Level 5
2 More London Riverside
London
SE1 2AP

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Markit Economics Research

04/08/2009

Global manufacturing prices

Supply chain price pressures on the rise

- **Global manufacturing Input Prices Index hits nine-month high as rate of decline in prices slows sharply again in July.**
- **Supplier delivery times and backlogs of work hint at further price pressures.**
- **China sees strongest price rises.**

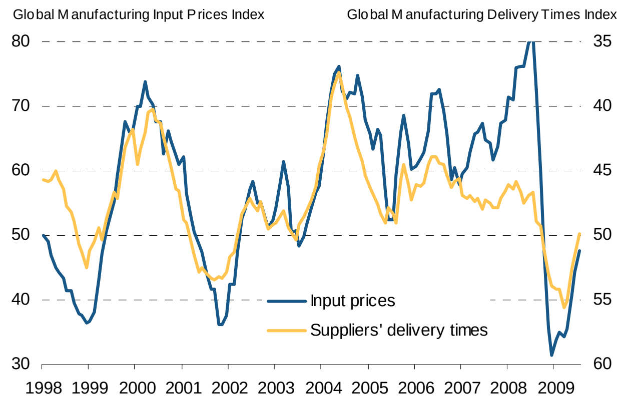
The Prices Index from the Global PMI, compiled by Markit on behalf of JPMorgan, rose for the fourth successive month in July, up sharply to hit a nine-month peak. The Index remained below the 50 level, meaning the number of purchasing managers reporting a fall in their average input prices continued to exceed the number reporting an increase. However, the rise in the Index suggests that the rate of decline of input prices has eased sharply in recent months.

This has been caused by an increase in demand for inputs from manufacturers, required to satisfy higher production needs (global manufacturing output rose for the second month running in July, showing the largest increase since the start of last year[1]). This turnaround in demand for inputs has meant suppliers have become busier, and therefore less willing to offer discounts which had previously been offered to stimulate sales.

A key gauge of how busy suppliers are is the time it takes them to deliver goods to manufacturers. Delivery delays are common at times of strong demand. Conversely, quicker deliveries are common when suppliers' warehouses are full of unsold stock which they are eager to ship out to customers.

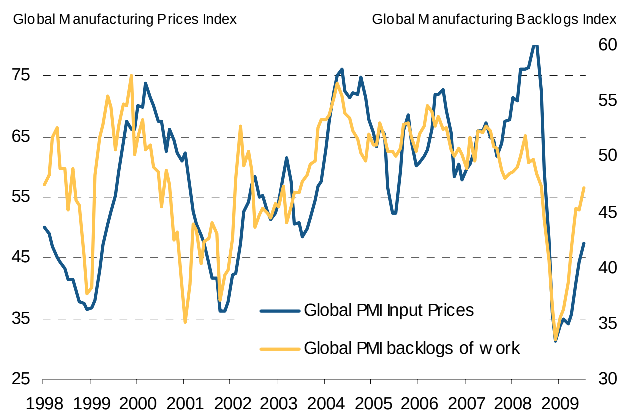
Chart 1 shows that delivery times shortened during the recent recession – as indicated by the Global PMI Suppliers' Delivery Times Index rising above 50 (note that the Index is inverted in the chart). This was because purchases of inputs had fallen at a survey record pace as manufacturers ran down inventories to cut costs. However, in July the Delivery Times Index broke through the 50 'no change' level for the first time in 10 months, signalling a marginal lengthening of lead-times. Although only slight, the move below 50 marks a shift from a buyers' to a sellers' market. Input prices invariably rise when the Delivery Times Index falls below 50.

Chart 1: Global supplier delivery times and prices



The delivery times index is of course a measure of suppliers' capacity utilisation. To get an idea of capacity usage at manufacturers themselves, we can look at the Backlogs of Work Index. As chart 2 shows, any increase in the Backlogs Index tends to be followed by rising price pressures and vice versa. The suggestion is that input prices look set to rise.

Chart 2: Manufacturing capacity and prices

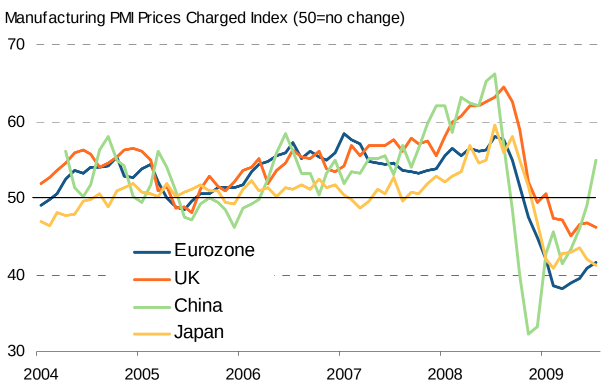


[1] http://www.markiteconomics.com/MarkitFiles/Pages/PressCenter.aspx

Selling prices still falling, but for how long?

So far we have only looked at input costs rather than manufacturers' output (selling) prices. A PMI measure of manufacturers' output prices is not available from the ISM survey in the United States, but is included in the Markit surveys, which include the Eurozone, UK, China and Japan amongst others. Chart 3 shows that, like input prices, prices charged by manufacturers fell during the recession as firms competed on price in the face of falling demand. With the exception of China, this trend continued into July, and the rate of price decline even accelerated in some cases, suggesting that the recent improvement in manufacturers' sales and output has been supported by price discounting. However, if input prices do come under increasing upward pressure in coming months, manufacturers will have to either endure a further profits' squeeze or stop discounting and raise their prices.

Chart 3: Manufacturers' selling prices



Low cost China?

China has led the global economic rebound, and has accordingly seen the strongest recovery of input price pressures (see chart 4). These higher prices have been immediately translated into higher output prices (see chart 5). Both input and output prices rose in July at the fastest rates since last August.

Thus, while it is hoped by many observers that the development of spare capacity during the recession will prevent the build up of inflationary pressures, it seems that supply chain pressures are already building in manufacturing, and particularly in China.

Higher commodity and manufacturing prices do not necessarily feed through to higher consumer price inflation, but certainly point to an increased risk of inflation rather than deflation.

Chart 4: Input price rankings

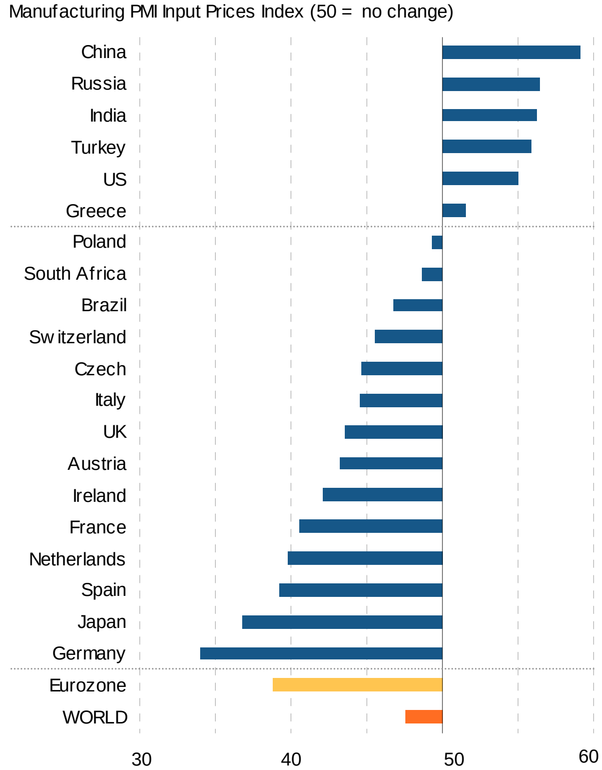
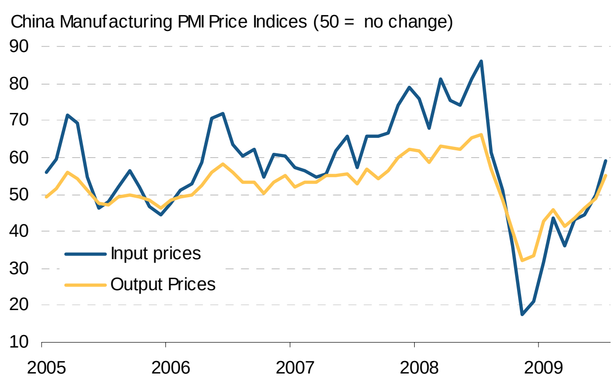


Chart 5: China PMI price indices



Level 5
2 More London Riverside
London
SE1 2AP

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Chris Williamson

Chief Economist
Markit
Tel: +44 20 7260 2329
Email: chris.williamson@markit.com

For further information, please visit www.markit.com