

Global manufacturing prices

Pipeline inflationary pressures growing

- **Suppliers' delivery times in global manufacturing sector increase at sharpest rate in three years.**
- **Supply chain bottlenecks contribute to price rises.**
- **But pass-through into consumer prices may be dampened by firms' lack of pricing power.**

PMI data suggest that supply chain bottlenecks in the global manufacturing sector are building, in turn leading to pipeline inflationary pressures.

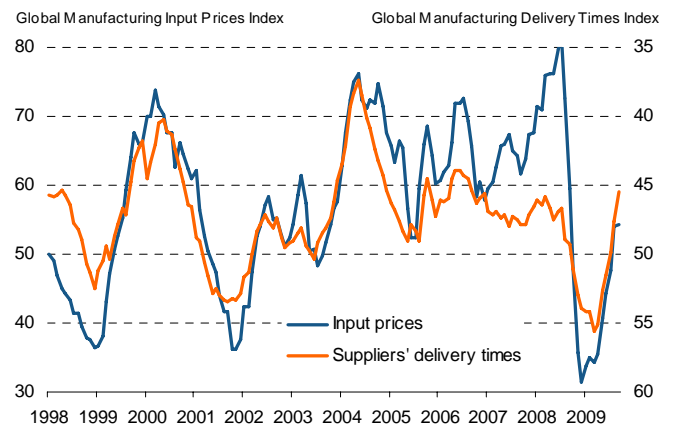
Suppliers' delivery times lengthen

First, the Suppliers' Delivery Times Index from the Global PMI, compiled by Markit on behalf of JPMorgan, indicated that average lead times lengthened at the sharpest rate for three years in September.

Anecdotal evidence from the PMIs suggests that delivery delays were often linked to shortages of stock at suppliers, following a period in which vendors depleted their inventories in response to weak demand in the midst of the global downturn. The recent recovery of global manufacturing production – which rose in Q3 at the fastest pace since Q2 2007 – has been accompanied by firmer demand for raw materials and hence greater pressure on suppliers.

Such imbalances between demand and supply usually suggest that underlying price pressures are growing, as vendors are less inclined to offer discounts and manufacturers become more willing to pay for timely deliveries. This shift from a buyers' to a sellers' market appears to have contributed to recent upward pressure on input prices; the Prices Index from the Global PMI has signalled solid increases in purchasing costs in the past two months following a ten-month period of decline.

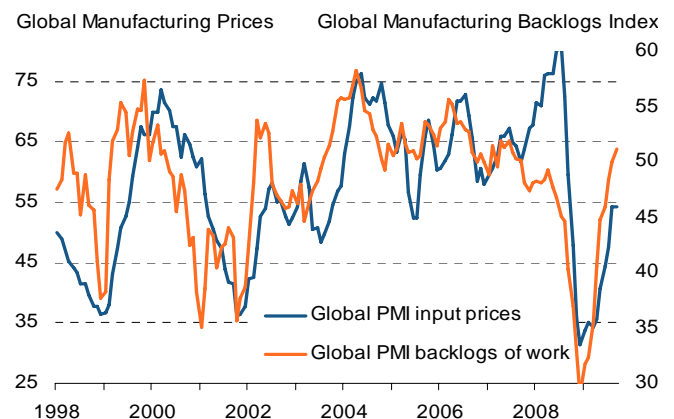
Chart 1: Global supplier delivery times and prices



Backlogs of work increase

Second, there is tentative evidence from the PMI surveys that manufacturers themselves are starting to see a rise in capacity usage. Outstanding business in the global manufacturing sector increased for the first time in two years in September, driven by strong growth of new orders. Rising backlogs typically encourage manufacturers to raise their prices or at least cease widespread discounting.

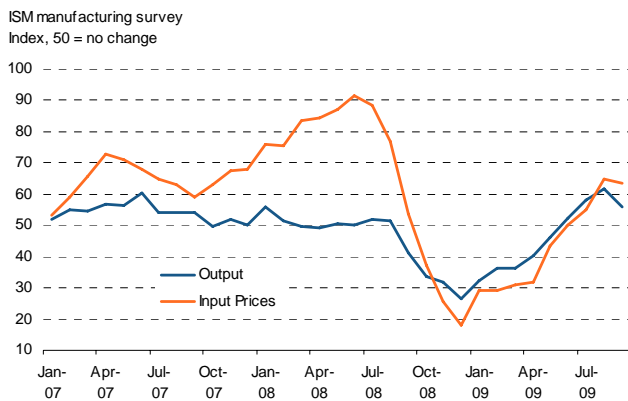
Chart 2: Manufacturing capacity and prices



Earlier than expected return of price pressures?

Analysis of the ISM manufacturing PMI survey for the United States shows that, during previous recoveries from steep downturns (such as those in the early-90s, early-80s and mid-70s), input prices have only started to rise several months after output has begun to increase. However, the current cycle has seen a synchronised upturn in prices and production.

Chart 3: US manufacturing output and input prices



It's possible that, with many firms having scrapped some of their operating capacity during the downturn, and many manufactured inputs (especially high-tech products) becoming obsolete faster than may have been the case in previous recessions, the current recovery in order books appears to have resulted in an earlier return of rising backlogs and shortages of stock at suppliers than in previous cycles, which has in turn led to this earlier than expected return of price pressures.

However, it's also possible that the price rises simply reflect bounce-backs from very low levels. A number of commodities have rebounded in price this year from post-financial crisis lows, notably oil and metals. Indeed, oil prices (in US dollar terms) have climbed approximately 65% from last December's low. Meanwhile, copper prices have more than doubled over the same period while aluminium is up 43% since February. There is now evidence that steel prices are on the rise, especially in Asian markets where demand has picked up strongly.

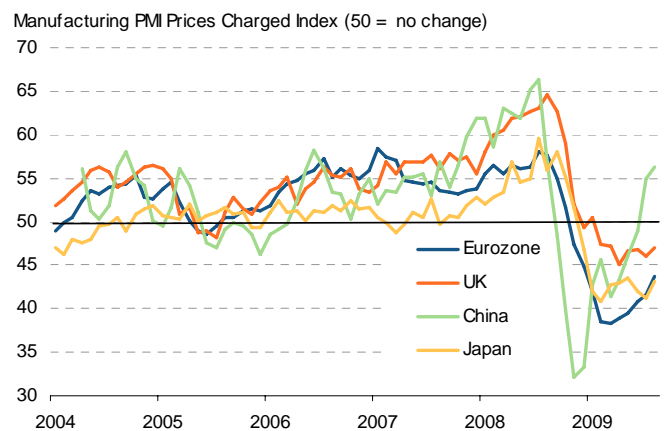
Manufacturers' pricing power key to inflation outlook

However, at the moment there is little evidence that manufacturers have been able to successfully pass on increased costs to customers in the form of higher selling prices. Instead, much of the rise in input costs

has been absorbed into margins as competitive pressures remain intense.

The notable exception to this is China, which posted a robust rise in output prices for the second month running in September. China has led the global recovery and has been the first to see a re-emergence of inflationary pressures. Although manufacturers in Europe and Japan have yet to see a similar improvement in their pricing power, a continuation of the recent strengthening of demand in those countries could change that.

Chart 4: Manufacturers' selling prices



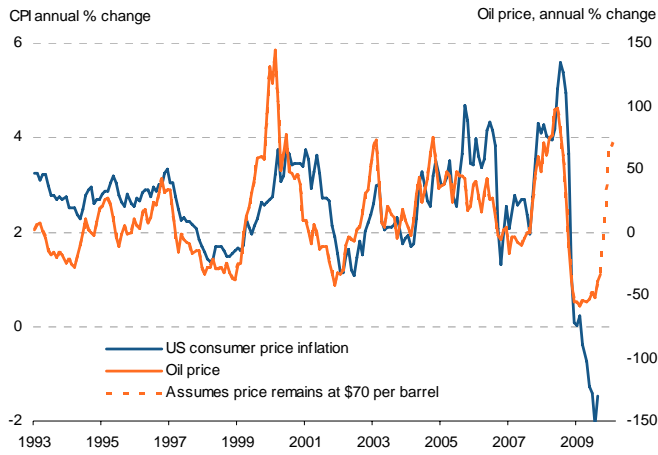
Consumer price inflation set to rise

Irrespective of whether or not manufacturers manage to pass through higher costs to customers, it is likely that consumer price inflation is set to rise in many countries simply due to the fact that inflation is measured in year-on-year terms, and many commodities will start to show strong year-on-year rises in coming months.

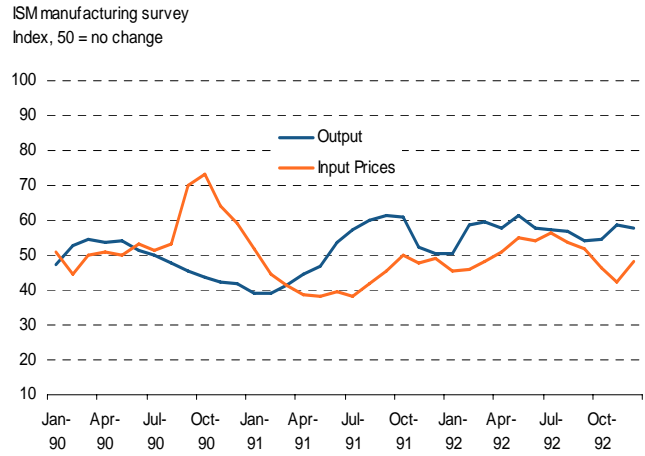
Most importantly, even if oil prices just hold steady at current levels of around \$70 per barrel, the annual rate of change in oil prices will soon start to rise sharply. By February, oil at \$70 per barrel will be 77% higher than a year ago.

Similar trends are likely to become evident for annual producer and consumer price inflation (both currently in negative territory in the US at -4.3% and -1.5% respectively) as base effects take hold.

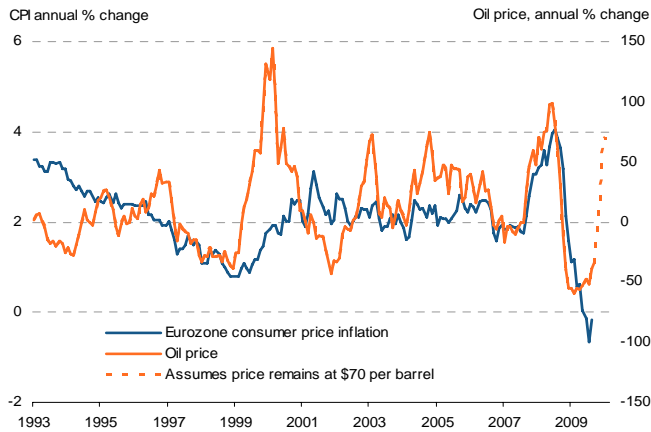
Oil prices and US consumer price inflation



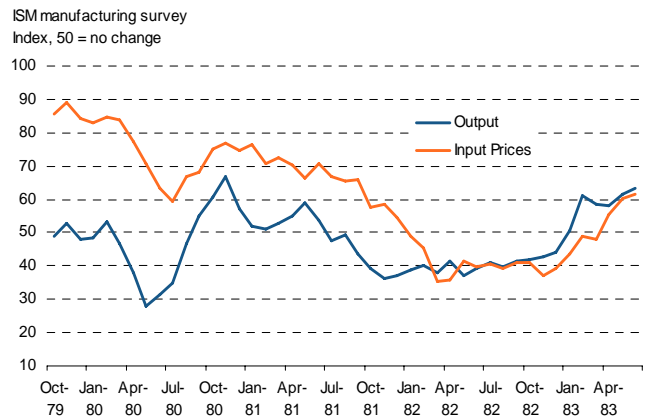
Prices trend in early-90s US downturn



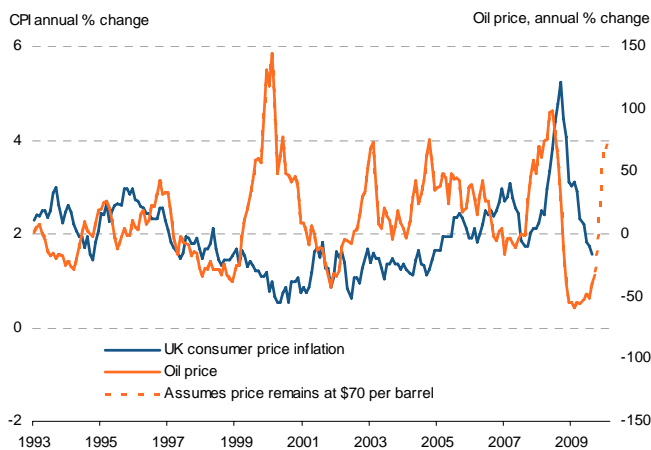
Oil prices and Eurozone consumer price inflation



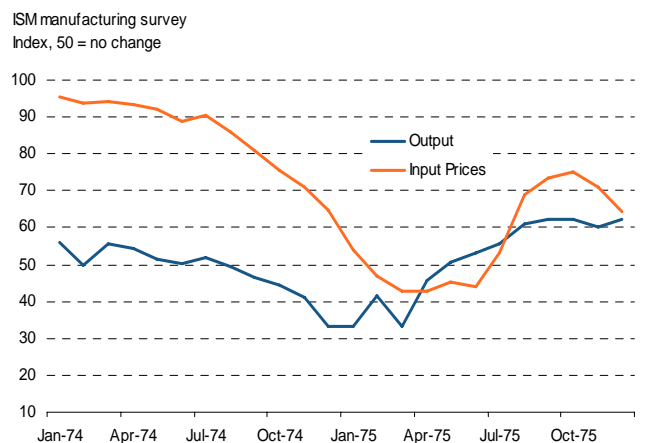
Prices trend in early-80s US downturn



Oil prices and UK consumer price inflation



Prices trend in mid-70s US downturn



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