Philippine Institute for Development Studies

Economic Issue of the Day

Inflation

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Many Filipino families continue to feel the burden of rising commodity prices. The hardship is aggravated when basic food items like rice, sugar, and corn have difficulty finding their way to the tables of the Mang Pandoys, especially since the latter's incomes do not increase proportionally with the rise in prices. As most Filipinos know, the main cause of their thinning wallet is the phenomenon of inflation. Hence, it comes as no surprise that when President Estrada asked the Filipino community for its wish for the Yuletide season, most families asked for lower inflation.

Since January of 1999, this wish has been fulfilled. As seen in the figure below, from a high of 11.5 percent in January, inflation has come down to 2.6 percent in January 2000 which is just a year's time. But still, the Filipinos are not satisfied and continue to protest against rising commodity prices. Could it be that they are being misled by the rosy inflation reports? Or is it just a matter of misunderstanding some basic concepts?

When prices of commodities rise, we refer to it as inflation. If prices fall, however, this is normally referred to as negative inflation or deflation. There are two major types of inflation, namely, the demand-pull and the cost-push inflation. Demand-pull inflation occurs when there are increases in consumer demand and production does not increase. The inflation in 1998 was a variant of demand-pull inflation since agriculture supply declined and could not cope with the existing demand for food.

In contrast, cost-push inflation is associated with the rise in the cost of inputs in the production process. A key example is the rise in the price of oil. An increase in wages also leads to cost-push inflation.

What is inflation?

Inflation measures the annual percentage increase in prices. The most usual measure is that of *retail* prices. The government publishes an index of retail prices each month, and the rate of inflation is the percentage increase in that index over the previous twelve months.

For example, if the price of *galunggong* were ₱20 per kilo in January of 1998 and then rose to ₱30 per kilo in January of 1999, we say that the inflation rate (based on *galunggong*) is 50 percent. This figure is determined by getting the price difference between the two periods and dividing said difference by the initial price, i.e., ₱20 per kilo in January 1998. If in January 2000, the price rose to ₱36 per kilo, the inflation rate would be 20 percent. The inflation rate did come down, but actual prices nevertheless still increased.

The *Economic Issue of the Day* is one of a series of PIDS efforts to help in enlightening the public and other interested parties on the concepts behind certain economic issues. This dissemination outlet aims to define and explain, in simple and easy-to-understand terms, basic economic concepts as they relate to current and everyday economics-related matters.

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The views expressed are those of the author(s) and do not necessarily reflect those of PIDS.

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An important concept in understanding inflation is the way it is measured. As mentioned, it is an annual percentage increase in prices of commodities. There are six major classifications of these commodities ranging from food to miscellaneous items. The National Statistics Office (NSO) assigns weights to these commodities representing the average expenditure of a typical Filipino. The weights are generally fixed for a period of time, and altered whenever the NSO changes its reference base period. This is partly reflective of the changing spending behavior of the Filipino.

Table 1

Weights per Commodity Group	1978	1988	1994
Food, beverages and tobacco	58.1	58.5	55.1
Clothing	7.9	4.4	3.7
Housing and repairs	10.5	13.3	14.7
Fuel, light and water	5.2	5.4	5.7
Services	10.7	10.9	12.3
Miscellaneous	7.6	7.6	8.5

Table 1 indicates the comparative weights of the commodities for 1978, 1988 and 1994. Food remains to be the biggest spending item of an average Filipino over the years. It is also interesting to note that people are spending more for services and housing in 1994 compared to 20 years ago.

Inflation in 1999 has been on a downward trend despite the sharp rise in fuel prices. One reason for this is that in measuring inflation, food has a large weight in the basket of commodities that is being monitored by the government. When food prices rose dramatically in 1998, inflation was high in that year. But improved weather conditions eased food supply problem and stabilized food prices in 1999, bringing down inflation to single-digit levels. And the rapid rise of some commodities like oil had very little direct effect on inflation.

But many consumers, arguing that prices continue to rise in spite of lower inflation, do not welcome this favorable trend. That is because many consumers confuse the notion of a rise or fall of prices with the rise or fall of inflation . A rise in inflation means a faster increase in prices, while a fall in inflation means a slower increase in prices.

Hence, the downtrend in inflation should be interpreted as prices of commodities rising at a slower pace compared to 1998. The bottom line is that prices are still increasing. What the Filipino people should hope for are lower prices of commodities . That being the case, the Filipinos should wait for the next Yuletide season and this time, make the correct wish. ❊