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Markit Economic Research

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Global manufacturing prices

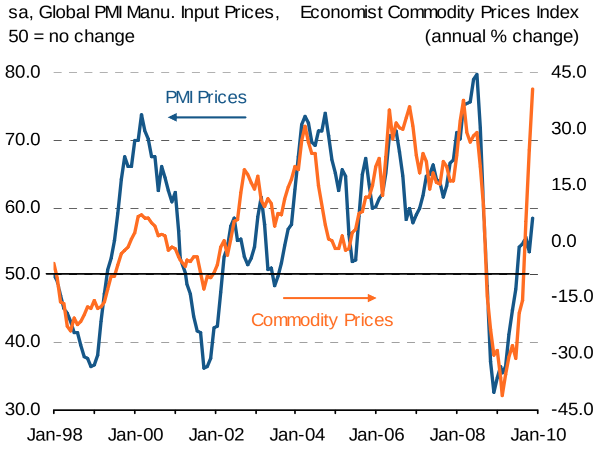
Global input cost inflation rose in December, pointing to short-term inflation spike

- **Rising commodity prices and supply-chain factors drive manufacturing cost inflation to 15-month peak.**
- **Commodity price rises transferring to services economy.**

Manufacturing input prices rose at fastest pace in 15 months in December

The Global PMI Manufacturing Input Prices Index, compiled by Markit on behalf of JPMorgan, rose sharply in December to reach a 15-month high of 58.5. The index has maintained a broad upward trend since hitting a record low at the end of 2008 and has now signalled increasing purchase prices for five successive months.

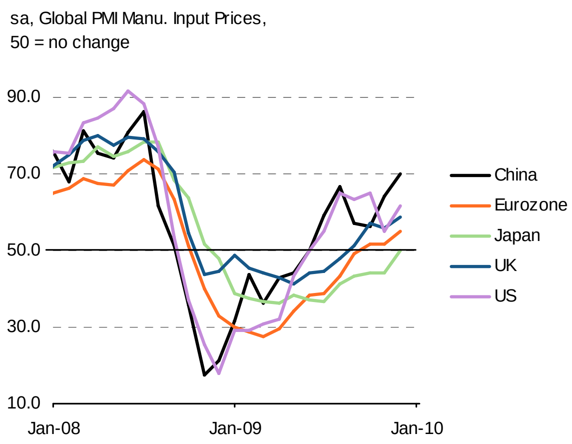
Global PMI Prices vs Commodity Prices



Sources: Markit, JPMorgan, ISM, Economist, Reuters EcoWin

Manufacturing input price inflation has generally been stronger in emerging markets than developed countries in recent months. The rate of increase hit a 17-month high across emerging markets in December, led by Taiwan, China and Russia. Meanwhile, manufacturing cost inflation was the fastest since September 2008 on average across developed countries. The rate of increase accelerated in the US and reached 15-month highs in both the Eurozone and the UK.

Global Manufacturing PMI Costs by Nation



Sources: Markit, JPMorgan, ISM

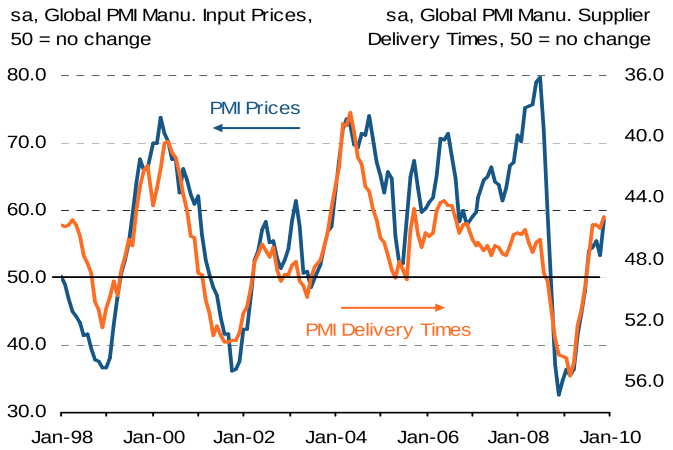
Supply chain factors and higher demand for raw materials drove up costs.

The rise in the Global Manufacturing PMI Prices Index reflects a combination of increased commodity prices and supply chain factors.

On the commodity front, although the average spot price for the benchmark West Texas Intermediate crude oil in December was lower than in November, $74 per barrel as opposed to $78, it was much higher than the average of $41 seen in December 2008. Natural gas (Henry hub) was at its highest level in 2009, copper prices continued to gain in strength (up 4.6% since November and around 127% over the year), while plastics and steel prices also rose over the month. The Economist's commodity price index ended the year on a new high, up 40% on a year ago – the fastest rate of increase since 1994. These commodity price increases are likely to have a short-term impact on headline consumer price inflation measures, given the base effects of the sharp demand-related falls in their cost during the worst of the recession.

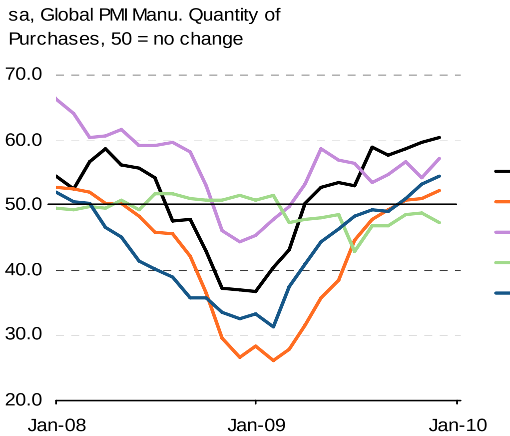
However, PMI survey respondents also continued to blame higher purchasing costs on supply chain factors, and in particular the development of a seller's market for inputs. Low levels of stock at vendors, particularly in emerging markets, were reported to have been causing increasingly widespread shortages and delivery delays as manufacturers' demand for inputs increased towards the end of last year, allowing suppliers to hike prices. Global PMI data show that average vendor performance deteriorated throughout the second half of 2009 and to the greatest extent for almost three-and-a-half years in December. At the same time, rates of increase in purchasing activity were the fastest for 22, 68, and 25 months in the Eurozone, China and the UK respectively during December.

Global PMI Prices vs PMI Delivery Times



Sources: Markit, JPMorgan, ISM

Global Manufacturing Purchasing Activity



Sources: Markit, JPMorgan

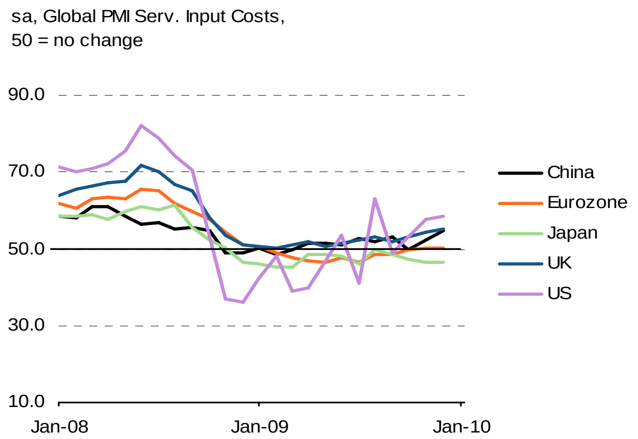
It is important to note that the inventory cycle appears to be playing a role in this raising of inflationary pressures, as part of manufacturers' increased purchasing in recent months represents a move towards the rebuilding of inventories which had been depleted at record rates during the recession. In other words, the need to restock has created an even greater imbalance between demand and supply.

Although global manufacturing stocks of raw materials continued to fall in December, according to PMI data, the rate of reduction was the second-weakest since September 2008 as an increasing number of companies showed signs of refilling their warehouses. Inventories in the emerging markets are now close to stabilising, led by rising stock holdings in China and India.

Commodity price rises may also be passing through to service providers

Rising costs are also being reported by service providers. The Global Services PMI Input Prices Index signalled an increase for the third successive month in December, with the rate of inflation rising throughout Q4 2009. Anecdotal evidence from the PMI surveys suggest that the latest increases are often being attributed to higher commodity prices, especially for energy and fuel related inputs.

Global Services PMI Costs by Nation



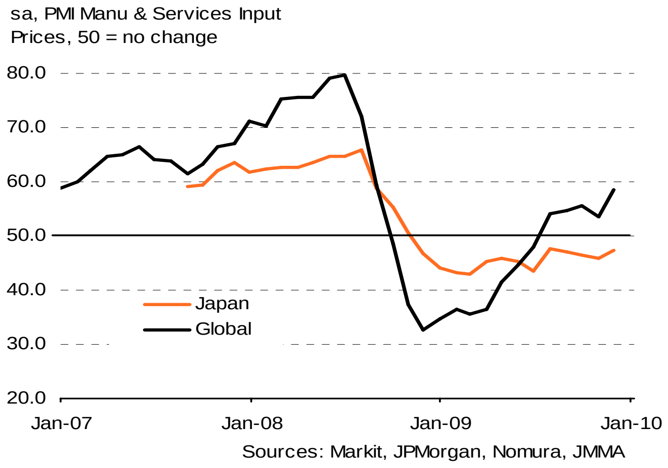
Sources: Markit, JPMorgan, ISM

Service sector cost inflation was only slightly more marked in emerging markets that the developed world in December, a slightly different scenario to the bias towards emerging countries seen for manufacturing input price increases. The fastest rates of increase in costs amongst the service economies covered by the Global PMI were Hong Kong (16-month high), Australia, Russia (ten-month high) and the US (four-month high). Cost inflation was relatively muted in the euro area.

Japan runs counter to global trend

While global indicators tended to show that inflationary pressures were rising, Japan continued to buck this trend. Costs fell in its manufacturing and service sectors alike, led by marked deflation at service providers. A further sign that deflationary pressures were still prevalent in Japan was provided by the data on average selling prices, as manufacturers and service providers both reported widespread decreases in charges.

Japan PMI Costs vs Global PMI Costs



Short-term inflation spike?

The latest global PMI data are therefore indicating that, with the possible exception of Japan, cost inflationary pressures are rising across much of the global economy, especially in the Asian emerging market manufacturing sectors. This is being driven by a combination of rising commodity prices and supply-chain factors. The rise in commodity prices in particular is likely to be viewed as only temporary, reflecting base effects resulting from lacklustre demand for raw materials at the worst of the recession. In all likelihood the inflationary effect of supply-chain factors are also likely to be only short-term as they are being exacerbated by the inventory cycle. However, demand may continue to exceed supply if suppliers and manufacturers defer the expansion of operating capacity due to uncertainties about the sustainability of the global economic rebound, meaning rising core inflationary pressures could become more firmly rooted.

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