

Commodities

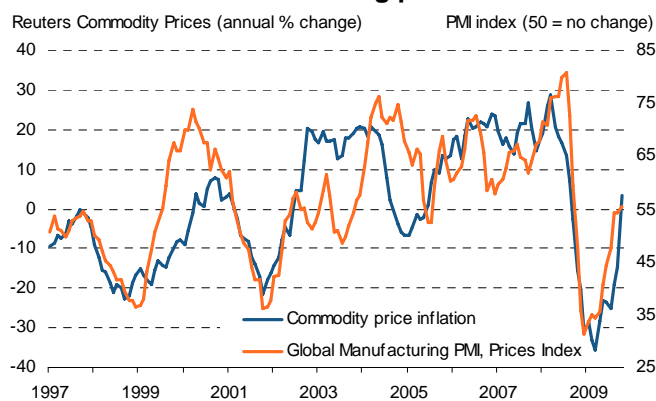
Supply chain delays boost commodity prices

- **Rising commodity prices push up manufacturers' input prices for a third month in October.**
- **Higher prices linked to supply shortages, which are more widespread than should be expected at this stage of the recovery.**

Manufacturing prices rise at increased rate in October

The Input Prices Index from the Global Manufacturing PMI, compiled by Markit on behalf of JPMorgan, continued to climb in October, signalling a rise in average input prices for the third successive month. The rate of increase accelerated to the highest since September of last year – just before prices slumped in the aftermath of the Lehman's collapse.

Chart 1: Global manufacturing prices



Sources: Reuters, Markit, ISM.

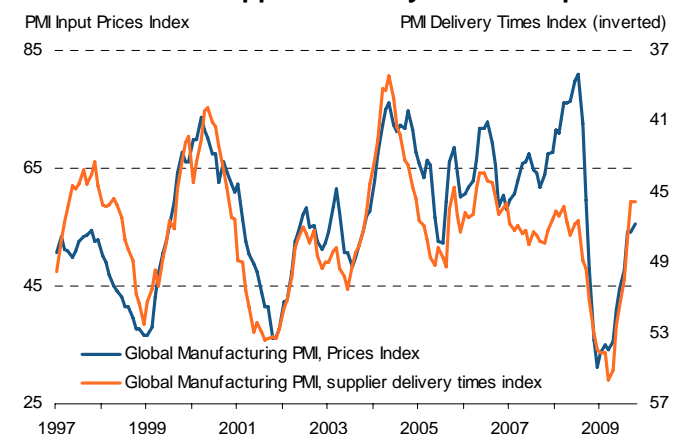
The increase in the PMI Prices Index has reflected rising commodity prices. Oil prices have risen to around US\$80 (GB£45) per barrel, up from a low of US\$34 in February, the highest since September 2008. This has driven up fuel and oil derivative product prices. From PMI survey evidence, we estimate that chemicals prices in general rose at the fastest pace for a year in October. Packaging prices are also rising as a result of higher plastics prices.

Metals prices are likewise still heading up, with zinc hitting an 18-month high in October, platinum and palladium hitting 14 and 15-month peaks respectively, while copper, nickel and many types of steel are trading near recent highs.

Supply shortages reported, despite spare capacity

In many cases, PMI survey respondents blame rising prices on supply shortages, with vendors reported as not having sufficient stock to meet the revival in demand from manufacturers for many products. This is reflected in the PMI survey Suppliers' Delivery Times Index. Globally, suppliers' delivery times have now lengthened for four straight months, with the incidence of supply chain delays rising to the highest for three years in October. As suppliers become busier, their need to offer discounts to sell stock diminishes, and the recent increase in manufacturers' input prices reflects this movement to a sellers' market.

Chart 2: Global supplier delivery times and prices

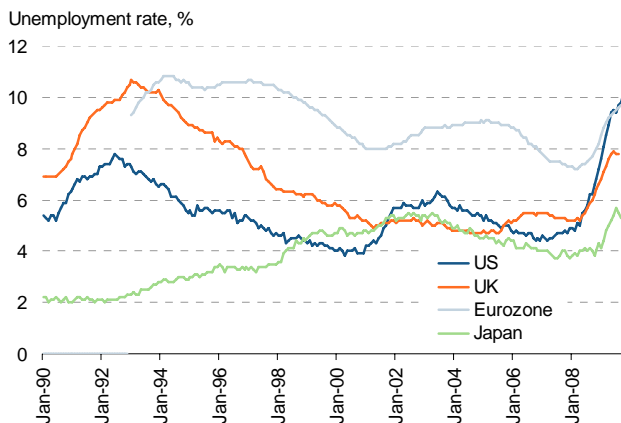


At first glance, the existence of supply shortages is surprising at this stage of the recovery process, as spare capacity should mean a buyers' market persists for most key inputs. The Bank of England, for example, only this week stressed that low levels of production and employment should help suppress inflationary pressures.

The US Federal Reserve uses similar arguments to reassure about inflationary pressures.

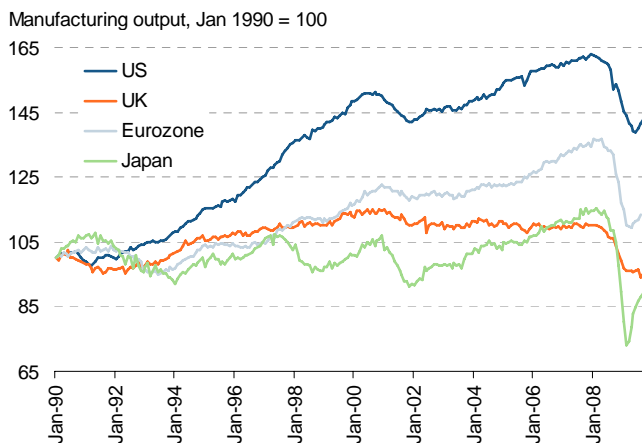
With unemployment at 7.8% in the UK, rising to a 26-year high of 10.2% in the US and closing in on 10% in the Eurozone, surplus labour certainly exists. Likewise, manufacturing output levels have slumped sharply from their pre-recession levels. In the UK, output is lower than at any time since comparable data were first published in 1992.

Chart 3: Unemployment rates



Source: Ecwin.

Chart 4: Manufacturing output levels



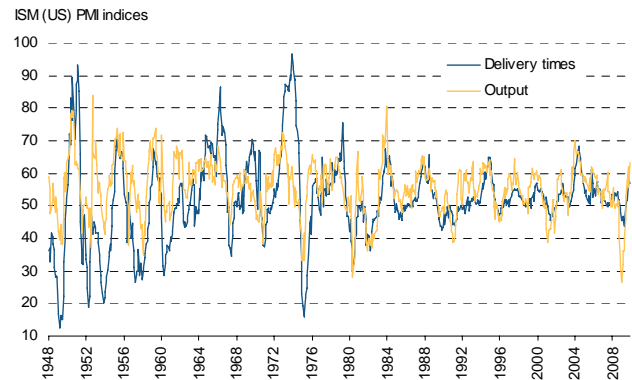
Source: Ecwin.

Past experience suggest delays are more widespread than should be expected at this stage of the recovery

However, given past experience, and the amount of surplus capacity currently in existence, the lengthening of delivery times (or in other words, supply bottlenecks) is worrying. For example, after the 1991 recession, the lag was five months. In 1983, the lag was three months. In this recovery, there has been no lag. And in previous

recoveries it took a considerably longer time for the incidence of delivery delays to reach anything like the level they are now.

Chart 5: US Delivery times and past downturns



Source: ISM.

One explanation for this could be that factories cut inventories, employment and capacity so aggressively at the onset of the recession that firms are having difficulty meeting demand. Output and new orders growth is now surging in many countries, while inventories continue to fall. Although the ratio of global manufacturing new orders to inventories has eased from an all-time high seen in August, it remains elevated by the historical standards of the survey. Further supply constraints and price rises should not be surprising.

Chart 6: Order:inventory ratio and prices



Source: Markit.

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