

Philequity Corner (June 09, 2008)
By Valentino Sy

Crude Oil: A Clear and Present Danger

Inflation has now supplanted the US subprime & credit crises as the primary risk to sustaining global growth. Just when it appears that the Fed has successfully averted the credit crisis, inflation rears its ugly head.

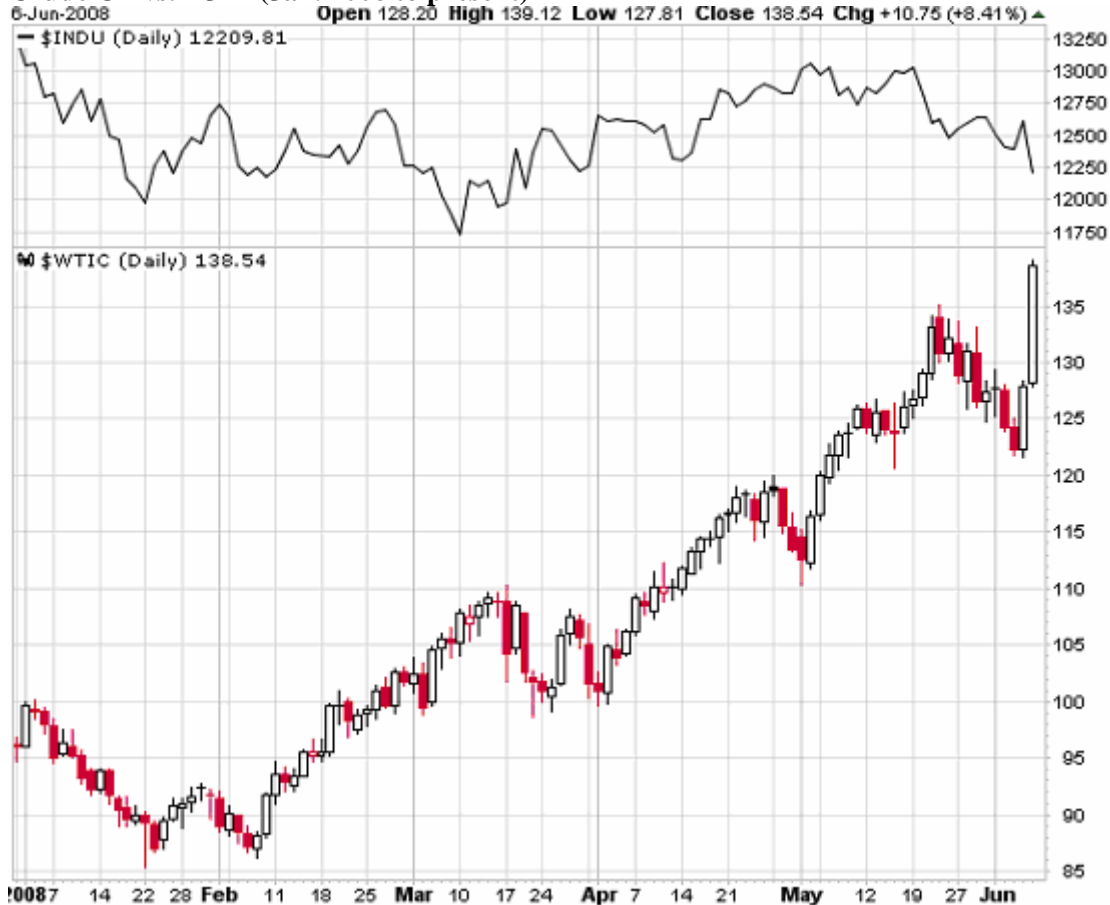
Biggest single-day leap

Crude oil prices jumped to a record \$138.54 per barrel on Friday, surging 8.41 percent for its biggest single-day leap ever. The meteoric rise of nearly \$11 for the day came after an increase of almost \$5.50 the day before, taking oil prices more than 13 percent higher in just two days.

On Wall Street, stocks fell violently in reaction to the oil surge on Friday. The Dow Jones Industrial Average (DJIA) plunged 394.64 points or 3.13 percent as it registered its biggest drop in more than 15 months.

Rising oil prices have cut short the recent rally in stocks. As seen from the chart below, the DJIA reversed in early May as oil prices broke above \$120 per barrel.

Crude Oil vs. DJIA (Jan. 2008 to present)



Source: *Stockcharts.com*

Sharing the same concern

High price levels of food and oil have, likewise, been causing a commotion over here (see “*Inflation Ri(ce)sing*” on April 14, 2008; and “*Rice Reprise*” on May 19, 2008 of **The Philippine Star**). On Thursday, the PSE index hit 2,718.42 (the lowest since October 2006) after headline inflation was reported at 9.6 percent in May, bringing the year-to-date average to 6.9 percent.

The May figure is the highest (so far) in nine years’ time, next only to the 10.5 percent rate recorded in January 1999.

Even our rice-exporting neighbors, however, were not spared. In fact, the Philippines still fared relatively better among countries that have reported May inflation rates. Moreover, some countries’ inflation figures have remained artificially low because of government subsidies. Malaysia, for example, reported 3% inflation as of April, but a recent 41% hike in fuel prices will definitely alter the economic landscape in the near future.

Country	Inflation Rate	as of
Sri Lanka	26.2%	May-08
Vietnam	25.2%	May-08
Indonesia	10.4%	May-08
Philippines	9.6%	May-08
China	8.5%	Apr-08
India	8.2%	May-08
Thailand	7.6%	May-08
South Korea	4.9%	May-08
Taiwan	3.7%	May-08
Malaysia	3.0%	Apr-08
Average for May-08 <i>(excl. China & Malaysia)</i>	12.0%	

Source: Bloomberg

Rice prices stabilize

While oil continues to surge, the good news is that the price of rice – which is Asia’s staple - has gone down. Rough-rice futures on the Chicago Board of Exchange have fallen by about 20 percent since touching \$25.05 per 100 pounds on April 24.

Agriculture Secretary Arthur Yap expects rice prices to further stabilize as supply is boosted by producers who will soon harvest the first crops of the year. Meanwhile, BSP Governor Amando Tetangco remains positive that food-related inflationary pressures are largely temporary and could be resolved by increasing supply through imports and/or increased domestic production.

Remaining Vigilant

So far, the BSP has done its job. It recently raised interest rates by 25 basis points in its latest policy meeting, citing “early evidence of second-round effects” and the “need to act promptly to rein in inflationary expectations.”

Nevertheless, we remain vigilant on oil prices and on inflation. Runaway inflation is a more serious threat to the Philippine economy than the aftershocks of the US subprime & credit crises. The side effects could be accelerating wage growth, rising business costs and lower consumer discretionary spending which will have a negative impact on corporate earnings.

Clearly, the oil/inflation shock is already present. What matters now is how persistent it will be, and how the markets and policy makers will react.

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