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CAPITAL MARKETS

REBOUNDING US IMPORT PRICES TO ADD TO 2018 DOMESTIC INFLATIONARY PRESSURES

**U.S. import prices increased 1% m/m and 3.6% yr/yr in January, driven by both a 21% yr/yr gain in petroleum import prices and an acceleration in nonpetroleum imports prices, which rose 0.5% m/m and 1.9% yr/yr, the largest gain since January 2012 (see Chart 1)*

**The persistent U.S. dollar depreciation and stronger domestic demand following the 2014-2016 industrial slump are pushing up prices of nonpetroleum imports, which will add modestly to domestic price inflation with some lag*

**Export prices increased by a strong 0.8% m/m, despite the U.S. dollar weakness, and non-food/fuels exports rose a strong 0.5% m/m, with improving global growth also increasing demand for U.S. manufactured goods*

Prices of imports fell during 2014-2016, reflecting a combination of sharp declines of oil and energy prices and falling prices of non-petroleum prices that reflected softer U.S. domestic demand growth and the strengthening U.S. dollar. This price trend in imports is now reversing, with higher energy prices, strengthening domestic demand, and a weaker U.S. dollar combining to boost import prices. This trend will add to overall U.S. inflation pressures in 2018.

Prices of non-petroleum imports reflect U.S. product demand and the U.S. dollar. U.S. domestic demand — consumption and business investment spending — have picked up decidedly: final sales to domestic purchasers rose 4.8% in the year ending Q4 2017, up from 3.6% in the prior year. The nominal broad-trade weighted U.S. dollar has fallen 8% from its peak at year-end 2016, but as global trade contracts are usually settled months in advance, exchange rate movements feed through to actual contract prices with a lag. The year-long depreciation of the weak U.S. dollar is just showing up in import prices.

Based on momentum in domestic demand and continued softness in the U.S. dollar, upward pressure on prices of non-fuel imports is expected through 2018.

The acceleration in import prices has been concentrated in energy and capital goods, reflecting higher oil prices and the decided pickup in domestic capital spending. Import price inflation of capital goods tends to lead the producer price index of capital equipment by about six months. Combined with stronger product demand, this suggests that domestic producers will continue to increase their selling prices (Chart 2).

Automotive import prices spiked 0.6% in January, but that followed a year of slight declines (Chart 3). Prices of imports of consumer goods excluding autos remain subdued, reflecting familiar factors that have constrained prices of many consumer goods in the U.S. (see Chart 4). Increases in broader domestic consumer inflation are likely to be driven by domestic services.

The price increases of U.S. exports despite the weak U.S. dollar are a result of strengthening global economies. In particular, prices of exported capital goods and consumer goods correspond to the marked pick-up in global demand (Chart 5).

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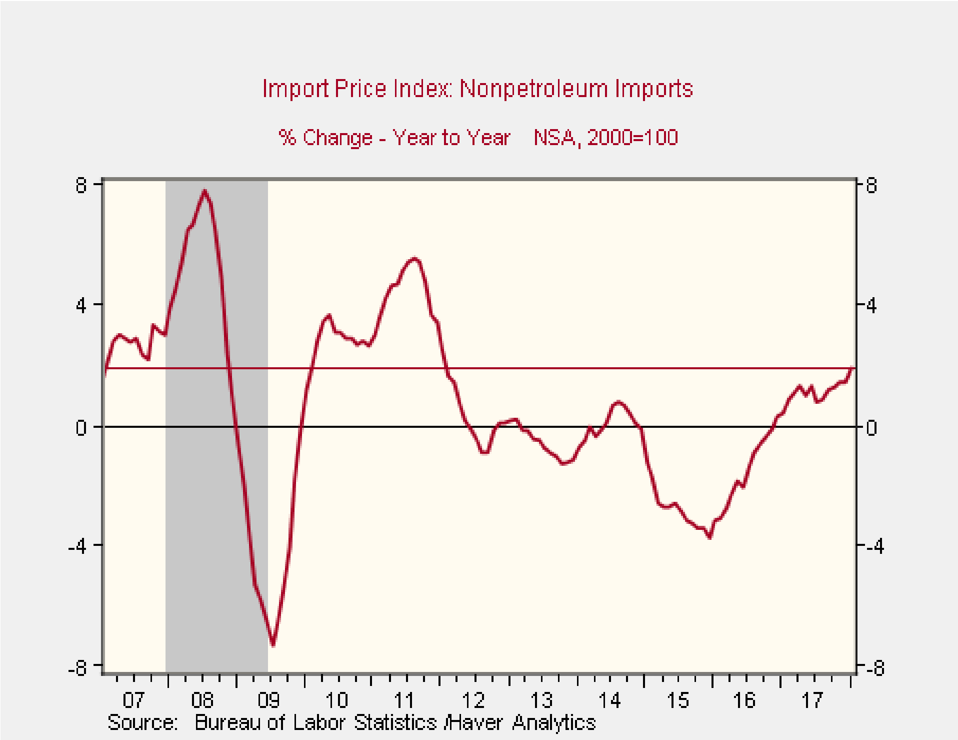
Mickey D. Levy
Chief Economist US, Americas and Asia
+1 646 445 4842
mickey.levy@berenberg-us.com

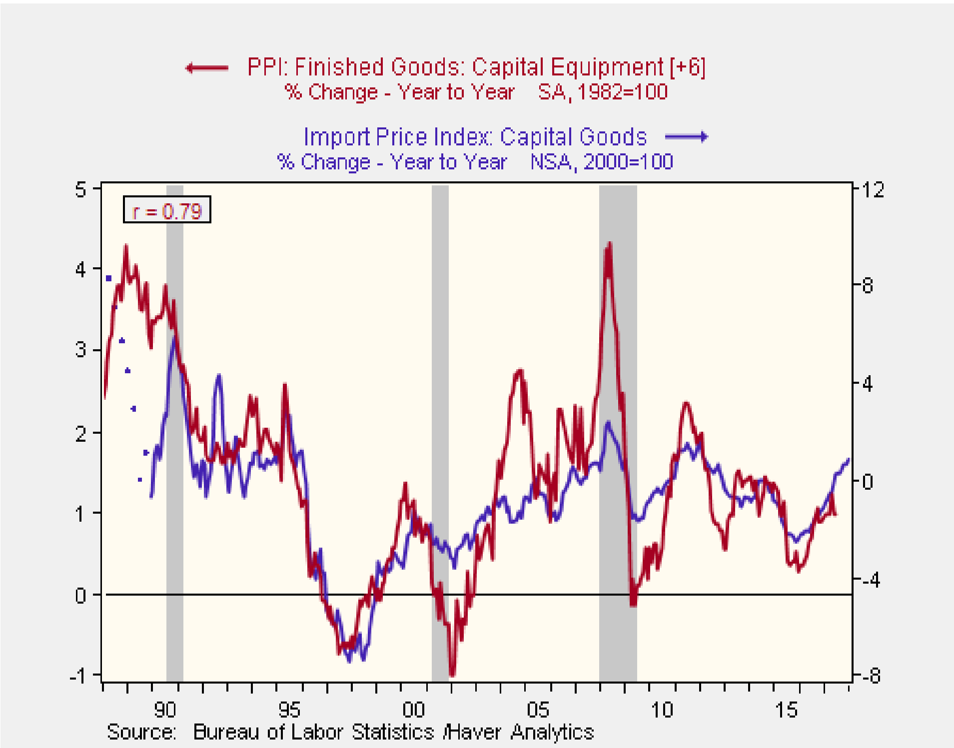
Roiana Reid
Economist
+1 646 445 4865
roiana.reid@berenberg-us.com

Chart 1: Nonpetroleum Import Prices



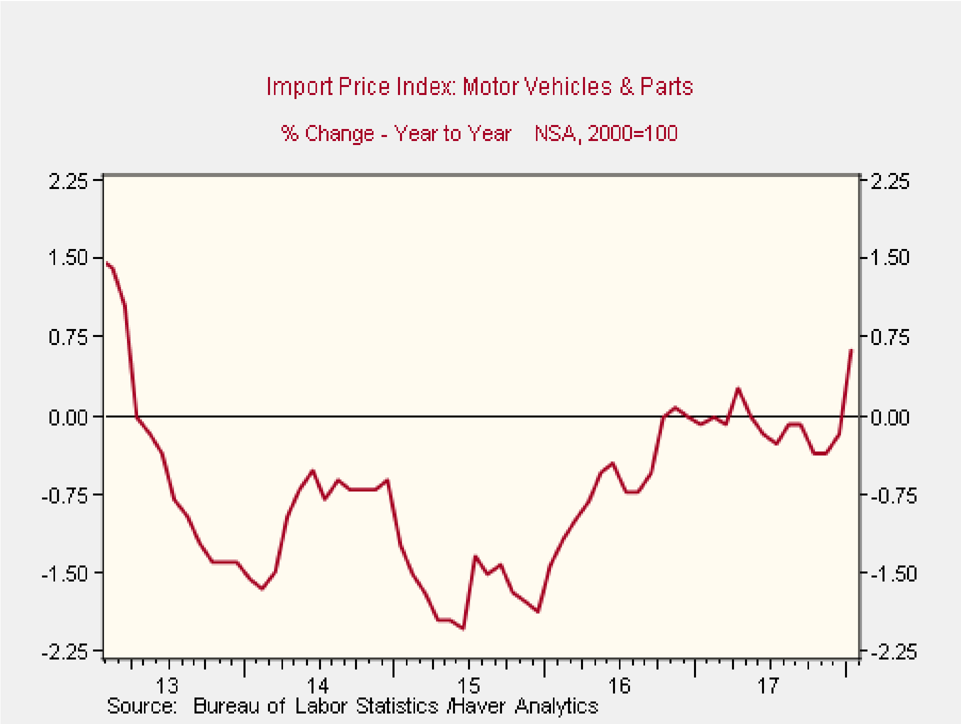
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: PPI and Import Prices of Capital Goods



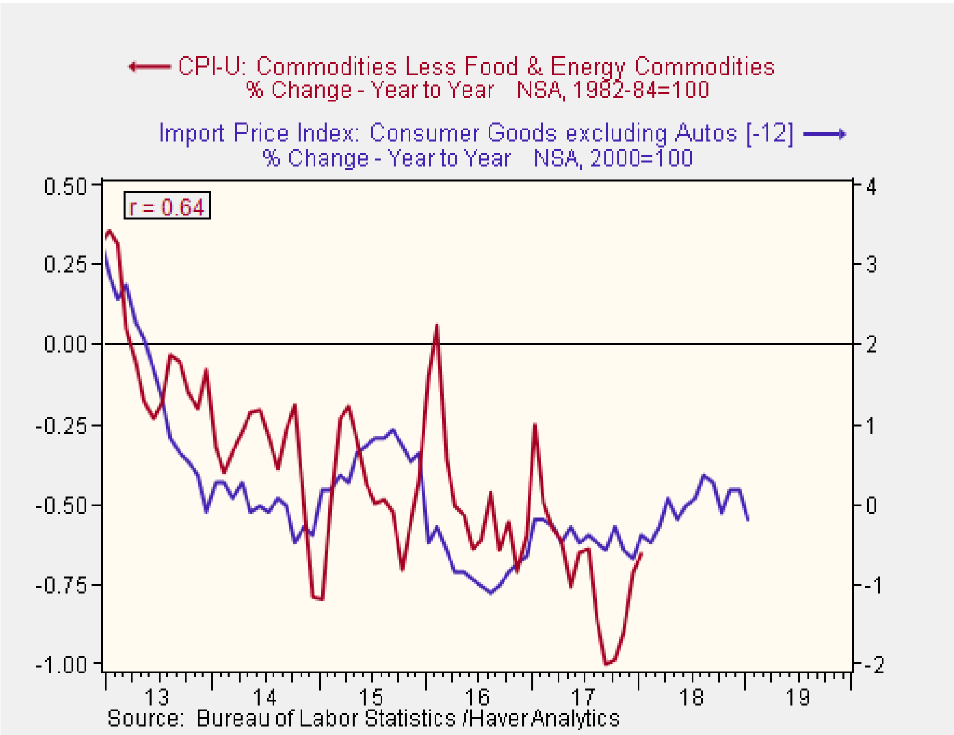
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Import Prices of Motor Vehicles and Parts



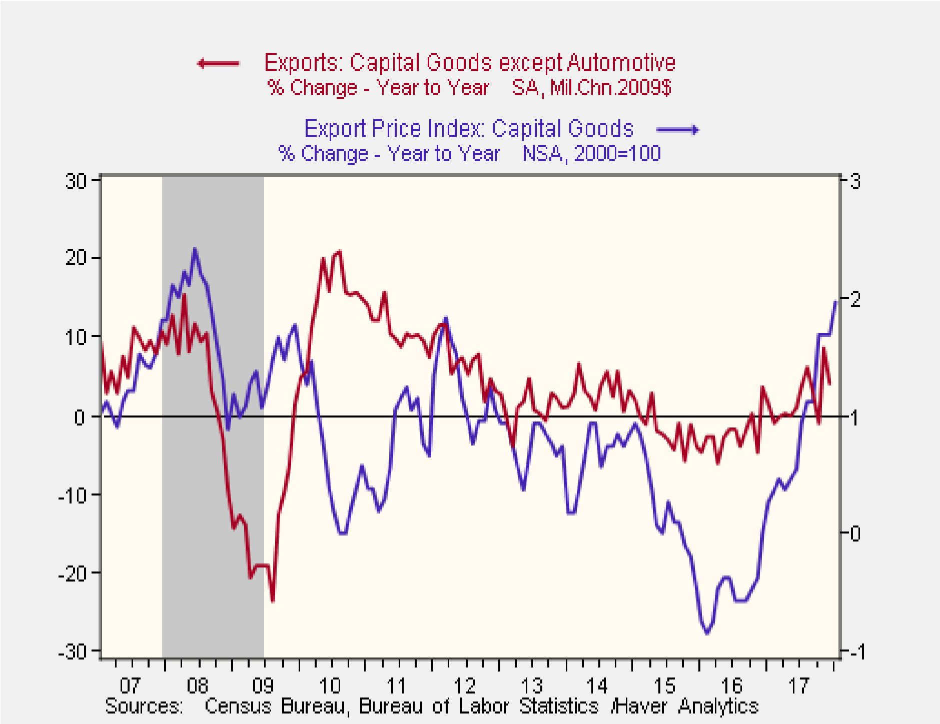
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 4: Import Prices of Consumer Goods ex Autos and CPI for Commodities Less Food and Energy



Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 5: Export Prices of Capital Goods and Exports of Capital Goods Ex Autos



Source: Monthly data. Source: Census Bureau, Bureau of Labor Statistics and Haver Analytics

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Contacts: BCM

www.berenberg.com
e-mail US: firstname.lastname@berenberg-us.com

JOH. BERENBERG, GOSSLER & CO. KG

Internet www.berenberg.com
E-mail: firstname.lastname@berenberg.com

EQUITY RESEARCH

AEROSPACE & DEFENCE
- Andrew Gollan +44 20 3207 7891
- Charlotte Keyworth +44 20 3753 3013
- Ross Law +44 20 3465 2692

AUTOMOTIVES
- Adam Hull +44 20 3465 2749
- Paul Kratz +44 20 3465 2678

BANKS
- Adam Barrass +44 20 3207 7923
- James Chappell +44 20 3207 7844
- Andrew Lowe +44 20 3465 2743
- Andreas Markou (EM) +44 20 3753 3022
- Eoin Mullany +44 20 3207 7854
- Peter Richardson +44 20 3465 2681
- Jonathan Sharpe +44 20 3753 3031

BEVERAGES
- Javier Gonzalez Lastra +44 20 3465 2719
- Batuhan Karabekir (EM) +44 20 3465 2631
- Adam Mizrahi +44 20 3465 2653

BUSINESS SERVICES, LEISURE & TRANSPORT
- Roberta Ciaccia +44 20 3207 7805
- Najet El Kassir +44 20 3207 7836
- Stuart Gordon +44 20 3207 7858
- Josh Puddle +44 20 3207 7881
- Julia Winarso +44 20 3465 2627

CAPITAL GOODS
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CHEMICALS
- Sebastian Bray +44 20 3753 3011
- Andrew Heap +44 20 3207 7918

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- Lush Mahendrarajah +44 20 3207 7896
- Robert Muir +44 20 3207 7860
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ENERGY
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FOOD MANUFACTURING AND H&PC
- Rosie Edwards +44 20 3207 7880
- Yordana Mavrodieva +44 20 3207 7817
- Fintan Ryan +44 20 3465 2748
- James Targett +44 20 3207 7873

FOOD RETAIL
- Batuhan Karabekir (EM) +44 20 3465 2631

GENERAL MID CAP - EU
- Gunnar Cohrs +44 20 3207 7894
- Martin Comtesse +44 20 3207 7878
- Flavien Hias +44 20 3465 2693
- Aymeric Lang +44 20 3753 3037
- Anna Patrice +44 20 3207 7863
- Benjamin Pfannes-Varrow +44 20 3465 2620
- Simona Sarli +44 20 3207 7834
- Julia Scheufler +44 20 3753 3016

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- Robert Chantry +44 20 3207 7861
- Sam England +44 20 3465 2687
- Ned Hammond +44 20 3753 3017
- Benjamin May +44 20 3465 2667
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- Graham Doyle +44 20 3465 2634
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- Emanuele Musio +44 20 3207 7916
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- Sami Taipalus +44 20 3207 7866

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- Zuzanna Pusz +44 20 3207 7812

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- Laura Janssens +44 20 3465 2639
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- Sarah Simon +44 20 3207 7830

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- Fawzi Hanano +44 20 3207 7910
- Yuriy Vlasov +44 20 3465 2674

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- Kai Klose +44 20 3207 7888
- Tina Munda +44 20 3465 2716

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- Jean Beaubois +44 20 3207 7835
- Georgios Kertsos +44 20 3465 2715
- Gal Munda +44 20 3465 2746
- Tammy Qiu +44 20 3465 2673

TELECOMMUNICATIONS
- Ondrej Cabejsek (EM) +44 20 3753 3071
- Usman Ghazi +44 20 3207 7824
- Siyi He +44 20 3465 2697
- Laura Janssens +44 20 3465 2639
- Paul Marsch +44 20 3207 7857
- Michael Summerville +44 20 3207 7914

THEMATIC RESEARCH
- Nick Anderson +44 20 3207 7838
- Asad Farid +44 20 3207 7932

TOBACCO
- Jonathan Leinster +44 20 3465 2645

UTILITIES
- Robin Abrams +44 20 3465 2635
- Andrew Fisher +44 20 3207 7937
- Lawson Steele +44 20 3207 7887

ECONOMICS
- Florian Hense +44 20 3207 7859
- Carsten Hesse (EM) +44 20 3753 3001
- Kallum Pickering +44 20 3465 2672
- Holger Schmieding +44 20 3207 7889

EQUITY SALES

SPECIALIST SALES

AEROSPACE & DEFENCE
- Bruna Zugliani +44 20 3207 7818

AUTOMOTIVE & THEMATICS
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- Iro Papadopoulou +44 20 3207 7924

BUSINESS SERVICES, LEISURE & TRANSPORT
- Rebecca Langley +44 20 3207 7930

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CONSUMER STAPLES
- Rupert Trotter +44 20 3207 7815

CONSUMER DISCRETIONARY
- Victoria Maigrot +44 20 3753 3010

HEALTHCARE
- Frazer Hall +44 20 3207 7875

MEDIA & TELECOMMUNICATIONS
- Julia Thannheiser +44 20 3465 2676

SPECIAL SITUATIONS
- Jeremy Grant +44 20 3207 7890

SALES

BENELUX
- Miel Bakker +44 20 3207 7808
- Martin de Laet +44 20 3207 7804
- Alexander Wace +44 20 3465 2670

GERMANY
- Michael Brauburger +49 69 91 30 90 741
- Nina Buechs +49 69 91 30 90 735
- André Grosskurth +49 69 91 30 90 734

GERMANY (cont'd)
- Florian Peter +49 69 91 30 90 740
- Joerg Wenzel +49 69 91 30 90 743

UK
- Alexandra Clément +44 20 3753 3018
- Fabian De Smet +44 20 3207 7810
- Karl Hancock +44 20 3207 7803
- Sean Heath +44 20 3465 2742
- David Hogg +44 20 3465 2628
- Peter Kaineder +44 20 3753 3062
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- George Smibert +44 20 3207 7911
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- Paul Walker +44 20 3465 2632

FRANCE
- Thibault Bourgeat +33 1 5844 9505
- Alexandre Chevassus +33 1 5844 9512
- Dalila Farigoule +33 1 5844 9510
- Clémence Peyraud +33 1 5844 9521
- Benjamin Voisin +33 1 5844 9507

SCANDINAVIA
- Frederik Angel +44 20 3753 3055
- Marco Weiss +49 40 350 60 719

SWITZERLAND, AUSTRIA & ITALY
- Andrea Ferrari +41 44 283 2020
- Carsten Kinder +41 44 283 2024
- Gianni Lavigna +41 44 283 2038
- Jamie Nettleton +41 44 283 2026
- Benjamin Stillfried +41 44 283 2033

CRM
- Louise Hughes +44 20 3753 3066
- Jessica Jarmyn +44 20 3465 2696
- Edwina Lucas +44 20 3207 7908
- Greg Swallow +44 20 3207 7833

CORPORATE ACCESS
- Lindsay Arnold +44 20 3207 7821
- Jennie Jiricny +44 20 3207 7886
- Stella Siggins +44 20 3465 2630

EVENTS
- Laura Hawes +44 20 3753 3008
- Suzy Khan +44 20 3207 7915
- Charlotte Kilby +44 20 3207 7832
- Natalie Meech +44 20 3207 7831
- Ellen Parker +44 20 3465 2684
- Sarah Weyman +44 20 3207 7801

SALES TRADING

HAMBURG
- Tim Storm +49 40 350 60 415

PARIS
- Vincent Klein +33 1 58 44 95 09
- Antonio Scuotto +33 1 58 44 95 03

LONDON
- Mike Berry +44 20 3465 2755
- Stewart Cook +44 20 3465 2752
- Mark Edwards +44 20 3753 3004
- Tristan Hedley +44 20 3753 3006
- Peter King +44 20 3753 3139
- Christoph Kleinasser +44 20 3753 3063
- Chris McKeand +44 20 3207 7938
- Simon Messman +44 20 3465 2754
- AJ Pulleyn +44 20 3465 2756
- Michael Schumacher +44 20 3753 3006
- Paul Somers +44 20 3465 2753

EQUITY TRADING

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- Marvin Schweden +49 40 350 60 576
- Linus Weidner +49 40 350 60 798
- Philipp Wiechmann +49 40 350 60 346
- Christoffer Winter +49 40 350 60 559

LONDON
- Edward Burlison-Rush +44 20 3753 3055
- Richard Kenny +44 20 3753 3083

ELECTRONIC TRADING
- Daniel Eichhorn +49 40 350 60 391
- Matthias Führer +49 40 350 60 597

BERENBERG CAPITAL MARKETS LLC

Member FINRA & SIPC

E-mail: firstname.lastname@berenberg-us.com

EQUITY SALES

SALES
- Kelleigh Faldi +1 617 292 8288
- Isabella Fantini +1 646 445 4861
- Shawna Giust +1 646 445 7216
- Rich Harb +1 617 292 8228
- Zubin Hubner +1 646 445 5572
- Jessica London +1 646 445 7218
- Ryan McDonnell +1 646 445 7214

SALES (cont'd)
- Emily Mouret +1 415 802 2525
- Peter Nichols +1 646 445 7204
- Kieran O'Sullivan +1 617 292 8292

CRM
- Laura Cooper +1 646 445 7201

CORPORATE ACCESS
- Olivia Lee +1 646 445 7212
- Tiffany Smith +1 646 445 4874

EVENTS
- Patricia Ehrhart +1 646 445 4863

SALES TRADING
- Christopher Kanian +1 646 445 5576
- Lars Schwartau +1 646 445 5571
- Brett Smith +1 646 445 4873
- Bob Spillane +1 646 445 5574

ECONOMICS
- Mickey Levy +1 646 445 4842
- Roiana Reid +1 646 445 4865