September 2018 inflation and TRAIN Q&A

As of October 16, 2018

1. **What is the inflation rate for the month of September?**
Inflation in September 2018 accelerated to 6.7 percent from 6.4 percent in August, bringing the average or year-to-date (YTD) inflation to 5.0 percent (Table 1). This is 1 percentage point (ppt) above the central bank's upper-end target of 4 percent. Meanwhile, month-on-month inflation (MOM) decelerated to 0.8 percent from 0.9 percent in August 2018.

Table 1. Summary of 2018 inflation rates (percent)

2018	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept
Year-on-year	3.4	3.9	4.3	4.5	4.6	5.2	5.7	6.4	6.7
Month-on-month	0.9	0.8	0.5	0.5	0.0	0.6	0.5	0.9	0.8
Year-to-date	3.4	3.7	3.8	4.1	4.1	4.3	4.5	4.8	5.0
Source: PSA									

2. **How big is TRAIN's contribution to inflation?**

Table 2. Top 10 drivers of September 2018 inflation

Rank	Top contributors to inflation	Contribution to year-on-year inflation (ppt)
1	Rice	1.0
2	Fish	0.8
3	Electricity, gas, and other fuels	0.7
4	Operation of personal transport equipment	0.6
5	Vegetables	0.5
6	Meat	0.5
7	Catering services	0.4
8	Housing rentals	0.4
9	Non-alcoholic beverages	0.3
10	Tobacco	0.3
	Total	**5.5**

Source: PSA

In September 2018, the top 10 contributors to inflation accounted for 5.5 ppt of the 6.7 percent inflation (Table 2). Of these products, TRAIN contributed around:

i. 25 percent of personal transport inflation,
ii. 5 of electricity and gas inflation,[1]
iii. 100 percent of non-alcoholic beverages inflation, and
iv. 20 percent of tobacco inflation.

These top 10 products have been among the top contributors to inflation, generally accounting for more than half of total year-on-year (YOY) inflation since late-2016.[2]

Among these products, the shares of petroleum input to total output are small (from 3.4 to 9.3 percent), suggesting minimal pass through of oil prices. This also suggests an even smaller pass through of oil excise taxes from TRAIN on consumer prices. TRAIN's contribution to higher oil prices is around 25 percent, while the soaring international price of crude imports accounts for the remaining 75 percent.

Moreover, the interplay of external factors contributed more to increasing fuel prices than TRAIN. Higher fuel prices were largely due to higher international crude oil prices (around USD 76.33 per barrel) and the depreciation of the peso (up to 53.94 pesos to a dollar). The oil excise imposed by TRAIN only contributed some 22 and 28 percent of the retail price increases, respectively, of diesel and gasoline. In September 2018, pump prices of diesel and gasoline increased by PHP 12.9 and 10.5 per liter, respectively, compared to September 2017. Of the total increase, only PHP 2.8 for diesel and PHP 2.97 for gasoline are due to TRAIN (excise and VAT included).

Raw food continues to be the main driver of inflation. In September, damages brought about by typhoon *Ompong* (international name: Mangkhut) reduced the supply of food and further drove up prices. This reinforces the need to urgently implement solutions that will increase and stabilize the supply of key food and agriculture products to bring down prices for Filipino families.

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[1] From a low of PHP 27.9 in Meralco areas (1.4%) to a high of PHP 162 in non-Meralco areas (8.1%) in the total billing for those consuming 200 kwh per month for electricity, and 0.9% for LPG (PHP 1.12 out of the PHP 123 per kg), and 7.8% for kerosene (PHP 3.36 out of the 43.25 per liter).

[2] See also the appendix tables for historical 2016 and 2017 data, when there was no TRAIN yet.

TRAIN's contribution to inflation, as previously estimated, remains at around 0.4 to 0.7 ppt. The Department of Finance (DOF), National Economic Development Authority (NEDA), and Bangko Sentral ng Pilipinas (BSP) all arrived at comparable estimates using different methods to model the legislated tax increases.

3. **What are the main drivers of inflation in September?**
   Among the highest contributors to inflation in September are rice, fish meat, and vegetables (total contribution of 2.8 ppt out of the 6.7 percent inflation). Rice has become the top contributor to inflation at 1 ppt in September, from only 0.1 ppt in January 2018. In other words, household spending on rice increased from 3 centavos for every additional peso spent in January to 15 centavos in September compared to a year before.

   Fish comes in second, contributing 0.8 ppt. This is equivalent to an additional spending of around 12 centavos for every peso in September 2018 compared with a year prior. Inflation of vegetables and meat remain elevated, each contributing 0.5 ppt. This is equivalent to an additional spending of around 7 centavos for every peso spent on either vegetables or meat compared to a year before.

   Food-abundant and agriculturally-productive Region III and CAR have the lowest inflation rates at 4.5 and 5.0 percent, respectively.

   This strongly suggests that reforming agriculture and increasing productivity are key to bringing down prices. Agricultural productivity can be increased by i) individualizing the agrarian reform collective titles to improve property rights and incentivize farm production, and ii) improving efficiency by reallocating the budget from favoring certain crops (e.g., rice) and production inputs into more broad-based farm infrastructure, R&D, and support service.

4. **The leading driver of inflation is rice. What can be done to reduce rice prices and inflation?**
   Rice contribution to inflation was just 0.1 percentage points in 2017, but between January to September 2018, it grew 10 times to 1 percentage point, making it the number 1 driver of inflation (Figure 1).

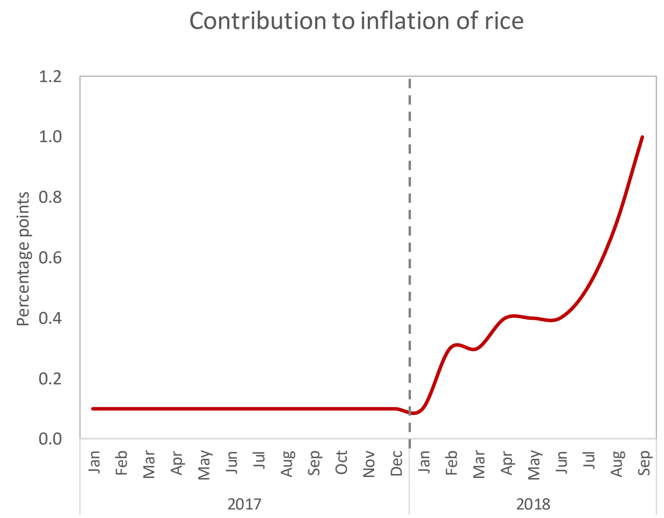
In fact, historically, whenever the country faces rice supply shortages, the inflation jumped. Rice supply problems were evident in 1995, 2008, 2014, and again in 2018 (Figure 2).

We have learned from the past experience and we will not allow this to happen again.

The rice tariffication bill is key to bringing rice prices down by 2 to 7 pesos per kilo. However, true tariffication also means that non-tariff barriers are also taken down, such as removing the need to get an import license from the NFA, which is one reason for high rice prices.

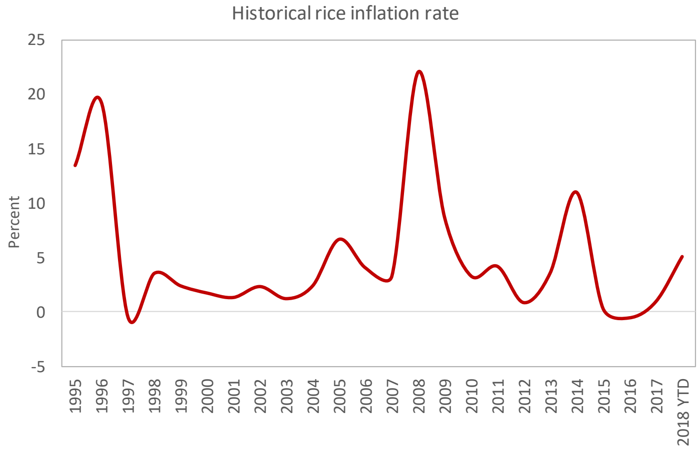
This is reflected in the Senate version, which is expected to be approved very soon. Thereafter, in the bicam, we must support the Senate version as the House version retains the import licensing power of NFA. Its quick enactment can further bring down food prices.

Figure 1. The contribution to inflation of rice has grown 10 times compared to 2017.



Source: PSA

Figure 2. Rice tariffication and food policy reform are needed to address repeated rice supply problems



Source: PSA
Note: Rice nflation rates from 1995 to 2012 are based on the 2006 series, while rates from 2013 to 2018 are based on the latest 2012 series.

5. **As the inflation target has been slightly breached, is there reason to be alarmed?**
The 2-4 percent inflation target is a medium-term target. The central bank forecasts inflation to average 5.2 percent in 2018 and expects it to slow down in the last quarter of 2018. Inflation is forecasted to continue declining towards the 3 percent average target in 2019.

   The main causes of the rise in food prices include seasonal weather disturbances and insufficient supply. As the government continues to implement quick reforms to address the insufficiency of food supply, we can expect inflation to ease in the coming months.

6. **What can be done immediately to reduce inflation?**
In the short-term, the Department of Agriculture may reduce inflation by increasing the supply of food.

   The President, through Administrative Order 13 (AO 13) and Memorandum Circulars 26, 27, and 28, has given DA the power to increase food supply. DA must take this opportunity to bring down food prices quickly.

   In particular, AO 13 contains the following items that can immediately help reduce food inflation:

- Streamlining of administrative procedures and removal of non-tariff barriers.
- Additional rice importation.
- Importation of fishery products.
- Expedited unloading of agricultural imports.
- Other remedial measures to improve logistics, transport, distribution, and storage of agricultural products.
- Creation of a surveillance team.

Also, the Department of Social Welfare and Development (DSWD) and Department of Transportation (DOTr) continue to fast-track the social mitigating measures of TRAIN, namely the distribution of cash transfers and fuel cash cards.

In the medium-term, food production must be enhanced to ensure adequate supply of food at reasonable prices and to keep up with population growth. To increase productivity, two key measures need to be enhanced and fast-tracked.

The first is to individualize the agrarian reform collective titles to improve property rights and incentivize farm production. Keeping the collective certificate of land ownership awards (CLOA) is akin to running a farm the "communist way," which does not incentivize farmers to be productive. China has long moved away from collective farming into household farming and has reaped agricultural productivity. We should follow suit and prioritize this now.

The second is to increase efficiency by reallocating the budget of agriculture from favoring certain crops, such as rice, and production inputs, into more broad-based farm infrastructure, R&D, and support services.

Improving efficiency of the budget and reforming food policy are key to raising production, not just giving more money to the sector.

7. **How are the poor affected by the increase in inflation?**
   With food as the main driver of inflation in September, the poor, particularly in regions with low supplies of fish, rice, meat, and vegetables, are mainly affected. On the other hand, food-abundant and agriculturally-productive Region III and CAR have the lowest inflation rates at 4.5 and 5.0 percent, respectively. This strongly suggests that reforming agriculture is key to bringing down prices.

   The economic managers are taking the necessary solutions in the agriculture sector to address supply issues on food. In addition, the DSWD and DOTr continue to fast-track the social mitigating measures of TRAIN, namely the distribution of cash transfers and fuel cash cards.

8. **What are the efforts of the government to protect the most vulnerable from the effect of inflation?**
   The Unconditional Cash Transfer (UCT) program of the DSWD aims to distribute PHP 2,400 in 2018 to the poorest 10 million households and individuals and will increase this to PHP 3,600 in the next two years to help the poor cope with the temporary but moderate inflationary effects of TRAIN. As of early October 2018, they have the full benefit to 7 million UCT beneficiaries. They aim to distribute to the remaining beneficiaries in the fourth quarter of this year.

   In addition, the DOTr has started the distribution of cash cards to PUJ drivers with legitimate franchise. As of mid-October, the DOTr has distributed around 53,000 cash cards. The benefits of this are two-fold. First, it helps mitigate the impact of higher fuel prices for drivers and operators. Second, it helps commuters by reducing additional price pressures on fares.

   While it is important to distribute the cash as soon as possible, it is also important to ensure that the right people, the poor, receive the money. That is why care must be given to ensure proper targeting to reduce leakage. The recent passage of the National ID by congress will help improve targeting in 2019 and beyond.

9. **Was the DOF mistaken with their inflation forecast due to TRAIN as overall inflation has already exceeded the target of 2 to 4 percent as of September 2018?**
   The DOF does not forecast inflation nor set inflation targets, as this is the role of the central bank. What the DOF contributed is computing the likely impact of TRAIN on inflation, which is 0.4 to 0.7 ppt. This corresponds with the estimates of various government agencies, such as NEDA and BSP. The method is straightforward. The standard input-output table is used to determine the share of oil products in production of various goods and service. Anyone with an input-output table can verify the estimates. This is also corroborated by results using a dynamic stochastic general equilibrium model.

10. **How is the government controlling profiteering or unwarranted price increase?**
    The DTI and Department of Energy (DOE) continue to closely monitor any unusual price increase. The DTI has been monitoring and checking prices of goods weekly, and have asked businesses selling goods exceeding the suggested retail prices to adjust their prices accordingly. For their part, the DA has set SRPs for most agricultural products to help stabilize prices.

    Although profiteering is hard to catch, there are clear evidence that it is happening. For instance, even before the excise on oil increased, prices of goods and services have gone up. In January 2018, prices have increased even when the excise tax on oil was not yet passed on to the consumers because oil firms were expected to be selling old stock from 2017 as they are required by law to keep at least 15 days worth of stock (the average is around 15 to 45 days). Therefore, if price increased even before excise increased, this can only mean that there is some profiteering or unwarranted price increase.

    Moreover, some businesses find it convenient to blame TRAIN as their reason for increasing prices. For instance, a pizza company and a transportation network vehicle services (TNVS) company reportedly used TRAIN as its reason to increase prices. They have, however, issued an apology after receiving a clarification (see below).

11. **Can we expect inflation to decrease in the coming months?**

As the government continues to take the necessary steps in addressing agricultural supply issues, we can expect inflation to temper in the coming months. We have seen that food-abundant and agriculturally-productive Region III has the lowest regional inflation rate at 4.5 percent. This strongly suggests that reforms in the agriculture sector is key to bringing down prices.

12. **What are the demand driven factors for higher inflation?**

Inflation may be caused by supply side or demand side factors. Supply-side factors include higher crude oil price and supply constraints.

On the other hand, demand-side factors can drive inflation. In 2018, the government is releasing PHP 32.5 billion monthly as additional disposable income for the people (Table 2). The breakdown is as follows: (i) PHP 2 billion per month for the Unconditional Cash Transfer (UCT) program, (ii) PHP 12 billion per month in personal income tax (PIT) reduction, (iii) PHP 15 billion per month in new wages as 30 percent of the government infrastructure spending of PHP 50 billion is labor cost, and (iv) PHP 3.5 billion per month on free state universities and colleges (SUC) tuition.

Table 3. Demand driven factors of higher inflation

Increase in consumption	Amount (PHP billion/month)
Unconditional cash transfer (UCT)	2
Personal income tax reduction (PIT)	12
Labor infrastructure effect*	15
College tuition effect	3.5
Total	**32.5**

Labor infrastructure effect*	Amount (PHP billion/month)
Gov't infrastructure	50
Wages (30 percent)	15