

US efforts to combat recession pose inflation risk

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By Matthew Robinson and Barani Krishnan

NEW YORK (Reuters) - Economic recovery efforts in the United States and abroad have raised the spectre of inflation, with signs they are already feeding a recovery in prices for oil and other commodities.

The Obama administration plans to spend nearly \$800 billion (537.3 billion pounds) over next couple of years on a range of programs including construction projects, while the Federal Reserve is putting more spending power in the hands of consumers and businesses to stimulate employment and economic growth.

Those factors, along with similar stimulus measures and interest rate cuts around the world aimed at combating the global economic crisis, are likely to give a long-term lift to commodities that could eventually inflate prices for consumer and producer goods, according to analysts.

"If all these things were to continue along straight line trajectories, we would have greater demand for commodities and a lot more money chasing the same number of goods, and that's inflationary," said Peter Beutel, president of Cameron Hanover in New Canaan, Connecticut.

Oil prices, down from record highs over \$147 a barrel in July to around \$50 as the economic crisis hurts demand, may find traction if the plans hike industrial consumption and increase market liquidity. Already, oil has steadily risen about 40 percent since mid-February and metals similarly have gained about 30 percent.

"There is no doubt as we get a broader stimulus back in the economy, some of the credit conditions unfrozen, capital markets flowing again, at that point in time you will start a new business cycle that will benefit industrial demand and that is going to be the real driver (for) transportation," said Eric Kalamaras, head of energy research for Wachovia Securities in Charlotte, North Carolina.

Copper prices are up more than 30 percent in the first quarter, reversing direction after a 60 percent drop in the previous six months. Traders say the rally could continue into the second quarter if stock markets remain buoyant and top metals consumer China keeps up its recent buying.

Food commodities, which saw historically high prices last year, could also get another boost with inflation, said Shawn Hackett, a commodities strategist in Florida, who called a buy on markets like wheat, sugar and coffee.

"This is where the rubber meets the road, where the deflationary forces of demand destruction give up to the inflationary forces of all the money that's being printed," Hackett said.

Surging demand from China and other emerging economies launched oil and other commodities on a six-year rally to record peaks before the economic crisis hit.

Prices also got a boost from a series of interest rate cuts by the U.S. Federal Reserve starting in the second half of 2007, which spurred investors to race into commodities as a hedge against inflation and the weak dollar.

The Fed has lowered its benchmark interest rates to near zero and introduced programs to encourage consumer and business lending. In addition, it is effectively printing money by buying U.S Treasury bonds, and economists say this increase in the money supply could ultimately lead to inflation.

Similar interest rate cuts and stimulus programs have been implemented around the world -- including a \$585 billion fiscal stimulus plan in massive oil and metals consumer China.

While the moves to reverse the economic recession have given a lift to commodities markets, some energy analysts warn that continued weak fundamentals like soft demand and swelling inventories still pose significant downside price risk.

"I think the market's anticipation of those inflationary risks have been exaggerated and telescoped too quickly into the present," said Edward Morse, Managing Director and Chief Economist for LCM Commodities.

"Certainly, there is an eventual concern about inflationary implications of what they have been doing as inevitably will be the case when you are printing money."

(Editing by Marguerita Choy)

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