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Global prices

Weaker consumer demand offsetting supply-chain inflation pressures

- **Surging manufacturing growth means supply delays continue to drive up producer prices**
- **But weak service sector growth helps to cool wider inflationary pressures**

PMI data show that the global economic recovery remains firmly biased towards manufacturing. Surging production of goods contrasts with subdued growth of service sector activity, the latter being restrained in many countries by persistent weak consumer demand. These divergent growth patterns are reflected in price trends: whereas strong demand for commodities is driving up producer prices, weak consumer demand is helping to prevent this feeding through to higher headline inflation rates in most cases.

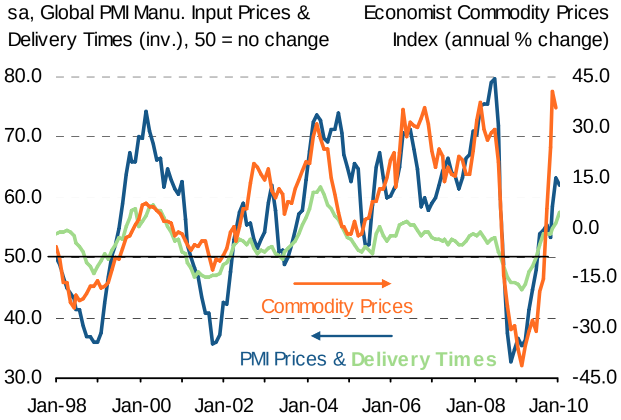
Supply pressures push up producer prices

In a previous note[1] we highlighted the role of supply-chain factors and commodity prices in driving purchasing costs higher at manufacturers as the economic recovery advances. Recent PMI data show a continuation of this trend in the early months of 2010.

In terms of supply constraints, the Global Manufacturing PMI – produced by Markit on behalf of JPMorgan – indicated a growing imbalance between supply and demand for raw materials in January and February. The Global Suppliers' Delivery Times Index is currently signalling the most widespread incidence of delivery delays for five-and-a-half years.

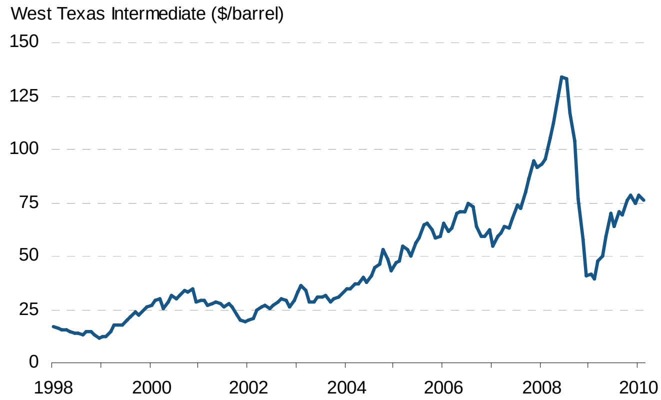
Shortages of goods mean suppliers have been increasingly able to push up the prices they charge manufacturers for inputs. This is illustrated by the Global PMI Manufacturing Input Prices Index, which remained close to January's 17-month high in February. The slight easing in inflationary pressures since January is likely to have been largely due to a dip in oil prices, rather than a fall in core-purchasing prices, which has since been reversed. (The PMI surveys ask respondents to compare the business situation at mid-month. The West Texas Intermediate oil price fell by around 7% between mid-January and mid-February, but has since more than recouped this decline.)

Supply-chains and commodity prices



Sources: Markit, JPMorgan, ISM, The Economist

Oil price (monthly average)

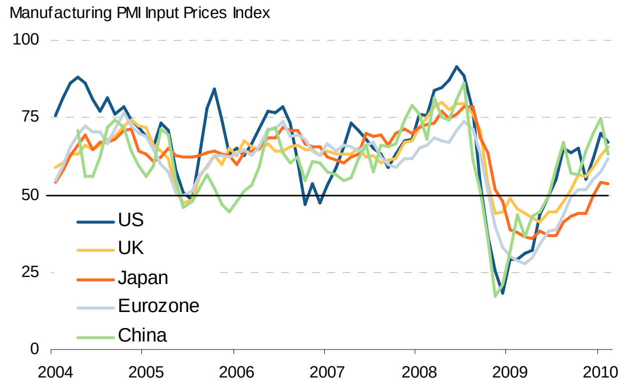


Source: Ecowin

Not all countries saw manufacturing input price inflation ease, however, with rates accelerating in both the Eurozone and the UK, where currency depreciations are likely to have driven up the price of imported inputs. Variations in input prices are also related to the strength of demand. Japan, for example, which is seeing below average manufacturing output growth compared to other major manufacturing nations, is seeing the weakest growth of input costs.

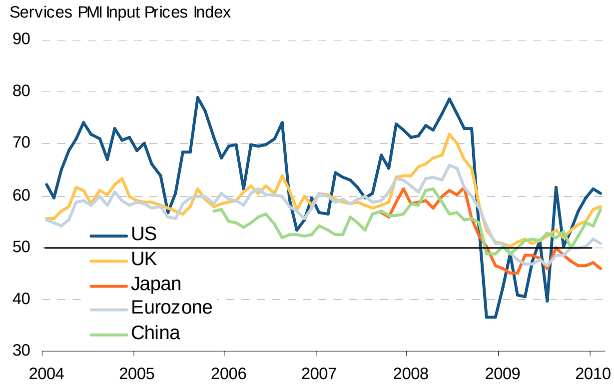
[1] http://www.markit.com/assets/en/docs/commentary/markit-economics/2010/feb/Global_MAN_PRI_10-02-11.pdf

PMI Input Price Indices



Sources: Markit, ISM

Service sector input costs



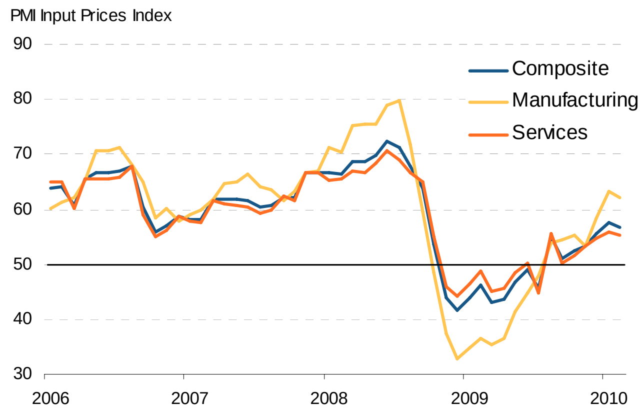
Sources: Markit, ISM

Services help cool inflationary pressures

Whereas overall strong growth of manufacturing output is fuelling price pressures in global supply chains, more lacklustre growth in the services economy is helping to cool wider inflationary pressures. A key factor holding back service sector expansion is the labour market which, while showing signs of stabilisation in many countries, continues to be characterised by high unemployment, job insecurity and weak wage bargaining power. This is holding down inflationary pressures in services via subdued staff costs and the need to offer price discounts to generate sales.

Consequently, the rate of growth of global service sector input costs is considerably weaker than input price inflation in manufacturing.

Manufacturing and services prices pressures



Sources: Markit, ISM, JPMorgan

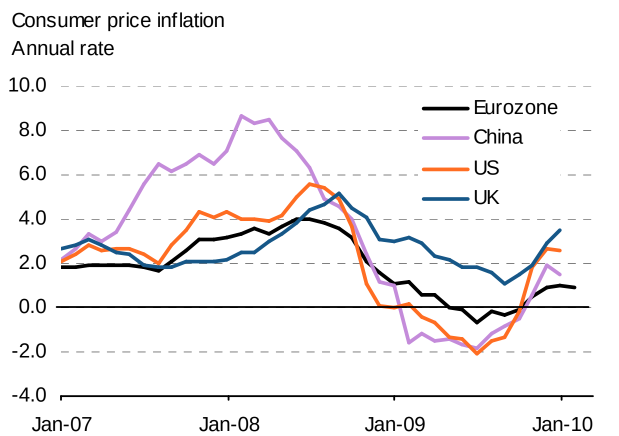
National variations in rates of service sector price growth are linked to the strength of demand for services. Price pressures are therefore strongest in the faster-growing services economies of the US and the UK, while the ongoing recession in Japanese services is generating further deflationary pressures.

Subdued core inflation likely

Rising goods prices have filtered through to headline inflation rates in many countries, and may continue to contribute to rising inflationary pressure in coming months providing the inventory cycle remains supportive of growth. But core inflation is widely expected to remain low due to the weak services, consumer and labour market situations.

Inflation in the US slowed to 2.6% in January, from a 14-month peak of 2.7%, and in China eased to 1.5% from a 13-month peak of 1.9%. The Eurozone recorded an increase of just 0.9% in February, marginally below the 1.0% posted at the start of the year. More worrying signs came from the UK, where consumer price inflation reached 3.5% in January, the fastest rate since November 2008. However, the reintroduction of higher VAT (sales tax) and higher import prices due to the weakened exchange rate contributed to this acceleration.

Consumer price inflation



Sources: Eurostat, Ecowin

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