



Economics Group

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Wholesale Inflation Ends 2012 on a Soft Note

Retreating food and energy costs kept wholesale inflation tame in December. Headline PPI fell 0.2 percent while core PPI rose 0.1 percent. Conditions are unlikely to prove problematic for the 2013 inflation outlook.

The Rising Trend in Food Costs Comes to a Halt in December

Falling for the third straight month, prices of finished wholesale goods edged down 0.2 percent in December. The primary driver throughout the fourth quarter has been the substantial decline registered in energy prices. Over the past three months, energy prices have contracted at a 19.6 percent annual rate as global growth slowed in the second half of the year and prospects for 2013 remain restrained.

That said, December's headline PPI decline was largely attributable to a 0.9 percent contraction in finished consumer food prices, ending a six month rising streak. Lower prices for beef and veal, which had risen in previous months because of higher feed costs, accounted for over one-third of the decline. Looking further down the production pipeline, the decrease was not held to just the finished stage as food prices declined 0.9 percent and 1.1 percent in the intermediate and crude stages, respectively. Year over year, finished consumer food prices are up 2.3 percent and have had limited pass through to the consumer, with the CPI food component up at a manageable 1.8 percent year over year. While December's decline is encouraging, we suspect the rising trend will resume this year and eventually take a large bite out of consumers' discretionary spending.

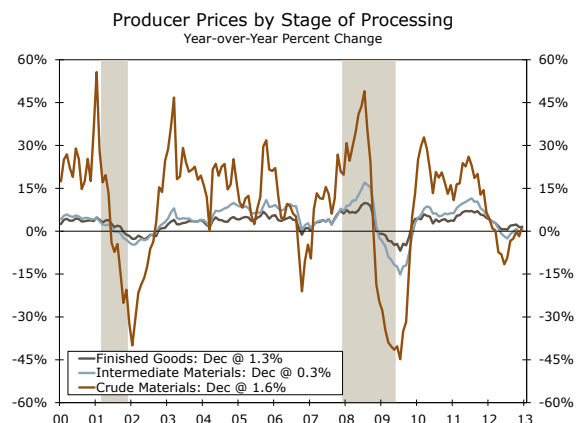
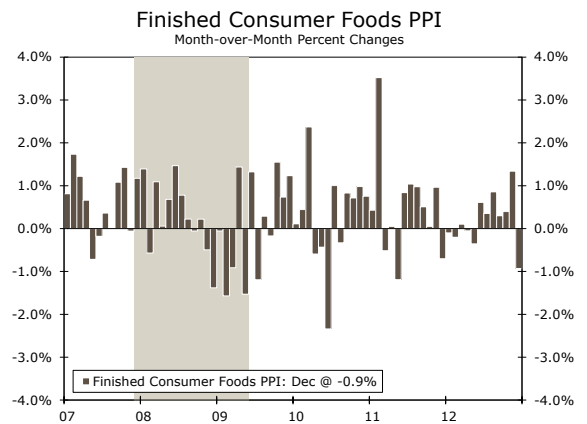
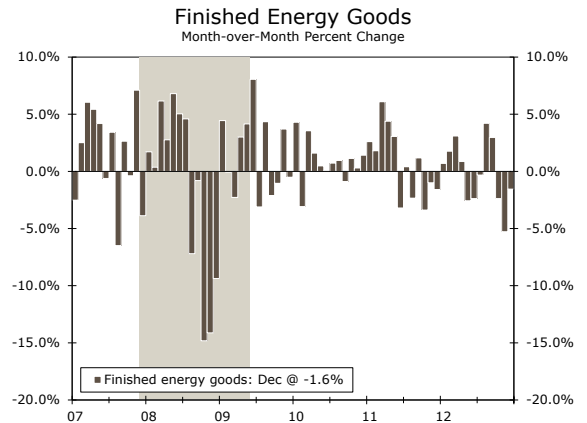
Pipeline Pressures Firm

Further back in the production pipeline, prices firmed up. Intermediate energy prices increased 0.9 percent last month, accounting for roughly two-thirds of the 0.3 percent gain in the intermediate goods PPI. The gain in energy prices was even more pronounced at the crude stage, where prices jumped 7.2 percent. Crude goods PPI jumped 2.5 percent on the month.

Wholesale Inflation May Accelerate in the Second Half

Today's report confirms our view that wholesale inflation should remain fairly benign in the first quarter. Concerns over U.S. fiscal issues will likely dampen growth in the near-term, furthering an environment of soft wholesale inflation. Our concerns, however, lie towards the second half of the year once we are able to get past the March fiscal deadlines and to an anticipated environment of stronger growth not only in the U.S. but also around the world. Indeed, China appears to be back on track to stronger year-over-year growth rates in 2013 (fourth quarter 2012 GDP will be reported Thursday) and while we do not expect the Eurozone to bounce back significantly, even stabilization in the region will prove positive to the global outlook and therefore would likely lead to higher commodity prices.

For the full year, headline PPI increased 1.3 percent in 2012 while core PPI rose 2.0 percent. Our current outlook expects headline PPI to advance 2.3 percent in 2013. While presently contained, the Fed will continue to watch inflation expectations with a close eye as we move through the year.



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