launch of the Open Electricity Market) and accommodation (amid lower housing rentals) costs. Compared to May, headline CPI declined 0.2% mom nsa, marking the fourth on-month decline for the last six months.
- **Headline CPI averaged 0.6% yoy for 1H19, but is still expected to accelerate to around 1.1% yoy in 2H19,** partly due to a lower base from October 2018 due to the collapse in oil prices and COE premiums. Our full-year 2019 headline CPI forecast is 0.8% yoy, compared to 0.4% for 2018. MAS and MTI reiterated their expectations that external sources of inflation remain benign, and full-year oil prices are likely softer than last year. On the domestic front, while labour market conditions remain resilient and should support moderate wage increases, nevertheless, they do not see an acceleration in inflationary pressures amid the slowing growth dynamics and continued restraining effects from previous policy tightening.
- **Core inflation, while softening to 1.2% yoy (slowest since March 2017) in June, continues to stay above the 1% yoy handle, which could dampen near-term market speculation of an immediate (or off-cycle) monetary policy easing.** Core inflation averaged 1.4% yoy for 1H19 and we tip only a modest deceleration to 1.3% yoy for 2H19. This would bring the full year 2019 inflation print to still hover around 1.4% (versus 2018: 1.7%yoy), which is well within MAS' comfort range of 1-2% yoy. In fact, MAS rhetoric has not deviated from the previous view that core inflation is expected to come in near the mid-point of the 1-2% forecast range in 2019.

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- **The path of least resistance is for a flattening of the S\$NEER slope at the October MAS policy meeting, which is equivalent of taking back one of the previous tightening moves in 2018.** This would be similar to what the global central banks like the FOMC is planning for the upcoming end-July meeting which is to cut interest rates, and what other Asian central banks like BI and BOK have done in recent weeks. Barring a sharp deceleration in core inflationary pressures in the coming months, for instance potentially triggered by a faster-than-expected softening in the domestic labour market (which is not our baseline case yet) or a collapse in crude oil prices (as was the case which prompted the off-cycle move in January 2015), we see little conviction for an immediate adjustment in the policy settings. Moreover the S\$NEER has recently retreated closer to the 1+% on the stronger end of its parity band, but is still some distance from testing the weaker side of the parity band as was the case through much of 2015.

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