

# US WEEKLY ECONOMIC UPDATE



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**Joseph G. Carson**

US Economist and Director  
Global Economic Research

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# US Economic and Investment Perspectives

## Manufacturers' Prices Are Rising Globally

The rise in manufacturers' prices has been one of the more important yet unnoticed global trends of the past few years. Based on our analysis, these prices are rising 3%, 4% or more annually on a global basis. Equally important, they are outpacing the rise in consumer prices, which have been running a bit less, and in some places a lot less. This trend is apparent in countries at various stages in the cycle: in the US and China, where growth is strong; Germany, where growth is weak; and in Japan, which still suffers from deflation.

Not since the 1970s have global manufacturing prices risen faster than consumer prices. We think this speaks volumes about the vigor of the global economy as well as the different makeup (i.e., more "old economy") in this expansion. While there is a risk that higher prices for manufactured goods will lead to a little more general inflation, we think the upside to growth is greater because higher prices will give manufacturers the economic incentive to invest more. Indeed, we expect greater investment to help sustain the global economic cycle over the next few years.

## Old-Line Manufacturers Are Growth Drivers

Increasingly, global expansion is again being driven by growth in old-line manufacturing and commodity industries. The speed and mix of today's global-growth cycle is extremely bullish for many of the emerging-market economies, which are heavily dependent on exports, and especially the commodities used by many of the old-economy manufacturers. Given this, it is not surprising to see the stock markets of emerging economies outperforming those of some industrialized economies.

The strength in manufacturers' prices also says something about global capacity conditions. Many argue that there is an abundance of manufacturing capacity in the world today, including in the US,

where manufacturing utilization capacity is 78%—far below prior cycle highs.

Typically, if capacity is inadequate or of the wrong type then not only will prices of manufactured goods rise but so will companies' order backlogs. This, in fact, has been the case in the US, where order backlogs for durable goods industries have increased a record \$42 billion since the start of the year, adding to the very strong gains of 2003 and 2004. (In fact, since early 2003, order backlogs have increased \$120 billion or 25%.) Other countries don't report order-backlog data, but some perspective is provided in the monthly reports from purchasing agents. According to these surveys, order backlogs are rising in Japan and Europe, confirming the US trend.

Rising manufacturers' prices and backlogs indicate that the global economic recovery is strong and stable, but that its composition differs from that of the 1990s. In a fundamental sense, the current make-up is better balanced because it is not as heavily skewed toward technology investment. We think this better balance could lead to a longer, more durable cycle, supported by investment in all manufacturing sectors that experience capacity shortages. This is a very bullish story for global manufacturing and investment spending, which will likely play out over several years.

## Global Price Trends

In looking at global price trends, we examined price data for 15 countries, including most large industrialized economies and several key emerging-market ones. All report a consumer price index, though there were minor differences in the composition of their manufacturing indices. Some countries, such as the US, report a producer price index, while others report a manufacturing index or a wholesale-price index. But the differences were not very substantive and we felt that these best captured the prices of products or goods produced in each country.

The accompanying display shows consumer and manufacturing price trends for six of the countries. Unfortunately, data limitations for China did not allow us to go back as far as with other countries. Yet trends in China followed similar price patterns: manufacturing prices have been rising faster than consumer prices in recent years.

Other countries showed similar trends, with one notable exception—Canada. In Canada, prices for manufactured products have been relatively weak for the past year and running well below the trend in consumer prices. This is probably tied to the 20% rise in the value of the country's currency against the US dollar in the past two years, which has likely limited manufacturers' ability to pass along cost increases.

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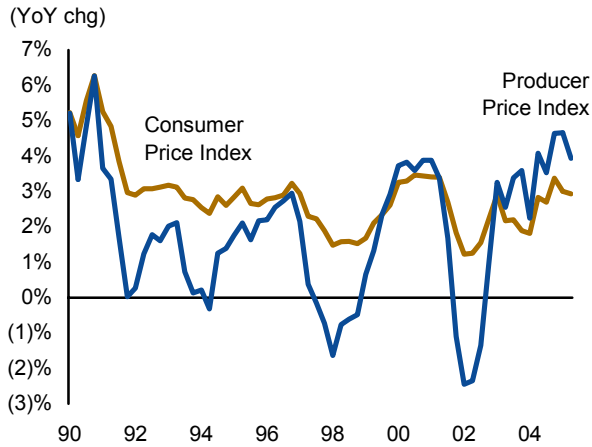
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More broadly, though, we think a very important global price pattern has emerged in manufacturing prices and that this trend will continue for a number of years. As in the 1970s, there is a risk that these price increases will lead to a little more consumer-price inflation down the road. But unlike the 1970s, central banks globally are not likely to tighten policy in a quick and large way since so many of them were worried about too little inflation, if not deflation, over the past few years. All of this point to a long cycle of relative strength in manufacturers' prices.

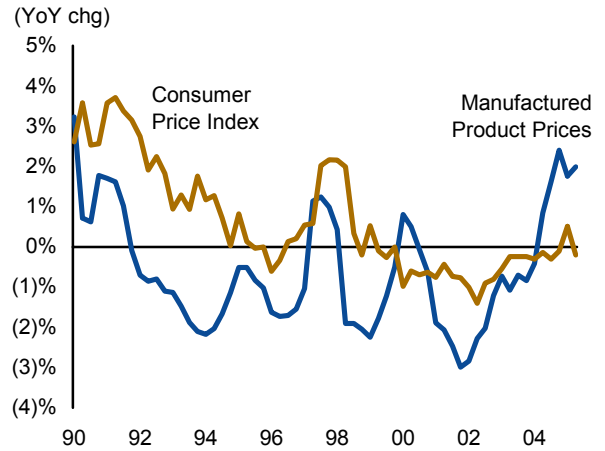
*Joseph G. Carson  
Global Economic Research  
October 7, 2005*

**Display: Manufacturer Prices Are Rising Globally**  
 Growth in Consumer and Manufacturing Prices

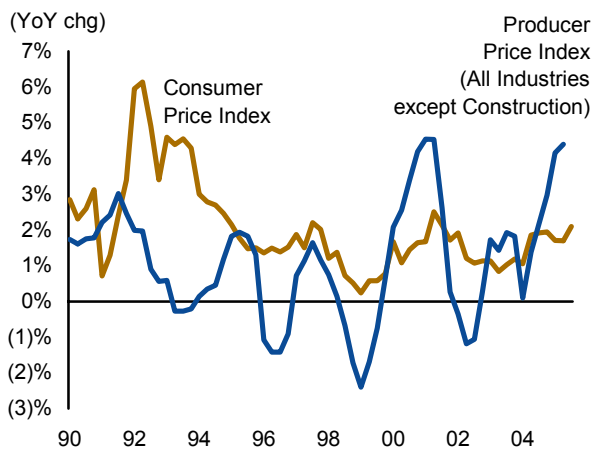
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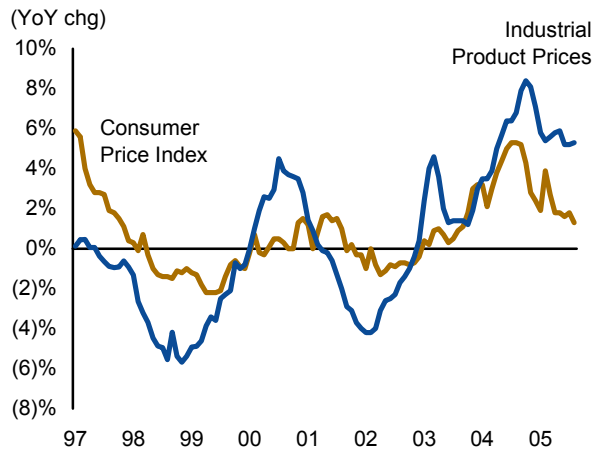
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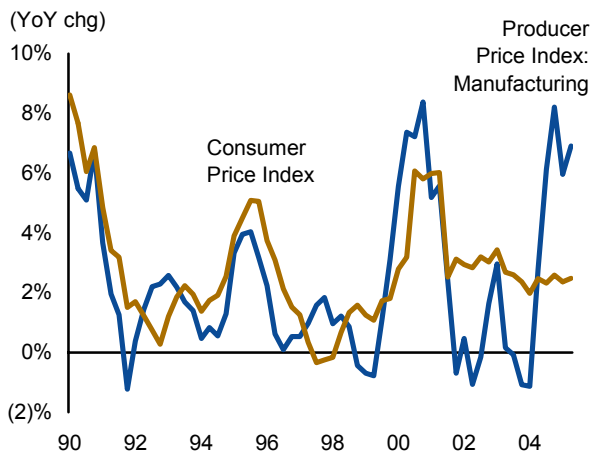
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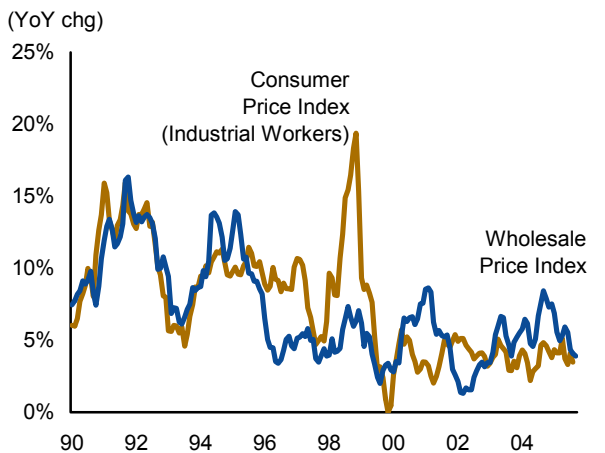
**China**



**Australia**



**India**



Source: Haver Analytics; October 7, 2005

