

Global Input Prices

Welcome signs of receding inflationary pressures in Q4

- **Global input price inflation eased in Q4**
- **Benefit may be short lived, as service sector costs remain stubbornly high...**
- **...and oil prices continue to gain**

The global economy saw a welcome easing in cost pressures at the end of 2011. Global input prices rose at the slowest pace in two years over Q4, according to PMI™ surveys, and at a much slower rate than the near record increases seen at the start of the year.

Cost inflation may well creep up again, however. The recent easing has been largely led by manufacturing, with service sector cost increases remaining stubbornly high. However, recent oil price strength could potentially hurt manufacturers and service providers alike, causing input cost inflation to rise again. This may muddy the inflation waters for central bankers looking to maintain, or even increase, the flow of monetary support in 2012.

Global input price inflation ticked up in December, but still below Q1 2011 highs

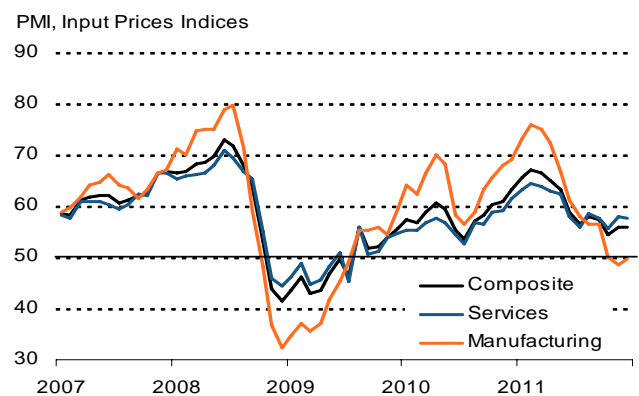
The JPMorgan Global All-Industry Input Prices Index – which is compiled by Markit – rose to a three-month high of 55.9 in December, but nonetheless remained below the peaks seen earlier in the year. The average index reading in Q4 2010 was a two-year low of 55.3, well below the 66.3 registered in Q1.

Cost trends at service providers and manufacturers were also much weaker in the fourth quarter than earlier in the year. The inflation news was especially good in manufacturing, as the lower demand for raw materials accompanying the slowdown in the sector over the course of last year meant producer input prices fell for the second month running.

PMI data indicated that producer input prices fell for the third straight month in both the US and the

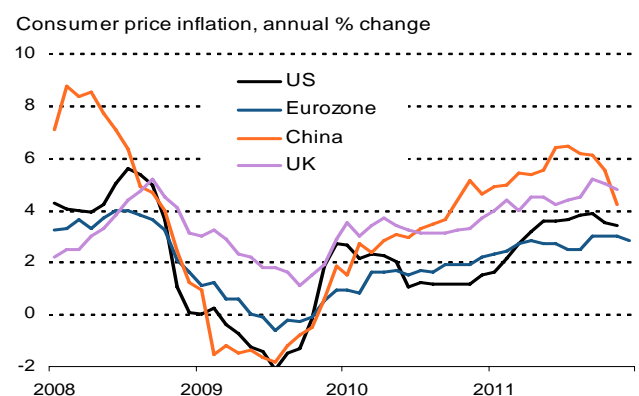
Eurozone during December, while back-to-back declines were seen in both China and the UK.

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The lower costs reported by manufacturers tally well with official data showing consumer price inflation easing in a number of countries. Part of this trend reflects the commodity price surge in late 2009 and early 2010 disappearing from the year-on-year calculation, a trend that should continue in the coming months. High unemployment rates and spare capacity, especially in developed markets, may also hold down cost increases.

Consumer Price Inflation



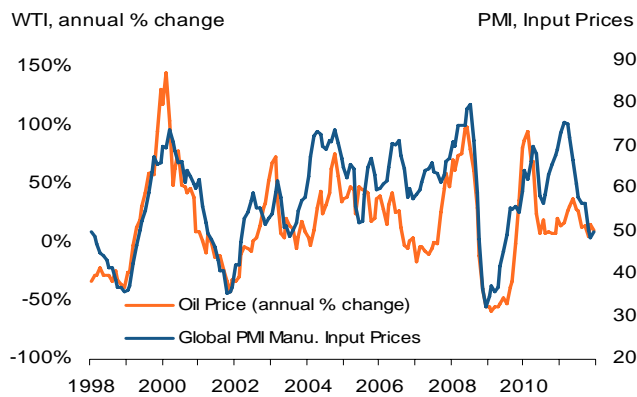
PMI data highlight pockets of high input price inflation

Recent evidence from the PMIs suggests that there are nonetheless still pockets of high inflation developing in the global economy.

Global service sector costs remained persistently high in December, particularly at US non-manufacturers and service providers in the UK, India, Russia and the Eurozone. Some companies are linking this to high fuel and utility bills and (to a lesser extent) rising staff costs. There are also pockets of high inflation at manufacturers in India, Turkey, Russia and Poland.

A further complication to the inflation outlook is that oil prices crept higher through much of the tail end of last year, from an average price of \$86 a barrel in August to a seven-month high of almost \$95 in December and over \$100 in early January. The knock-on effects to transportation, energy and chemical prices would be a broad squeeze on the finances of consumers, businesses and governments.

Global cost pressures and oil prices



Central bankers beware

The general easing in pipeline cost pressures and consumer price indices are a useful offset against the potential inflationary pressure resulting from monetary and credit stimulus. High unemployment and spare capacity, especially in developed markets, are also playing a role in subduing the inflation outlook.

However, signs that cost pressures are not receding to a greater extent in the large global services economy, alongside rising oil prices, may change this outlook towards the middle of the year. This would be an unwelcome complication to the ongoing efforts by central bankers in supporting economic growth without stimulating inflationary pressures.

All sources: Ecwin, JP Morgan, Markit, ISM.

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