

Economics Group

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Producer Prices Ease in October

Producer prices fell more than expected in October, helped by lower energy prices and annual quality adjustments to motor vehicle prices. The door remains open for easy Fed policy.

A Reprieve in Energy Prices Helps to Lower Producer Prices

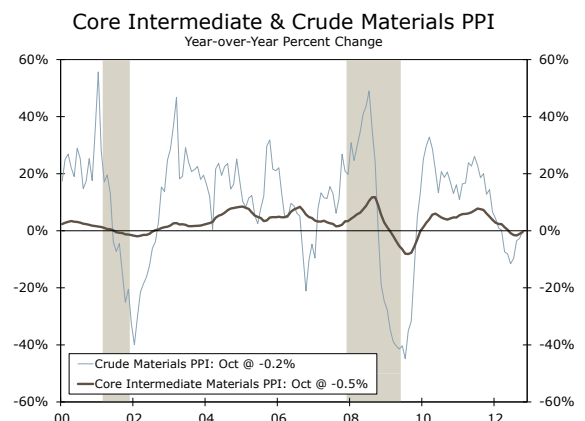
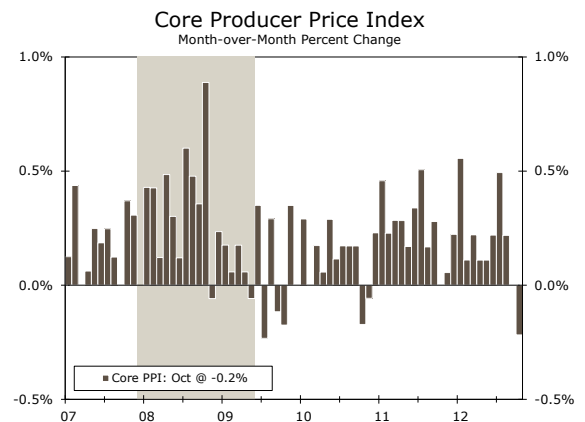
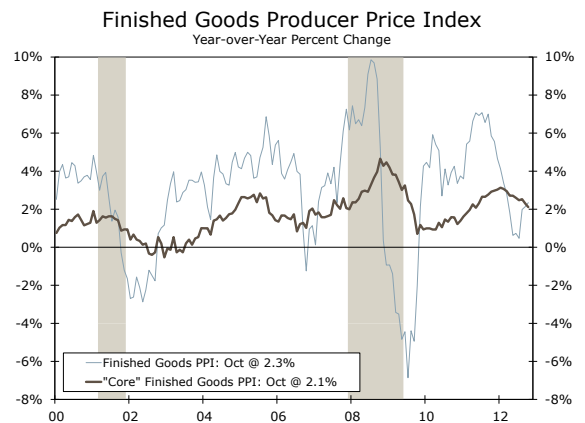
Following two months of 1 percent-plus gains, the producer price index fell 0.2 percent in October. Lower energy prices helped to pull down the topline number. The energy index fell 0.5 percent during the month as gasoline prices declined 2.2 percent, offsetting a 1.6 percent increase in residential electricity and 0.2 percent rise in residential gas prices. Finished food prices continue to climb as the effects of this summer's drought move through the pipeline. Food prices rose 0.4 percent in October, led by increased pork, chicken and dairy products as costs for animal foods and feeds build. However, finished turkey prices were nearly flat over the month and down 5.3 percent over the year, which if passed on to consumers, could make for a less expensive Thanksgiving.

Excluding food and energy components, wholesale prices fell 0.2 percent in October. This was the first monthly decline in core prices since November 2010, driven by declines in motor vehicle prices. October is the month in which annual quality adjustments for vehicles are introduced, which always presents a bit of a wildcard to the core price index. Passenger car prices fell 1.6 percent in October as quality adjustments accounted for 40 percent of the increase in manufacturers' invoice prices for 2013 models. Similarly, light truck prices fell 1.5 percent over the month as quality adjustments were equal to 45 percent of the increase in manufacturers' prices.

Pipeline Pressures Ease

Further back in the pipeline, price pressures on food continues to build. Intermediate foods and feeds rose 0.7 percent and are now 7.4 percent above year-ago levels. Animal feed prices backed off over the month, but are up over 20 percent over the past year, which helped to drive finished meat prices higher. Crude foodstuffs and feedstuffs posted another rise in October, increasing 1.9 percent, and are now up 8.6 percent from a year earlier. Excluding food and energy, core intermediate and crude price changes are down on a year-over-year basis, which suggests that overall wholesale price pressures remain modest, and swings in future producer prices will continue to be driven by the food and energy sectors.

Today's report confirms our view that wholesale prices will remain fairly benign through the remainder of the year. However, an improved outlook for the global economy in 2013, particularly in China, will likely lead to a faster pace of producer price growth over the next year. Given that the U.S. economy is still not firing on all cylinders, producers remain limited in their ability to pass higher input costs on to consumers. This, along with what seems to be a willingness to accept slightly higher inflation in order to support the labor market, will keep the Fed's expansionary monetary policy in place over the course of 2013 in our opinion.



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