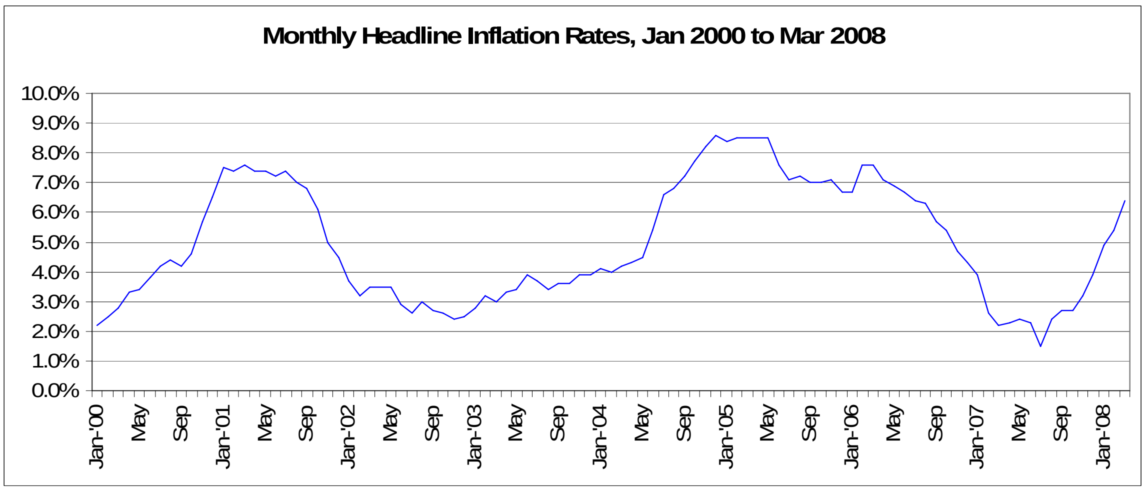
Philequity Corner (April 14, 2008)
By Valentino Sy

Inflation Ri(ce)sing

The March headline inflation rate's jump to 6.4 percent (versus 2.2 percent the previous year and 5.4 percent in February) gave the local market some spook. Rising prices often mean bad news for markets: it could signal the start of rising interest rates; and, coupled with ripples of recession fears from the US, a more fearful specter may sneak in – that of stagflation.

The Bangko Sentral ng Pilipinas (BSP), while admitting that inflation may go slightly beyond target this year, says that the March hike should not be a cause for alarm. Historically, however, we note that inflation (from peak to trough and vice versa) runs within a two-year cycle. As can be seen in the graph below, from a peak of a little over 7% within the first quarter of 2001, inflation trended down until early 2003, moved up until 1st quarter of 2005, and slid once more until the early 2007. Looking at past cyclicality, it is very possible to see inflation peaking up to the early months of 2009.



Source: National Statistics Office

Global Phenomenon

Inflation is not a unique concern to the Philippines. Looking at how some of our neighbors have fared, we are still below the average rate (i.e., 8.58%) of selected Asian countries.

Country	Inflation Rate (%)	Latest Month	Bank Rate (%)
China	8.7	Feb-08	7.47
Hong Kong	6.3	Feb-08	3.75
India	4.8	Jan-08	6
Indonesia	8.2	Mar-08	8
Macau	9.5	Feb-08	n.a.
Malaysia	2.7	Feb-08	3.5
Philippines	6.4	Mar-08	5
South Korea	3.9	Mar-08	5
Sri Lanka	23.8	Mar-08	n.a.
Taiwan	3.96	Mar-08	3.95
Thailand	5.3	Mar-08	3.25
Vietnam	19.4	Mar-08	n.a.

Source: Bloomberg

Not only a rice problem

The sharp increase in March's inflation rate can be attributed to a mix of factors: a low inflation base from the previous year, surging oil prices, and higher food prices, which weigh heavily – at almost 47% – on the CPI (Consumer Price Index) basket.

While rice is a big component of inflation, it should be noted that other commodities have been moving up also.

		% Change year-on-year
Rough Rice	US$ 19.67/cwt	70.0%
Corn	US$ 5.84 /bu	41.4%
Soybean	US$ 13.49/bu	54.2%
Wheat	US$ 9.67/bu	106.6%

Source: Bloomberg

We have alerted our readers as far back as October 2007 (see "*Oil and other commodities surge as Fed eases rates*", **The Philippine Star**, October 1, 2007) about this explosion in commodity prices. The high prices of these commodities have since contributed to the sharp rise of inflation across the globe.

Investing in commodities

The rise in global commodities prices is also a result of investors chasing higher returns, and not only a consequence of the supply and demand dynamics. Cash is being poured into commodity futures because other alternatives appear less attractive: interest rates, equities, and home prices are mostly down.

But a number of developments can turn the commodities tide. A reversal of the weak US dollar can trigger a flight out of commodities. A cut in worldwide commodity demand is also possible, once end-users decide to look for substitutes for exorbitantly-priced goods. Meanwhile, farmers or even governments may decide to expand production of these agricultural commodities as these can be grown and are usually cyclical.

Nonetheless, the bottom is not going to fall out of the commodities market. Unlike "sophisticated" financial products that caused the sub-prime mess, commodities are tangible and consumable, and therefore retain real value.

No to hoarding

As commodities continue to hit new highs, a few unscrupulous traders may be tempted to stock up on supply. Again, we recommend alternative investments such as exchange traded funds (ETFs) for oil, gold or even agricultural commodities (see "*Volatility and opportunities abound in 2008*", **The Philippine Star**, January 7, 2008).

ETFs trim the risk of commodities bubble by diversifying. Moreover, they are easy to get into and out, and have a much lower entry price.

In that article we recommended an agricultural ETF Powershares DB Agriculture ETF (symbol:DBA). From its low of 24.58 in August 2007 (before the first Fed cut), the ETF has surged by 77 percent to a high of 43.50. Year-to-date, it is up by more than 12 percent as of Friday's close of 38.58.

So don't hoard rice; not only is it illegal, you would also do our country a favor. Buy DBA instead.

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