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Shortages set to affect goods prices globally, but maybe not for long

As shortages and supply chain disruptions are priced through to consumers, goods inflation is set to trend higher. We still believe the impact will be temporary, but in the US less so than in the eurozone

Global shortages are particularly hitting the auto industry

A perfect storm

Problems in production and supply chains and the surprisingly quick recovery of demand for goods after the first lockdown have caused shortages for all sorts of inputs around the world. With demand returning quickly and supply having been scaled down in the aftermath of the first wave of Covid-19, isolated events have created a perfect storm in the markets for lumber, plastics and semiconductors.

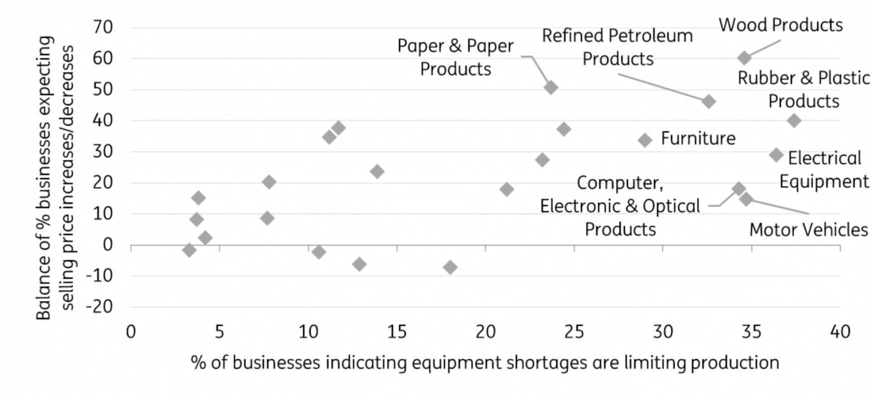
With input costs rising sharply, the rise in consumer price inflation has only just begun, as businesses grappling with shortages have indicated they will pass higher costs onto the consumer. However, past episodes show us that there is no lasting effect once shortages end, suggesting the surge in prices will be temporary.

Shortages in many eurozone sectors

When you look at industry as a whole in the eurozone, reported input shortages are now at their highest level since the start of the indicator in 1985, with 22.8% of businesses reporting equipment shortages as a key factor limiting production. The impact of shortages on production is varied, with the main problems accumulating in the auto sector so far due to semiconductor shortages. This has brought production down -14.3% from its November peak.

Furniture production is also down 6% from its recent highs, while smaller declines are reported among computer and electronics producers. Input price pressures are starting to build, although there are big differences in the importance of imported inputs in overall costs across sectors, and stages of production. Strikingly, even where input price rises have remained modest, businesses are reporting raised expectations of increasing their selling prices – especially in sectors experiencing shortages.

Eurozone industries with equipment shortages expect to increase selling prices



Source: European Commission, ING

DG ECFIN Industrial Confidence Indicator

Expect surging goods prices from here on, but we do expect it to remain mostly temporary

Shortages have driven increases in selling price expectations in the past, especially when scarcity is widespread and synchronised across many sectors, as was the case in 2011 following natural disasters in Japan and Thailand. In the past, once shortages had fallen back to normal levels, selling price expectations were also quick to normalise, mainly within the same quarter. But given the historic highs that reported shortages have reached, it's possible that a longer period of elevated selling price expectations is in store.

Consumer prices are going to increase further from here

Consumer prices have only risen modestly so far, but with supply chain issues, shortages of inputs and strong demand likely to continue through the rest of this year, they are going to increase further from here, and add to inflation that is already above the European Central Bank's target. This means that when energy base effects start to fade, the ECB will still not be off the hook, and we expect inflation to remain above 2% for a large part of 2021, making a discussion around tapering unavoidable in the coming months.

As the global recovery becomes more established, we do expect most disruptions, and the shortages, to ease, (with semiconductors being the major exception, where tight markets are likely to remain). This means that barring any second-round effects, in the eurozone the spell of above-target inflation is likely to end sometime early next year.

In the US, shortages are broader-based, including the labour market

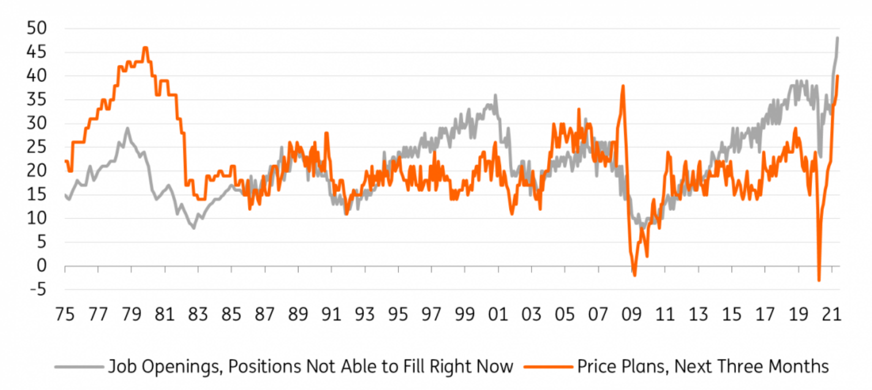
In the US case, the problem of supply shortages is broadly spread across the manufacturing sector. The ISM reported 17 out of 18 industries were facing slower supplier delivery times with the index showing the worst conditions since 1974. Semiconductor shortages are well documented with several auto plants having already slowed output as a result, but this is not the only issue. Covid containment measures have forced changes to manufacturing operations and this has led to bottlenecks across a range of production facilities.

Demand for workers continues to rise

The shortage of workers is another huge issue for the sector. Demand for workers continues to rise as the economic recovery gathers momentum, yet employment growth has slowed noticeably as companies struggle to find applicants. There have been anecdotal reports of some firms offering payments just to turn up to a job interview.

It has got to the point where for the small business sector a record 48% of companies have vacancies they can't fill. The consequence is that if you want to hire workers you are having to pay more to recruit and retain, as highlighted by the latest Federal Reserve Beige Book survey.

Small businesses in the US are reporting hiring difficulties and planning higher prices



Source: Macrobond, ING

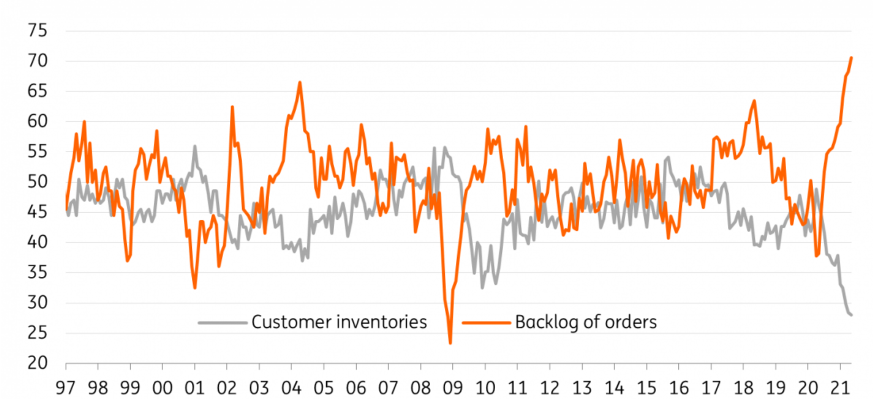
NFIB Small Business Survey Indices, seasonally adjusted

Now factor in the oil price

Commodity prices, components and employment costs are all on the rise and this is being compounded by gasoline prices hitting 7-year highs, adding to other cost pressures in freight shipping. The good news for manufacturers is that economic conditions mean that they can pass much of these higher costs onto their customers.

We are at a point currently where new orders are growing rapidly, but output cannot keep pace with demand. Consequently, the backlog of orders has hit a new all-time high according to the ISM. At the same time, manufacturers know that their customer inventory levels are at historical lows. The scramble for stock means manufacturers have significant pricing power and their customers can't do little about it.

US businesses are seeing order backlogs rising and customer inventories are running low



Source: Macrobond, ING

ISM Purchasing Managers Indices

US inflation risks being higher for longer

Of course, these strains should ease in time, but there is significant uncertainty as to when that will be. We expect labour supply to become more abundant from September once schools fully return to in-person tuition and the additional Federal unemployment benefit expires for all current recipients.

Nonetheless, there are still likely to be issues given the strength of economic demand. With the global growth story roaring back, the competition for commodities and components may not be so swiftly resolved. This is yet another reason to conclude the risks are skewed to US inflation staying higher for longer.

Author

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

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