



## Contrasts on Inflation

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The Consumer Price Index (CPI) is the most common measurement of inflation used by market observers. The CPI is produced by the Bureau of Labor Statistics (BLS) and is a weighted index of consumer prices obtained from 87 urban areas and 23,000 retail and service establishments around the country. Two other less well known measures of inflation are the Commodities Research Bureau's CRB Index, which is an un-weighted index of 17 commodities and the Goldman Sachs Commodity Index (GSCI) which is a weighted index of 26 commodities.

As the government keeps telling us that inflation is not a problem, then the question that naturally follows is how long can productivity gains, slack global manufacturing capacity, price competition and global labor outsourcing keep the inflation genie in the bottle?

There are a couple of key possibilities when raw material prices are up substantially across the board. One is inflation and the other is profit margin contraction. Granted, low interest rates have helped bottom line profit numbers, but gross margin ultimately pays the bills.

Two primary ways to combat inflation and

| Annualized | CPI  | CRB   | GSCI  | Oil   | Gold  | Productivity |
|------------|------|-------|-------|-------|-------|--------------|
| 1 Year     | 2.30 | 22.17 | 21.39 | 14.11 | 26.29 | 5.10         |
| 2 Year     | 1.95 | 17.60 | 18.32 | 16.73 | 18.62 | 6.14         |
| 3 Year     | 2.23 | 10.49 | 9.85  | 11.07 | 18.21 | 4.81         |
| 4 Year     | 2.52 | 7.26  | 8.06  | 7.62  | 11.17 | 4.78         |
| 5 Year     | 2.46 | 8.14  | 12.86 | 16.58 | 8.76  | 4.58         |
| 10 Year    | 2.46 | 2.23  | 5.17  | 9.19  | 0.87  | 4.17         |

margin pressure are productivity gains (which are difficult to measure and are low in comparison to the run-up in commodity prices as can be seen in the table)

The table above shows the 1, 2, 3, 4, 5 and 10 year annualized increases in the CRB Index, the GSCI, Crude Oil, Spot Gold, the BLS Productivity (Productivity) as measured by output per hour in the manufacturing sector and inflation as measured by the CPI. All periods shown are ending March 31, 2004 except productivity and inflation, with periods ending December 31, 2003.

and labor outsourcing. It's easier to outsource manufacturing than it is services (legal, professional, health care, etc.). But some are even trying that without much success (think Dell call centers in India and programming).

**"...gross margin ultimately pays the bills."**

As mentioned, the CRB is an un-weighted index of 17 commodities ranging from cocoa to crude oil. The GSCI is a weighted index of 26 commodities, again ranging from cocoa to crude oil. The primary difference is that the GSCI is heavily weighted to petroleum products which make up almost 63% of this index. This index should be up, after all oil prices are through the roof and dominating the news cycles lately. But, look at the equal weighted CRB. In all but a couple of the periods shown both indexes are very similar, meaning commodity prices are up across the board—everything from cocoa to crude oil—and have been increasing rapidly for quite a while.

I'm not an economist, but something has to give. What's that old adage – "I'm from the government and I'm here to help." Our friends who are here to help keep telling us that inflation is not a problem, to wit: Federal Reserve Chairman Alan Greenspan says, "As yet, the protracted period of monetary accommodation has not fostered an environment in which broad-based inflation pressures appear to be building." Treasury Secretary John Snow provides the English translation and is clearly toeing the party line saying, "I'm not particularly concerned about it [inflation] at this point."

Stayed tuned—This inflation thing could be a major story and return with a vengeance.