

## Stagflation cross-winds

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Cutting growth forecasts (due to looming recession) in one breath while raising inflation forecasts in the next: It's this painful mix of announcements by the Federal Reserve (the Fed) – amid rising producer prices, falling consumer confidence and sharply lower house prices - that's got economists speculating over the US heading for 1970s-style stagflation.

Strong commodities and food prices have caused the Fed to upgrade core inflation forecasts for 2008 from 1.7 per cent-2.0 per cent to 1.9 per cent-2.3 per cent. Meantime, growth forecasts were also downgraded to 1.3 per cent-2.0 per cent from 1.8 per cent-2.5 per cent.

Federal Reserve Chairman Ben Bernanke admitted price pressures could make it harder for the Fed to ensure the economy keeps growing. Based on Labor Department figures consumer prices in the US jumped 0.4 per cent in January and are close to a 16-year high of 4.3 per cent over the past 12 months. Analysts expect manufacturers to recoup rising prices of key raw materials by passing them on to consumers.

However, Bernanke doesn't subscribe to the stagflation outlook which characterized three US recessions during the 1970s - during which inflation rose to around 15 per cent, while unemployment hit a whopping 9 per cent.

Instead of joining prevailing pronouncements of prolonged inflation and stagnation, Bernanke believes that if commodities stabilise in coming months then inflation should come down. Unlike his predecessor during the 1970s, Bernanke appears considerably more comfortable with the US economy enduring short-term pain in order to get inflation down again.

But there's little evidence that a slowing US economy is negatively impacting global commodities or food prices.

According to Nick Orlic economic analyst with NabCapital research, the key reason why inflation is on the up, despite the downturn in the OECD developed economies, led by the USA, is China. Incidentally, prices for imports from China jumped 0.8 per cent in January, the largest monthly increase since the Labor Department began reporting the data in 2003.

Orlic said strong demand growth in China is pushing up the price of oil, metals and foodstuffs. "Problems with pig-meat in China have added to inflation there but growing global shortages of grain has been a major contributing factor," said Orlic.

*Mark Story*