

Global inflation

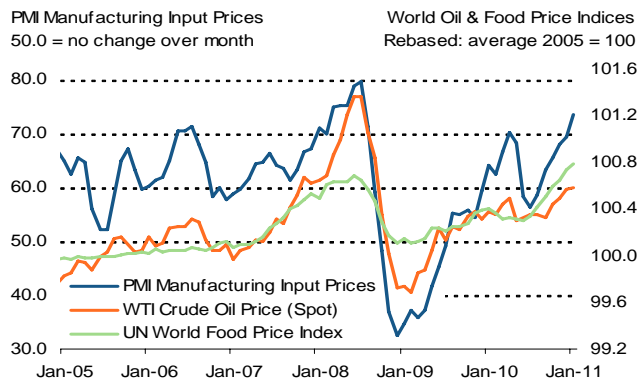
Manufacturing price pressures continue to build but longer term inflation outlook remains uncertain

- **Manufacturing input price inflation hit 30-month high in January.**
- **Cost increases broad-based by nation.**
- **Still little evidence of longer-term inflationary pressures.**

Commodity prices surge

The JPMorgan Global Manufacturing PMI – compiled by Markit – showed that input cost inflation rose to a two-and-a-half year high in January. Price rises were reported for a wide variety of raw materials, including many agricultural commodities, fuels and metals.

Commodity price surge continued in January



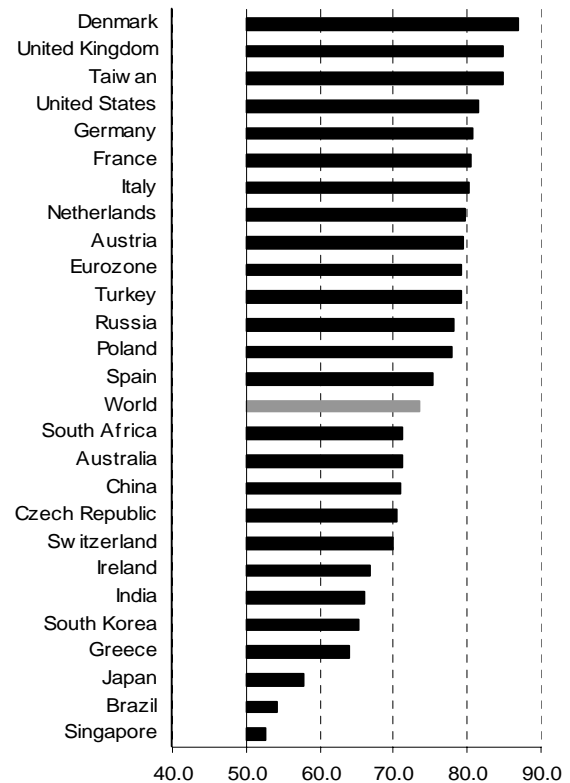
Average purchase prices rose at the steepest pace since July 2008 in the US and at survey record high rates in both the Eurozone and the UK. Within the euro area, cost indices pushed higher in all of the nations covered, hitting record peaks in Germany, Italy, Spain and Austria.

Cost inflation was also at, or near to, survey highs in many of Markit's Asia PMI surveys, notably Taiwan, India and South Korea. Even Japan saw a faster increase in input prices, the steepest since last April. China was a notable exception from what was the largely global trend of rising cost inflationary pressures,

but even here the rate of increase remained well above its long-run series average.

National PMI Manufacturing Input Price Indices

DI, sa, 50 = no change



The higher rate of inflation signalled by the PMI's price indices continue to principally reflect rising food, oil and metals prices. The United Nation's Food Price Index reached a record high in January, as the indices for edible oils, meat and sugar also rose to (or stayed at, in the case of meats) record highs. Meanwhile, average oil prices hit a post-crisis peak of just under \$90 per barrel in the US during the opening month of the year (with Brent Crude hovering around \$100), and the price of copper – a benchmark industrial metal – broke new highs in excess of \$10,000 per tonne in the opening weeks of February.

While central banks in a number of emerging nations have already moved to tighten policy, none of the major developed nations have followed suit, despite consumer price inflation running above target in both the Eurozone and the UK and forecast to rise higher in coming months.

The lack of policy action by the European Central Bank and Bank of England in particular rests on the majority belief that the current increase in inflationary pressures is almost entirely due to temporary factors, which in the UK includes an increase in VAT (sales tax), which in turn means that inflation rates will moderate again in early 2012.

Uncertainty over longer term price trends

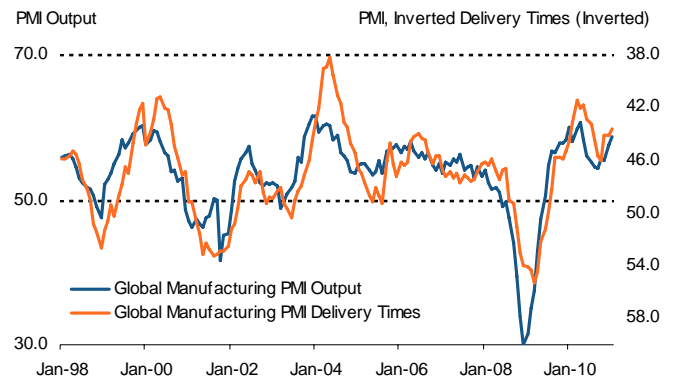
There are, however, some signs that inflation may turn out to be more than a temporary ‘hump’, to paraphrase ECB president Trichet. The recent increase in raw material prices is being driven not just by supply shocks such as flooding in Australia, but also reflects robust economic growth which is driving demand for inputs. This in turn is causing suppliers to struggle to meet demand, which therefore increases their ability to raise prices. The Global PMI shows that suppliers’ delivery times have lengthened throughout the past 19 months, with the incidence of delays running at a level rarely seen in the history of the survey (albeit below the peak seen during the growth surge earlier last year).

If output continues to grow strongly in coming months, underlying inflationary pressure will build, which will worry central bankers. PMIs already show that current rates of growth of output are at levels which would – in ‘normal’ times – have triggered rate hikes in the US, UK and Eurozone.

There are other factors, however, which continue to argue against the need for rate hikes. First, price

pressures continue to be focused on the manufactured goods and energy sectors, while prices charged for many services are showing far more modest growth due to weak demand ([see our sector PMI note](#)).

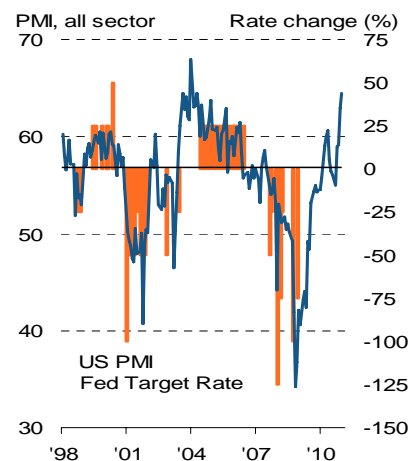
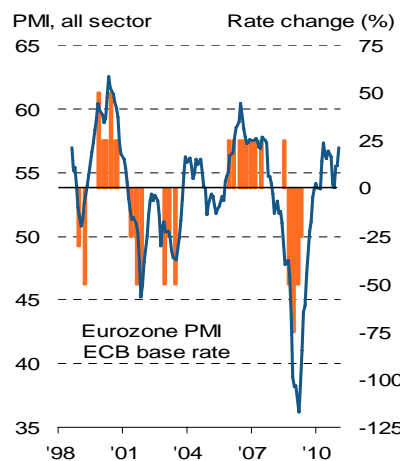
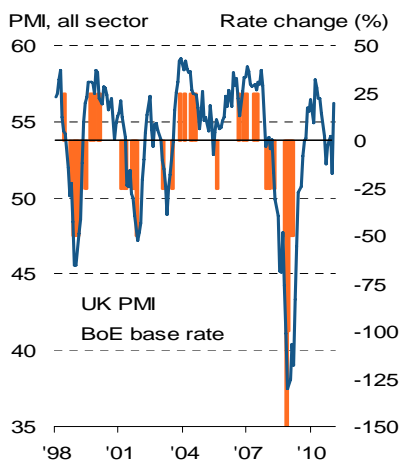
Global supply chain price pressures



Second, unemployment rates remain stubbornly high in many developed countries, which suggests that demand for many goods and services will remain subdued in coming months – especially in countries where austerity measures are biting.

Third, high unemployment is also restraining wage growth. Our survey of UK recruitment agencies in January, for example, showed that pay growth remained very subdued in January despite the number of people placed in permanent jobs rising to the highest for six months.

Ultimately, the strength of the economic recoveries will determine the extent to which the current short-term manufacturing-oriented price pressures will feed through to wider price pressures and wages. The coming months’ economic data will therefore be crucial to the next moves in US and European policy rates.



Sources (charts, page 1): *Markit, ISM, JPMorgan, United Nations, EcoWin*
(charts, page 2): *Markit, ISM, Bank of England, ECB, US Federal Reserve Bank*

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