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Economics Group

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Producer Prices Surprise on the Upside in July

The producer price index increased by 0.2 percent in July after dropping by 0.4 percent in June. However, the core producer price increased twice as much, 0.4 percent. Both came in higher than market expectations.

The Price Pipeline Continues to Build

The pipeline on price pressure continues to build as the producer price index came in stronger in July than what the market was expecting, printing a growth rate of 0.2 percent compared to a 0.1 percent expectation. But what was more surprising was the producer price index excluding food and energy, which increased by 0.4 percent and marked the eighth consecutive increase in the core producer price index. The year-on-year producer price index increased by 7.2 percent, double the 3.6 percent rate it recorded in January 2011.

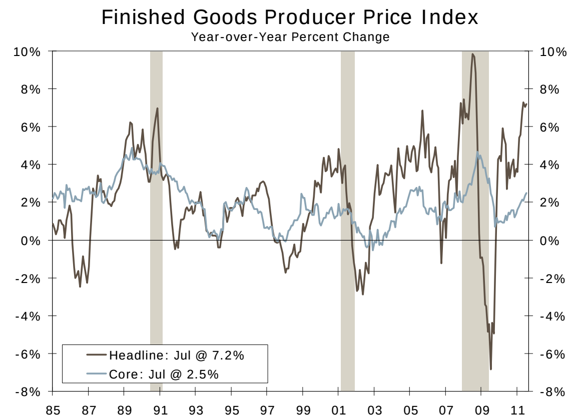
Finished food prices increased by 0.6 percent during the month, while energy prices dropped by the same amount according to the report. It is clear that the last two negative readings in energy prices have given input suppliers more degrees of freedom to increase prices of other goods and this has been reflected in the core producer prices measure. It will be interesting to see if this trend is also going to be seen in the consumer price index, which comes out tomorrow.

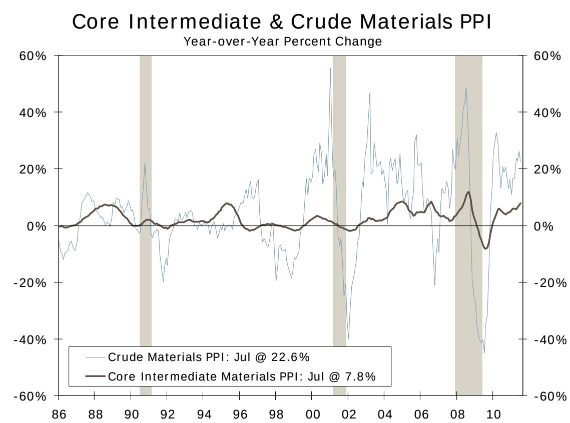
Mixed Bag of News for the Federal Reserve

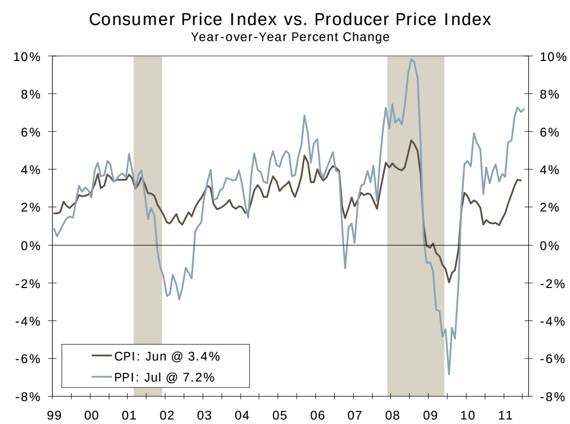
The recent increase in the producer and consumer price indexes are an indication that the Federal Reserve policies are starting to work. However, the lack of economic growth at a time when inflation is increasing is not what the Federal Reserve wanted. They wanted both economic growth and higher prices, but what they are getting is higher prices and very little growth. This combination of higher inflation and no, or very little, growth is called stagflation, a combination of inflation and stagnation.

Inflation is Still Very Low but It is Hurting

Of course, whoever looks at U.S. inflation, especially from outside of the country, would say that the U.S. does not have an inflation issue. Inflation rates of 3 percent to 4 percent are not high by world standards. Remember that inflation rates in the late 1970s, but especially in the early 1980s, were in the double digits. However, while today's inflation is not as high, households' economic situation was much better then in the sense that debt as a percentage of personal disposable income was not as high as it is today. Thus, households had more degrees of freedom than what they have today when debt as a percentage of personal disposable income is north of 100 percent. This means that even though inflation today is nowhere close to inflation rates during the 1970s and 1980s, the effects of today's rate of inflation on the average American family are probably as important as the effects it had during those decades. This is especially true in the food and energy spectrum whose prices have been growing strongly for the last several years. Thus, these numbers are not good news for those who want more quantitative easing from the Federal Reserve.







Source: U.S. Department of Labor and Wells Fargo Securities, LLC

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