

# Global Prices

## Soaring commodity prices fuel inflation spike in December

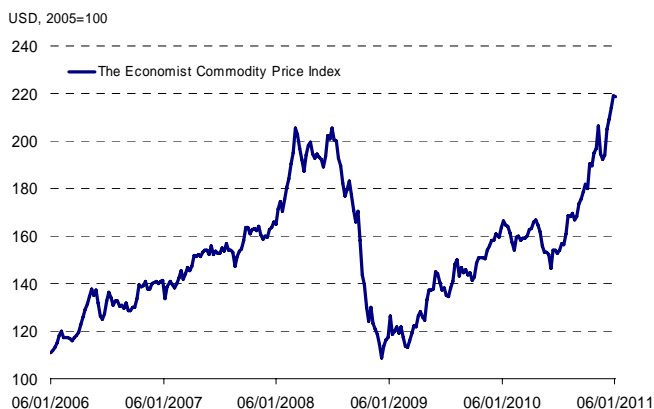
Rising commodity prices are feeding through global supply chains, most notably driving a record (19-year high) rise in UK manufacturers' input prices in December.

Central banks in several emerging markets have already responded to rising price pressures with higher interest rates. No major developed economy has yet to see higher policy rates, as the need for economic stability has outweighed concerns surrounding inflation. However, with inflation already above target in the UK and the Eurozone, latest data have increased the chances of earlier than expected rate hikes in Europe.

### Commodity price surge

Commodity prices continued to soar in December, with all-time peaks seen for many food items and metals (including copper and many precious metals), and Brent crude oil approached \$100 a barrel. Meanwhile, both *The Economist* commodity price index and the UN food prices index reached record highs.

### The Economist Commodity Price Index

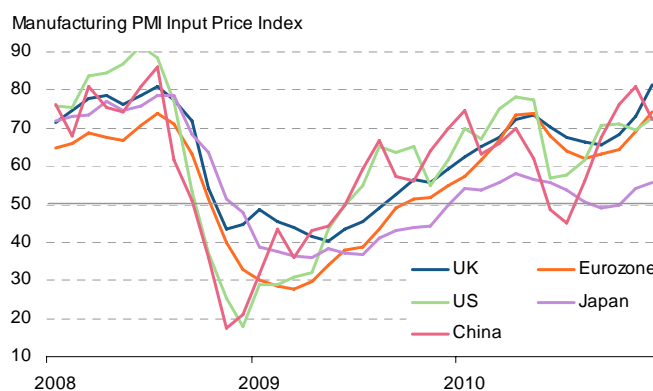


Source: *The Economist*.

Purchasing managers responding to the PMI surveys reported sharply higher input prices as a result of rising commodity prices. Ongoing supply chain delays were also reported to have allowed suppliers to raise prices, as strong demand chased limited availability for many items. Most notable was a series record (19-year) rate of increase in the UK manufacturing PMI input price measure. In addition, both the US and Eurozone saw an

acceleration in input cost inflation during December, while manufacturers in Eastern Europe saw the strongest increase in purchasing costs in the region's 12-year survey data history.

### Manufacturing PMI Input Prices Index



Sources: Markit, HSBC, ISM.

Looking at emerging markets, Brazil saw a sharp uptick in cost inflation, while substantial increases were seen in China, India (fastest in eight months) and Russia (32-month high). Across Q4 as a whole, average input prices faced by emerging market manufacturers rose at the strongest rate since Q2 2008, according to PMI data.

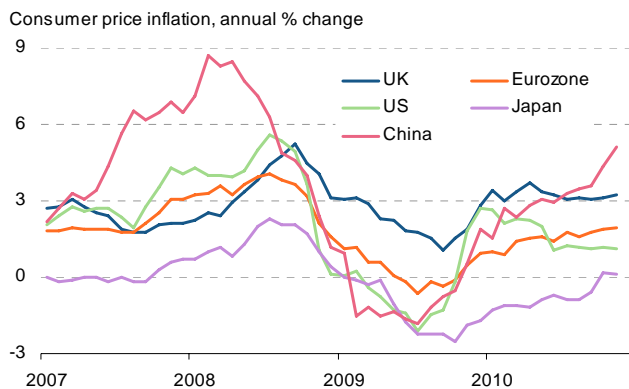
### Emerging markets set to raise rates further

Higher commodity and manufacturing prices are beginning to feed through to consumer price inflation, especially in emerging markets, where food often accounts for a larger share of the basket of goods bought compared to the developed world. China's inflation rate hit 5.1% in November, up from 4.4% in October, prompting a Christmas day rate hike by the Bank of China. In Russia, inflation is at 8.8%, while India's price index, which eased throughout much of 2010, suddenly spiked in December. Meanwhile, Brazil's main gauge of inflation is running at a six-year high. As a result, central banks in Brazil, India and Russia are all widely expected to raise rates by at least 0.25 basis points at their January policy meetings, whilst another rate hike is forecast for China in Q1.

## Which G4 central bank will hike first?

While many emerging markets began raising interest rates during the course of 2010, neither the European Central Bank nor the Bank of England acted to increase the cost of borrowing, as concerns about the sustainability of their economic recoveries outweighed those regarding inflation. However, with consumer price inflation edging higher above policy targets to 2.2% and 3.3% for the Eurozone and UK respectively, contrasting with still low rates of inflation in the US and Japan, talk has turned to which central bank will act first to ensure it retains its credibility and manages inflation expectations.

### Consumer Price Inflation

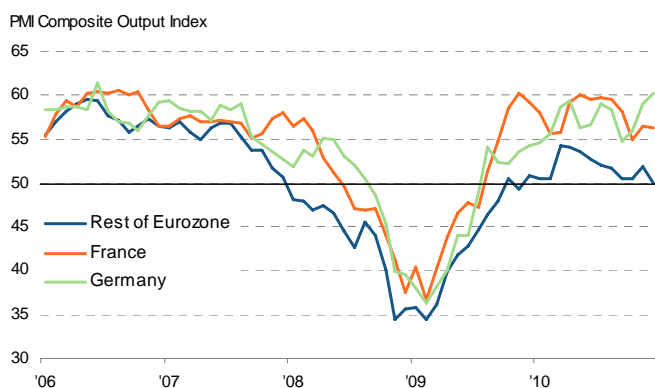


Sources: ONS, NBS, Bureau of Labour Statistics, Eurostat, BoJ.

Above-target consumer price inflation for the UK has increased the likelihood of a spring rate rise by the Bank of England, with increasing numbers of economists bringing forward their calls for a rate hike from late-2011 to as early as February in some cases.

The case is less clear cut in the Eurozone, due to widening growth divergences towards the end of last year. The periphery stagnated while Germany boomed.

### Eurozone Growth Divergence

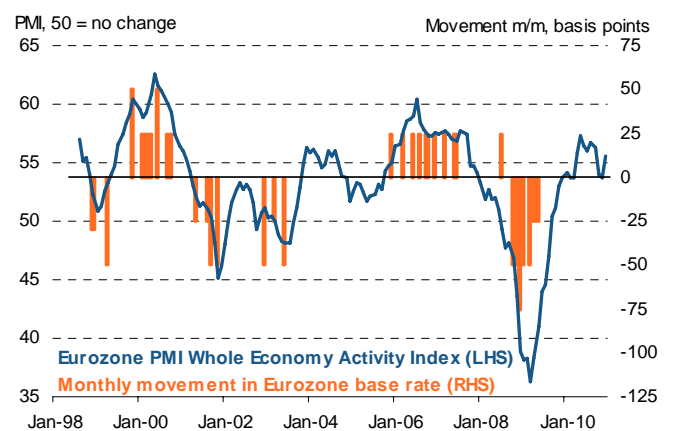


Source: Markit.

The differing policy prescriptions that the growth divergences present will provide a dilemma for the

European Central Bank in 2011. However, we should not forget that the ECB has put inflation before growth in the past, as highlighted by a rise in interest rates in July 2008. At that time, Markit's Eurozone Composite PMI Output Index had already turned down sharply and even pointed to a decline in private sector output for the first time in almost six years. Nevertheless, rocketing oil prices persuaded the ECB that a rate rise was warranted. However, when charted against the PMI, the July 2008 rate increase appears an unusual decision, which was in fact soon to be reversed.

### ECB Interest Rate Setting



Sources: Markit, ECB.

### Pay pressures to have the final say

However, perhaps irrespective of the rise in manufacturing and commodity prices, the true test of central bank nerves will most likely lie with second-round pay pressures, whereby rising costs fuel increased pay demands, threatening a wage-price spiral. At present, pay growth is muted in the G4 economies due to high unemployment, but any further strengthening of labour markets may cause alarm bells to ring louder.

To find out how to receive PMI data, please contact [economics@markit.com](mailto:economics@markit.com)

**Chris Williamson**

**Chief Economist**

Markit

Tel: +44 20 7260 2329

Email: [chris.williamson@markit.com](mailto:chris.williamson@markit.com)

**Alex Hamilton**

**Economist**

Markit

Tel: +44 1491 461 076

Email: [alex.hamilton@markit.com](mailto:alex.hamilton@markit.com)

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