

## January 2019 inflation and TRAIN Q&A

*As of February 19, 2019*

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

Inflation in January 2019 sharply decelerated to 4.4 percent year-on-year (Table 1). This is the lowest monthly inflation figure in 10 months, and is more than 2 percentage points (ppt) lower compared to its peak in 2018. This inflation figure is 0.4 percentage points above the central bank's upper-end target of 4 percent. However, for the full year 2019, the central bank forecasts inflation to fall towards the 2 to 4 percent target range, and to further slow-down in 2020.

**Table 1. Summary of 2019 inflation rates (percent)**

2019	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Year-on-year	4.4	-	-	-	-	-	-	-	-	-	-	-
Month-on-month	0.2	-	-	-	-	-	-	-	-	-	-	-
Year-to-date	4.4	-	-	-	-	-	-	-	-	-	-	-

Source: PSA

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

**Table 2. Top 10 drivers of January 2019 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

Rank	Top contributors to inflation	Contribution to year-on-year inflation (ppt)
9	Public transp.	0.2
10	Vegetables	0.2
	<b>Total</b>	<b>3.3</b>

Source: PSA

- In January 2019, the top 10 contributors to inflation accounted for 3.3 ppt of the 4.4 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. In 2018, TRAIN's contribution to higher retail oil prices was around 25 percent, while the international price of crude imports accounted for the remaining 75 percent, on average. Meanwhile, January 2019 retail prices of oil products are very close to pre-TRAIN prices, so the effects of the excise taxes on oil are hardly felt.

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

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 2018. In the past three 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 being felt.

<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).

The raw food items in the top 10 contributors to inflation in January are rice, fish, meat, and vegetables (total contribution of 1.4 ppt out of the 3.3 percent inflation, or around 42 percent).

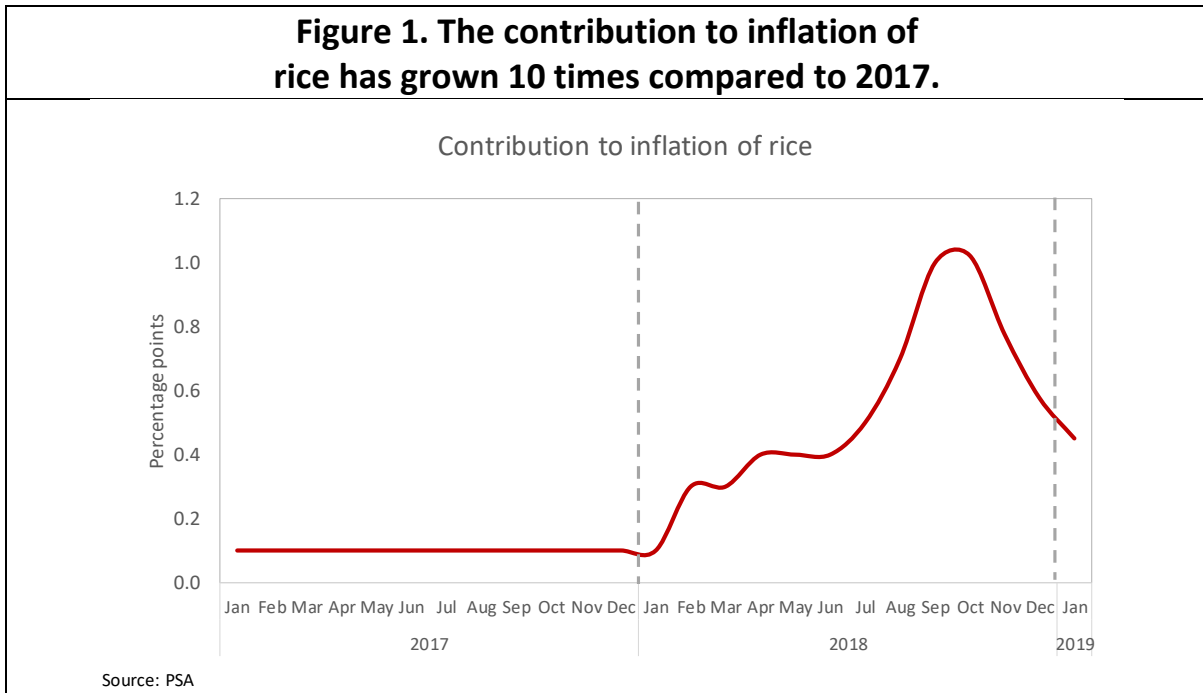
- Rice remains the top contributor to inflation at 0.5 ppt in January 2019, from only 0.1 ppt in January 2018. In other words, household spending on rice increased from 3 centavos for every additional peso spent in January 2018 to 11 centavos in January 2019 compared to a year before.
- Fish comes in second, also contributing around 0.4 ppt. This is equivalent to an additional spending of around 9 centavos for every peso in January 2019 compared to the prior year.
- Inflation of meat remains elevated, contributing 0.3 ppt. This is equivalent to an additional spending of around 7 centavos for every peso spent on meat compared to a year before.
- Lastly, inflation of vegetables decreased, but remains in the top 10, contributing 0.1 ppt. This is equivalent to an additional spending of around 2 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?**

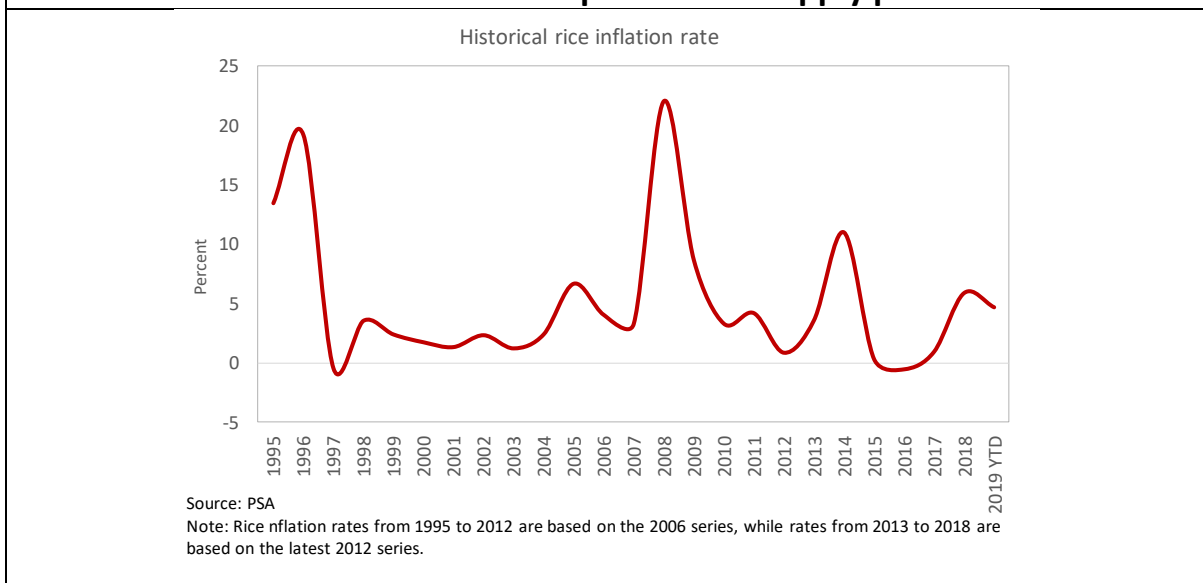
- In January 2019, rice remains the top driver of inflation, although to a much lesser extent compared to its peak. Its contribution to inflation decreased to 0.5 ppt in January from a full 1 ppt in October 2018. On a MOM basis, however, rice prices fell by 0.7 percent on average compared to last month. Despite the slight decrease, rice prices in general remain elevated due to 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.
- The rice tariffication bill 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**



**5. As the inflation target has been breached, is there reason to be alarmed?**

The central bank's inflation target is set for the whole year. Even if the inflation rate in January 2019 slightly breached the full year target by 0.4 ppt, the central bank forecasts inflation to fall towards 3.2 percent for the full year 2019. This is well within the 2 to 4 percent target range set for this year.

Inflation in January sharply decelerated to 4.4 percent YOY. This is the lowest monthly inflation figure in 10 months, and is more than 2 ppt lower compared to its peak in 2018. The continued deceleration of inflation in recent months points to a downward inflation path.

As we continue to feel the effects of government efforts to temper inflation and the relatively low 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 being felt as seen through the decline of raw food's contribution to the top 10 drivers by less than half in January 2019. 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) remain committed in implementing 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, CAR, and CARAGA have among the lowest inflation rates at 3.1 and the latter two both at 3.7 percent. This strongly suggests that reforming agriculture is key to bringing down prices. With 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) remain committed in implementing 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. As of 14 January 2019, they have released the full benefit to 9.2 million UCT beneficiaries. They aim to distribute to all 10 million beneficiaries by the first quarter of this year. The benefits will increase to PHP 3,600 in the next two years to help the poor cope with the temporary but moderate inflationary effects of TRAIN. The DSWD aims to release the 2019 benefits by June of this year.

In addition, the DOTr continues to distribute cash cards to PUJ drivers with legitimate franchises. 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 January 2019?**

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 only around 0.3 ppt for this year. This corresponds with the estimates of various government agencies, such as the 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 2018.

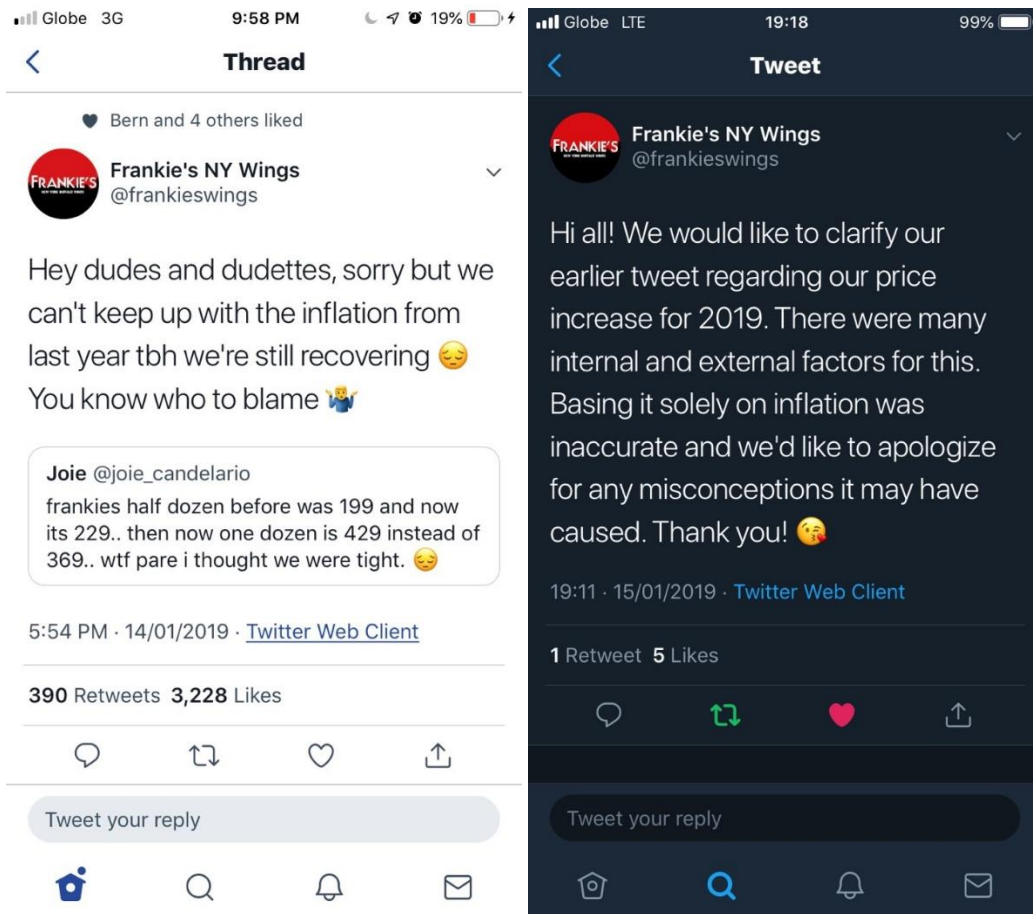
Although profiteering is hard to prove, there are clear evidence that it is happening. For instance, even before the excise on oil increased, prices of goods and services have gone up. In January 2018, prices have increased even when the excise tax on oil was not yet passed on to the consumers because 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 continued deceleration in 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 lower global crude oil prices.

For the full year 2019, the central bank forecasts inflation to fall towards 3.2 percent, which is well within the 2 to 4 percent target range, and to further slow-down in 2020.