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PRICE DATA - - TRICK OR TREAT?

This month's report on producer prices from the Labor Department offers an example of the conundrums faced by those whose jobs require them to predict changes in the national economy. Consumer prices echoed the producer price trends, but did not show the built-in contradictions so vividly.

The headline was that wholesale inflation had plunged by the largest number in three years. Good news, except that core inflation (excluding energy and food) was up 0.6%, the biggest increase in 20 months. On balance, not very good news.

But, delving deeper into the numbers, one learns that the big increase in core inflation was principally due to very large increases in new car and light truck prices, which were up by 2.8% and 3.5%, respectively. The jump in new car prices was the highest in 16 years for cars and in 21 years for light trucks. Without the vehicle price increases, the core wholesale inflation would have been only 0.1% -- very good news.

So what are we to make of these numbers? There is something for everyone, optimists and pessimists alike. Those who fear that inflation is becoming uncontrolled will point to the core rate. Those who are more sanguine will point out that vehicle prices are higher (after recent declines) in reaction to declining gas prices – in effect, a way that prices outside the core can have an effect on those within the core.

Of course, the producer and consumer price indices are not the only word on the status of the economy. The housing market is under stress, with prices down, the number of houses for sale way up and the house price-to- income ratio at an unhealthy level. The index of Leading Economic Indicators has been down for two months in a row (three months straight is supposed to be a warning of recession). And, of particular importance to the steel industry, the Philadelphia Manufacturing Index went from 18.5 in August to a negative 0.4 in September, a decline much greater than expected and bad news for new order projections.

The "wisdom" on Wall Street expects the Fed to keep interest rates unchanged through the rest of 2006. But, there are plainly some inflation hawks who have a vote in the Fed's Open Market Committee on the issue, so nothing is sure. One major U.S. bank recently forecast that the Fed's rate one year hence will be 4%, while another such bank thinks that it will be 6%.

Turning to some of the numbers for this month:

- Scrap and Pig Iron. Prices were down across the board this month. Number 1 dealer bundles and #1 busheling (Chicago) both dropped by $30 per mt, to $245 and $250, respectively. The spot price for Brazilian pig iron (cif New Orleans) also declined by $30 to $285 per mt.

- Ocean Freight. It is always dangerous to make predictions, but it appears that ocean freight rates have now stabilized. The Baltic Capesize Index has remained at 3178 for five months in a row, and it has hovered around that number for nine months running. Thus, until something changes, we shall not be reporting on this item in the future.

- Natural Gas. While gasoline prices were dropping 22.2% in September (the largest decline on record) and home heating oil was down 18.5%, the Nymex contract price for natural gas rose almost 50 cents, or 9%, to $6.18 mcf. Many observers think that the prices will continue to rise over the course of the next 18 months, but one hedge fund, Amaranth Advisors, closed its doors after losing $6.5 billion in the natural gas market betting on higher prices.

- Exchange Rates. As of today, the dollar has strengthened against the euro since last month, going from $1.28 to $1.25. The pound also declined against the dollar, dropping from $1.90 to $1.87. The Canadian dollar is at 88¢, down a penny from last month.

As ever, we are interested in hearing back from you with suggestions and your own views on what we say. This letter will be posted on our web site www.coreysteel.com and in the international site, www.steelonthenet.com.