

Box 5

PRICES OF INDUSTRIAL RAW MATERIALS AND PRODUCER PRICE PRESSURES IN THE EURO AREA

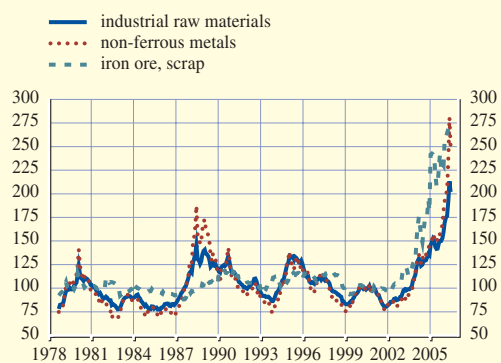
Over the past year, the prices of industrial raw materials have surged to all-time highs on global markets. As these raw materials are important inputs into the production process¹, this box considers the implications of the increase in the prices of industrial raw materials for pressures on producer prices, and ultimately, as they pass through the production chain, on consumer goods prices in the euro area.

Although the prices of industrial raw materials have surged significantly on the world market since the middle of 2005, they have in fact been increasing steadily since 2002 and now stand at an all-time high (in nominal terms) compared with levels observed over the last 30 years (see Chart A). In US dollar terms, the HWWA industrial raw materials price index rose by over 40% in the year to June 2006, mainly driven by a strong increase in metal prices. Increases in other components, such as spinning material or wood, have been much more modest. Although some metal prices declined in the last month, prices still remain at high levels.

The increase in metal prices can be mainly attributed to strong demand from Asian emerging economies, in particular China. At the same time, limited production growth and high energy prices have also contributed to a rise in prices for many non-energy commodities

Chart A World market prices of industrial raw materials (in US dollar terms)

(index: 2000 = 100)

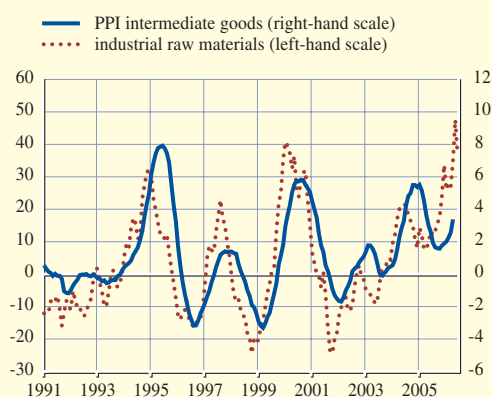


Source: HWWA.

¹ This box focuses on industrial raw materials, which are commodities that are used in industrial production processes. They include some agricultural raw materials, for example spinning material and wood, as well as metals, both non-ferrous metals and iron ore and steel scrap.

Chart B Industrial raw materials (in euro terms) and intermediate goods producer prices

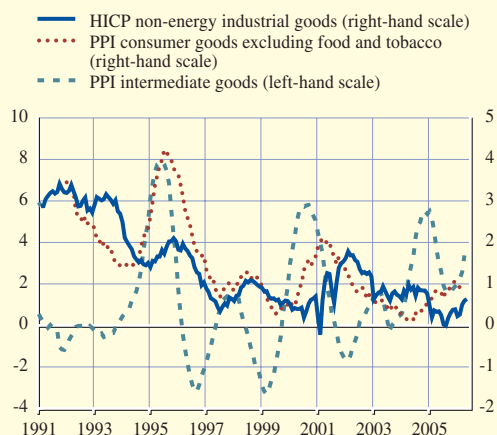
(annual percentage changes)



Sources: HWWA and Eurostat.

Chart C Intermediate and consumer goods prices

(annual percentage changes)



Source: Eurostat.

– such as energy-intensive aluminium and steel. Given significant adjustment costs, the response of producers to increasing demand has not been immediate, thus giving rise to some bottlenecks in the supply chain and low inventory levels. In addition, anecdotal evidence suggests that growing interest on the part of financial investors in diversifying into overall commodities markets may have added to the pressures on prices in some commodity markets.

The increase in the prices of industrial raw materials has already started to show up in prices at the earlier stages of the production chain in the euro area. Chart B illustrates the historical co-movement between the prices of industrial raw materials and industrial producer prices for intermediate goods. Since late 2005 the annual rate of change in the latter has started to increase again. This recent acceleration is consistent with the historical co-movement observed with the prices of industrial raw materials, as well as with survey evidence (from the Eurozone Manufacturing Purchasing Managers' Index) in which respondents cite the need to pass through higher prices for energy and various other commodities (especially metals) as a factor behind the increases in output prices.

These price increases at the earlier stages of the production chain will add to the pressure on prices towards the latter stages, in particular, consumer goods prices. Chart C illustrates developments in industrial producer prices for intermediate goods and for consumer goods excluding food and tobacco, alongside the evolution of HICP non-energy industrial goods prices. The annual rate of change in industrial producer prices for consumer goods (excluding food and tobacco) has increased since 2004. This increase reflects higher industrial raw materials prices as well as higher oil prices. On the other hand, other factors, such as subdued GDP growth, strong competition and exchange rate and labour cost developments, may have served to attenuate the pass-through from higher commodity prices, particularly in comparison with the period 2000-2001. Nonetheless, some further impact on consumer goods prices can be expected in the future as indirect effects from past commodity price increases are passed through the production chain, especially in the context of strengthening economic activity.