

Germany

PMI data indicate that plunge in German PPI will continue in early-2009

- **Official figures showed a further swift reversal of German producer price inflation in December...**
- **...as signalled in advance by PMI data.**
- **Producer price downturn likely to intensify in 2009, following plunge in raw material demand and costs.**

Official data released on 21st January showed a plunge in German producer price inflation (PPI) during December, extending the sharp turnaround seen since the July 2008 peak. Producer prices in the manufacturing sector were 0.1% lower on a year-on-year basis, a much weaker outturn than the 1.2% annual rate of inflation recorded in November.

This weakness was suggested several weeks in advance by the Markit Germany Manufacturing PMI, with the PMI Input Prices Index falling in December to its lowest level since data were first collected in April 1996. Chart 1 illustrates that this Index has a strong relationship with official Federal Statistic Office figures for German manufacturing producer prices.

Moreover, turning points in the PMI Input Prices Index tend to occur ahead of the official producer prices series, since changes in factory gate prices can lag behind movements in input costs. Indeed, based on this historical lead, the PMI Input Prices Index suggests that the turnaround in the official German producer prices series has much further to run in the months ahead, as the effects of lower oil and raw material costs work through to the factory gate.

A useful guide to the causes of changing input costs, and by extension factory gate prices, can be found by using the PMI Suppliers' Delivery Times Index. Longer deliveries signal heightened stress in the manufacturing supply chain, which is typically accompanied by upward pressure on prices (a sellers' market develops as demand outstrips supply). Conversely, if raw material

buying falls, delivery times become shorter and prices fall (a shift to a buyers' market).

The close relationship between prices and delivery times is shown in Chart 2. The chart suggests that the steep rise in input costs last year was not related to widespread supply chain pressures linked to strong demand, but instead caused primarily by high oil prices. However, the subsequent plunge in input cost inflation in the second half of 2008 followed a marked drop in German supply chain pressures earlier in the year, as well as the collapse in the oil price. With delivery times having shortened substantially in recent months, lower demand for inputs and spare capacity at suppliers will both exert a downward influence on producer prices in the months ahead.

Chart 1: PMI Input Prices vs. Manufacturing PPI

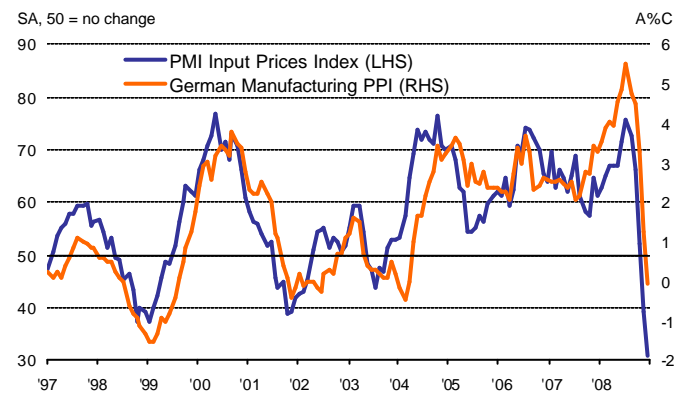
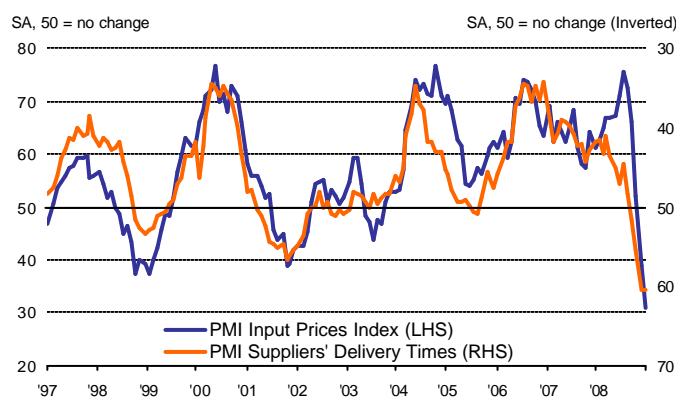


Chart 2: PMI Input Prices vs. supply chain pressures



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