

## December 2018 inflation and TRAIN Q&A

As of January 30, 2019

### 1. What is the inflation rate for the month of December?

Inflation in December 2018 decelerated to 5.1 percent year-on-year, bringing average or year-to-date (YTD) inflation to 5.2 percent (Table 1). This is 1.2 percentage points above the central bank's upper-end target of 4 percent. Meanwhile, month-on-month inflation (MOM) further decelerated and is negative at -0.2 percent. This means that, on average, prices are lower in December compared to what they were in November of this year. It has continued to decelerate for four consecutive months starting September, and was negative starting November.

**Table 1. Summary of 2018 inflation rates (percent)**

2018	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Year-on-year	3.4	3.9	4.3	4.5	4.6	5.2	5.7	6.4	6.7	6.7	6.0	5.1
Month-on-month	0.9	0.8	0.5	0.5	0.0	0.6	0.5	0.9	0.8	0.3	-0.2	-0.6
Year-to-date	3.4	3.7	3.8	4.1	4.1	4.3	4.5	4.8	5.0	5.1	5.2	5.2

Source: PSA

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

**Table 2. Top 10 drivers of December 2018 inflation**

Rank	Top contributors to inflation	Contribution to year-on-year inflation (ppt)
1	Rice	0.6
2	Fish	0.6
3	Elec., gas, fuels	0.4
4	Housing rentals	0.4
5	Catering Services	0.4
6	Non-alc bev.	0.4
7	Meat	0.3
8	Tobacco	0.3

9	Public transp.	0.2
10	Vegetables	0.2
	<b>Total</b>	<b>3.8</b>

Source: PSA

- In December 2018, the top 10 contributors to inflation accounted for 3.8 ppt of the 5.1 percent inflation (Table 2). Of these products, TRAIN contributed around:
  - 25 percent of personal transport inflation,
  - 5 of electricity and gas inflation,<sup>1</sup> and
  - 100 percent of non-alcoholic beverages 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.
- 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. For the full-year 2018, TRAIN's contribution to higher retail oil prices is around half, while the international price of crude imports accounts for the other half.
- Moreover, the interplay of external factors contributed more to increasing fuel prices than TRAIN. As Dubai crude oil price continue to stay low, we will also see retail pump prices of gasoline and diesel further decrease.
- 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.

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<sup>1</sup> From a low of PHP 27.9 in Meralco areas (1.4 percent) to a high of PHP 162 in non-Meralco areas (8.1 percent) in the total billing for those consuming 200 kwh per month for electricity, and 1.9 percent for LPG (PHP 1.12 out of the PHP 58 per kg), and 7.1 percent for kerosene (PHP 3.36 out of the 47.57 per liter).

### **3. What are the main drivers of inflation in December?**

Raw food used to be the main driver of inflation, contributing more than half to the top 10 drivers of inflation, particularly when inflation peaked around the third quarter of this year. In the past two months, however, its total contribution to the top 10 drivers has now fallen to less than half. This implies that effects of government efforts and directives to tame inflation, such as AO 13 and MCs 26, 27, and 28, are continuing to be felt.

The raw food items in the top 10 contributors to inflation in December are rice, fish, meat, and vegetables (total contribution of 1.7 ppt out of the 3.8 percent inflation, or around 44 percent).

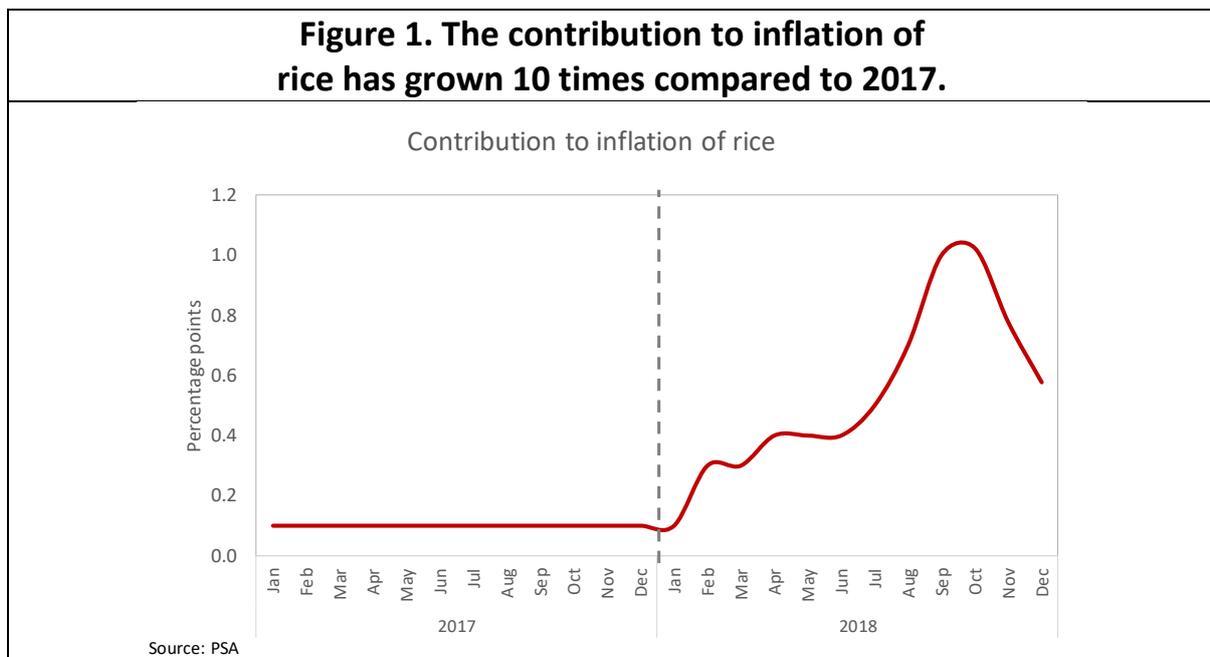
- Rice remains the top contributor to inflation at 0.6 ppt in December, from only 0.1 ppt in January 2018. In other words, household spending on rice increased from 3 centavos for every additional peso spent in January to 12 centavos in December compared to a year before.
- Fish comes in second, also contributing around 0.6 ppt. This is equivalent to an additional spending of around 12 centavos for every peso in December 2018 compared with a year prior.
- Inflation of meat remains elevated, contributing 0.3 ppt. This is equivalent to an additional spending of around 6 centavos for every peso spent on meat compared to a year before.
- Lastly, inflation of vegetables decreased, but remains elevated, contributing 0.2 ppt. This is equivalent to an additional spending of around 4 centavos for every peso spent on vegetables compared to the same period last year.

### **4. The leading driver of inflation is rice. What can be done to reduce rice prices and inflation?**

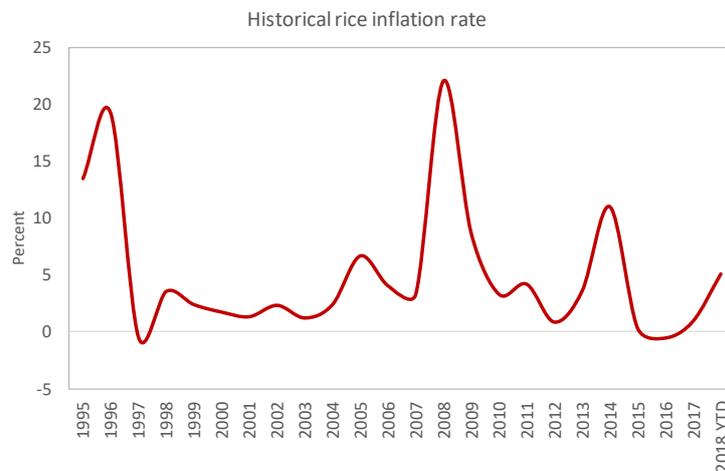
- In December 2018, rice remains the top driver of inflation, although to a much lesser extent compared to its peak. Its contribution to inflation decreased to 0.6 ppt in December from a full 1 ppt in October. On a MOM basis, however, rice prices fell by 1.7 percent on average compared to last month. Despite the slight decrease, rice prices in general remain elevated due to recent weather disturbances and inadequate imported rice.

- 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.
- 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.
- Rice tariffication was recently approved by both houses, and is expected to be signed into law by the president very soon.

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



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



Source: PSA  
 Note: Rice inflation 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?**

Inflation for 2018 averaged at 5.2 percent. The full-year YOY inflation is 1.2 percentage points above the central bank’s upper-end target of 4 percent. Meanwhile, MOM inflation has continued to decelerate for four consecutive months starting September, and was negative starting November. Inflation is forecasted to continue declining towards the 3 percent average target in 2019.

As we continue to feel the effects of government efforts to temper inflation and the decreasing world oil prices, we can expect inflation to further decelerate in the coming months.

**6. What can be done immediately to reduce inflation?**

Government efforts and directives, such as AO 13 and MCs 26, 27, and 28, to tame inflation are now beginning to be felt as seen through the decline of raw food’s contribution to the top 10 drivers by less than half in December 2018. However, persistently high food prices still 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.

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 rice and fish as top contributors to inflation in recent months, the poor, in regions with low food supply, are mainly affected. On the other hand, food-abundant and agriculturally-productive regions III and CAR continue to have the lowest inflation rates at 3.4 and 4.0 percent, respectively. This strongly suggests that reforming agriculture is key to bringing down prices. With MOM inflation decelerating in recent months, we can see that efforts of the government in addressing food supply are effective in immediately tempering inflation.

Moreover, to help mitigate the impact of inflation, whether TRAIN related or not, the Department of Social Welfare and Development (DSWD) and the Department of Transportation (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 14 January 2019, they have released the full benefit to 9.2 million UCT beneficiaries. They aim to distribute to the remaining beneficiaries in the first quarter of this year.

In addition, the DOTr has started the distribution of cash cards to PUJ drivers with legitimate franchise. As of 15 January 2019, the DOTr has distributed around 74,714 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 December 2018?**

The DOF does not 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?**

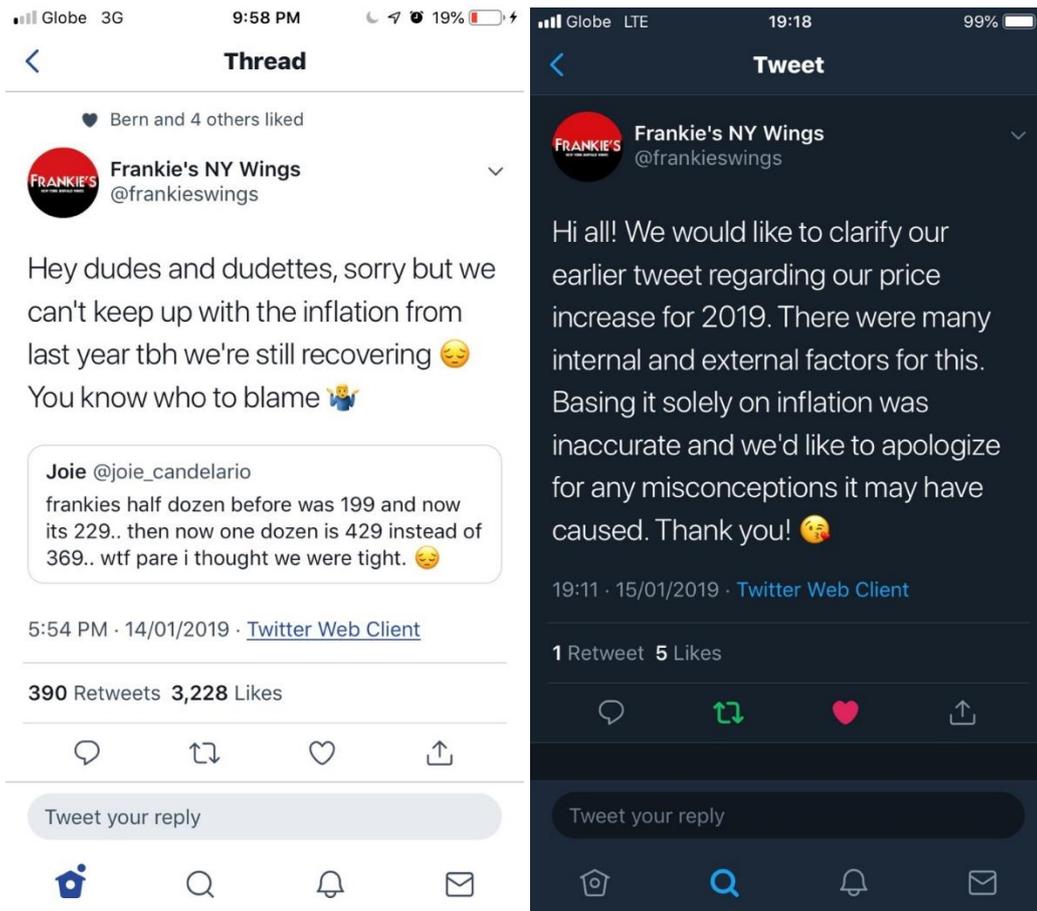
The DTI and Department of Energy (DOE) continue to closely monitor any unusual price increase. The DTI has been monitoring and checking prices

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 which was implemented in mid-October.

Although profiteering is hard to prove, 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 transportation network vehicle services (TNVS) company, a pizza company, and a chicken wings company reportedly used TRAIN as its reason to increase prices. They have, however, issued an apology after receiving clarification (see below).





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

The substantial and negative MOM inflation points to a downward inflation path. This reflects the results of concerted government efforts in recent months to tame the prices of goods, most especially raw food products, and decreasing global crude oil prices.

Going forward, the central bank expects inflation to fall towards the 2 to 4 percent target range in 2019, and to further slowdown in 2020.

**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**

<b>Increase in consumption</b>	<b>Amount (PHP billion/month)</b>	<b>Labor infrastructure effect*</b>	<b>Amount (PHP billion/month)</b>
<b>Unconditional cash transfer (UCT)</b>	2	<b>Gov't infrastructure</b>	50
<b>Personal income tax reduction (PIT)</b>	12	<b>Wages (30 percent)</b>	15
<b>Labor infrastructure effect*</b>	15		
<b>College tuition effect</b>	3.5		
<b>Total</b>	<b>32.5</b>		