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# Economics Group

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# PPI Strengthens, but Underlying Price Pressures Still Tame

***After declining over the past two months, producer prices rose 0.4 percent in December. Higher energy prices pushed gauges of core and intermediate prices higher, but inflation remains rather tame.***

## Producer Prices Pick Up on Higher Energy Costs

As expected, the Producer Price Index rose 0.4 percent in December. The increase snaps a two month slide and pushes the year-over-year pace of price growth from 0.7 percent to 1.2 percent. Across-the-board increases in energy prices, including a 2.2 percent rise in gasoline and 6.4 percent jump in home heating, pushed the finished goods index higher. In contrast, food prices fell 0.6 percent as fresh and dry vegetables plummeted 13.4 percent.

Outside of food and energy, producer prices rose 0.3 percent, the most since July 2012. While this could be seen as a sign of firming in underlying price pressures, nearly half of the increase came from a 3.6 percent hike in tobacco prices as companies test higher prices around the turn of the year. A few other consumer products, however, also showed a pickup. Prescription prices increased 0.5 percent and are now up 5.1 percent over the past year. Alcohol prices rose 0.6 percent while passenger car prices ticked up 0.2 percent in December. Prices for capital equipment rose a trend-like 0.1 percent on the heels of a 0.5 percent rise in light trucks. Compared to a year earlier, core finished goods are up 1.4 percent.

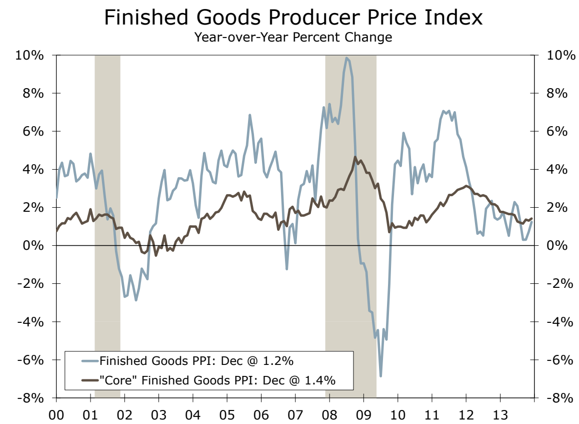
In earlier stages of production, prices firmed a bit. Crude prices rose 2.4 percent over the month, led by a 6.2 percent rise in energy goods. Core crude prices rose 0.6 percent on higher iron and steel scrap prices, which is consistent with the turnaround seen in manufacturing activity. Intermediate prices rose 0.6 percent on higher energy, food and core prices at this stage.

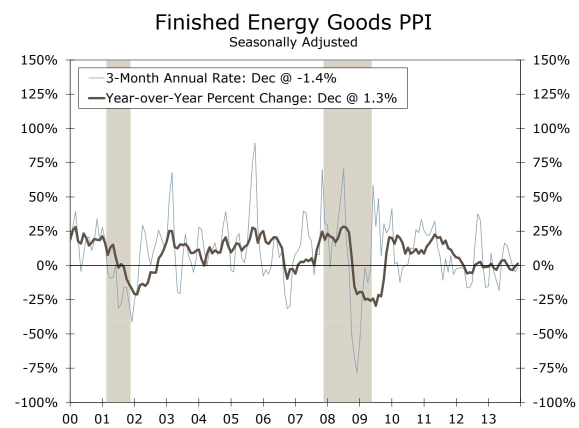
## Firming Economy Should Lift Prices in 2014

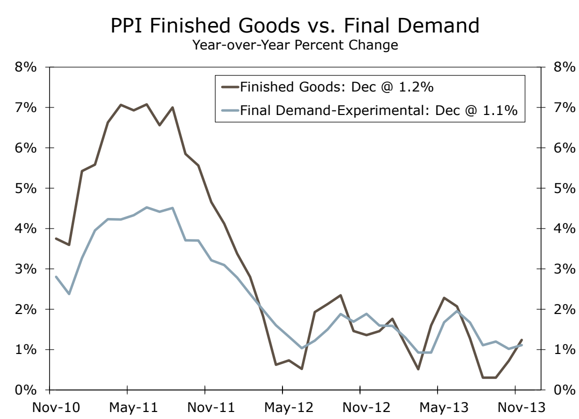
We look for producer prices of finished goods to gradually trend higher through this year, but for price growth to remain fairly weak. At 1.2 percent, the increase in finished goods prices over the past year was the weakest turnout since 2009, but the downward pressure on energy goods seen over the better part of 2013 is likely to fade. Moreover, the improving outlook for the U.S. economy should increase demand for inputs and be supportive to producers raising prices as consumer and business spending improves.

## PPI to Capture Broader Range of Products Next Month

Next month, the PPI report will switch from the current Stage of Processing system to the Final Demand-Intermediate Demand system. The new system will include service and construction products in the headline index, in addition to the finished goods currently reported as the topline number. The final demand index will capture more than twice as many products and provide a more encompassing picture of inflation in the economy through the perspective of the producer. More information is available from the BLS at www.bls.gov/ppi.




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

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