Flash Economics

N° 13
August 13th, 2024

Causes and consequences of the divergence between prices of manufactured goods and prices of services

Over one year, in June 2024, the prices of manufactured goods (goods excluding energy and food) fell by 1.8% in the United States and rose by 0.7% in the Euro zone, while the prices of services rose rapidly, by 5% year-on-year in the United States and by 4.1% year-on-year in the Euro zone.

This divergence between the prices of goods (manufactured products) and the prices of services is no longer due to:

- in the United States, the increase in rents (actual and implied);
- the evolution of energy prices or other raw materials;
- the evolution of labor productivity.

The only explanation that remains for this divergence is therefore a strong difference between the growth of demand for goods (which is low) and that of demand for services (which is high).

The first consequence of this divergence between the evolution of prices of manufactured products and prices of services is the appearance of a "Dutch disease" type mechanism: the higher profitability of the production of services compared to the production of goods, which is due to the difference in price trends, distorts the economy towards services at the expense of goods (manufactured products). In addition, this divergence may pose a problem for central banks, which often look at "super-core" inflation (the increase in prices of services excluding rent), which is currently very high.

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Divergence between the growth of prices of goods (manufactured products) and that of prices of services

Charts 1A and 1B compare the evolution of consumer prices of industrial products, producer prices of industry and consumer prices of services in the United States and in the Euro zone.

Chart 1A
United States: Consumer price indices of services and nonenergy industrial goods, producer price index for total industry excluding construction and energy (Y/Y as %)

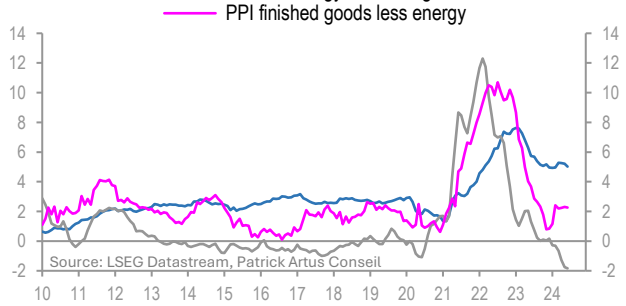
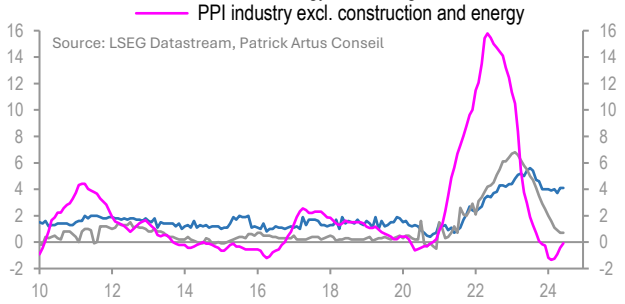


Chart 1B
Euro zone: Consumer price indices of services and nonenergy industrial goods, producer price index for total industry excluding construction and energy (Y/Y as %)



Since September 2022 in the United States and since July 2023 in the Euro zone, **the prices of services have increased much faster than the prices of industrial products.**

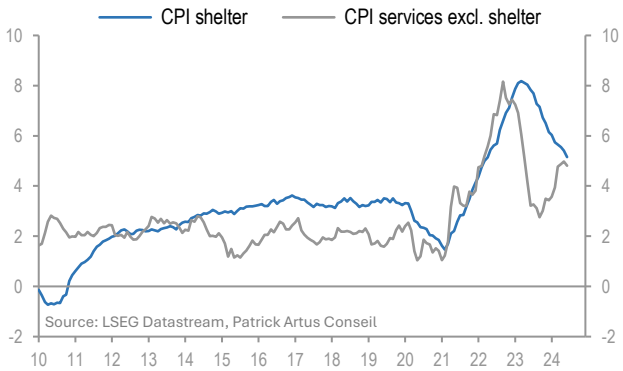
We will look at **the possible causes and consequences** of this divergence in the recent period between the prices of goods (excluding energy and food) and the prices of services.

What is not the cause of the divergence between the prices of goods (manufactured products) and services?

This divergence is not due to:

- in the United States, **the increase in rents (shelter prices)**, since the prices of services excluding shelter also increase very rapidly (**Chart 2**);

Chart 2
United States : Consumer price indices (CPI, Y/Y as %)



- **the evolution of energy prices or other raw materials**, which mainly influence the prices of manufactured products, since they are currently increasing (**Charts 3A/3B**);

Chart 3A
Energy consumer price indices (Y/Y as %)

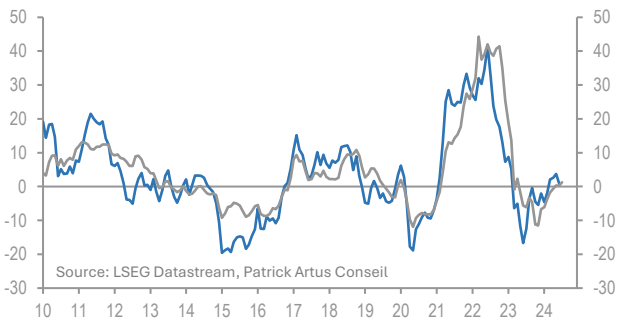
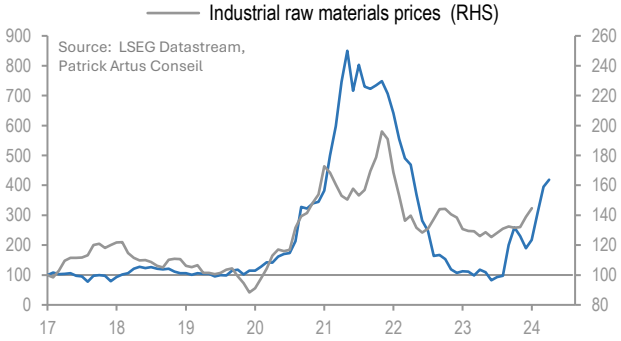


Chart 3B
Industrial raw materials prices and maritime freight cost (08.05.2017 = 100)



- **the evolution of labor productivity**, faster in services than in manufacturing, equivalently in the whole economy than in industry (**Charts 4A/4B**).

Chart 4A
United States: Productivity per head in the manufacturing sector and in the business sector (Y/Y as %)

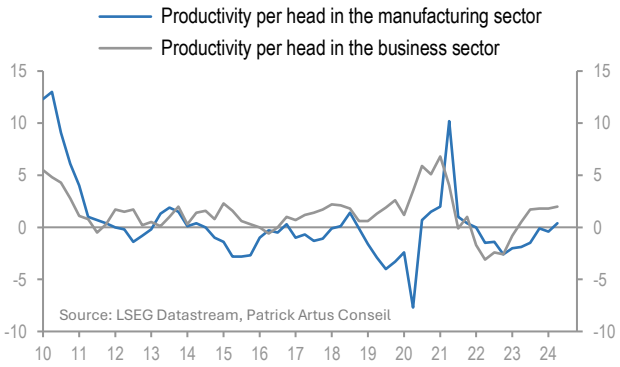
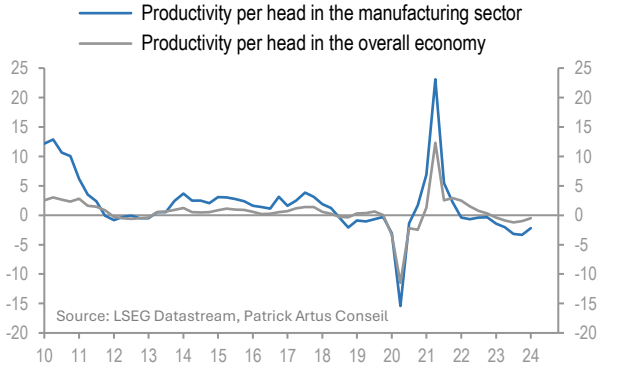


Chart 4B
Euro zone: Productivity per head in the manufacturing sector and in the overall economy (Y/Y as %)



The only explanation that remains

The only explanation that remains for the divergence between the prices of manufactured products and the prices of services is therefore **a divergence also between the progression of the demand for goods (manufactured products) and that of demand for services**.

This divergence can be seen in the gap between the PMI (or ISM, i.e. the production outlook) in industry and in the whole economy (**Charts 5A/5B**), or in the stagnation of manufacturing output (**Chart 6**), or in the decline since the end of 2021 of the capacity utilization rate of industry (**Chart 7**).

Chart 5A
United States: Manufacturing, services and composite PMI (indices)

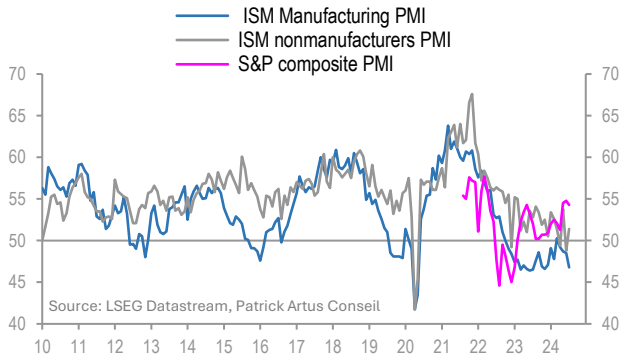


Chart 5B
Euro zone: Manufacturing, services and composite PMI (indices)

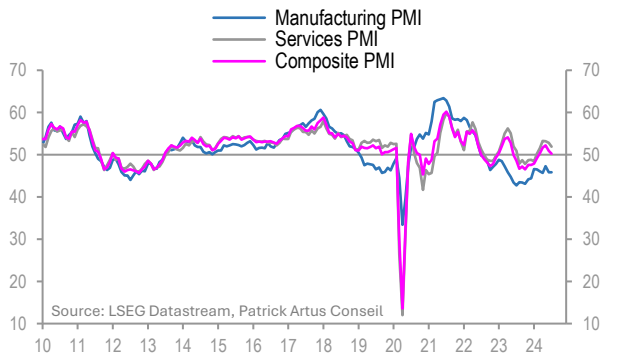


Chart 6
Manufacturing production (2010.M1 = 100)

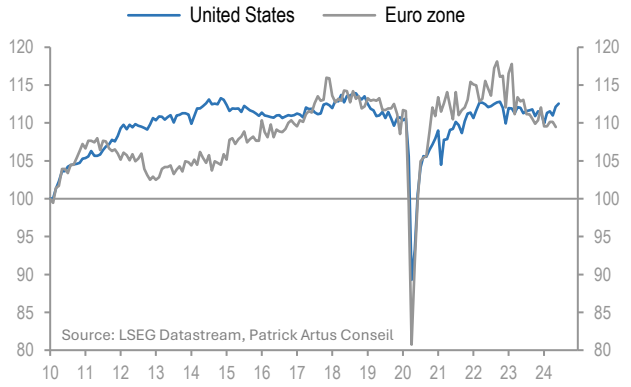
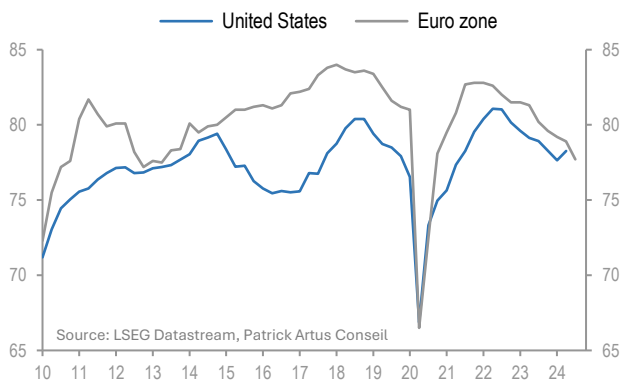


Chart 7
Capacity utilization rate (as %)



Summary: consequences of the divergence between prices of manufactured products and prices of services

The prices of services continued to rise rapidly in the United States and in the Euro zone in the spring of 2024 while the prices of manufactured products fell (United States) or increased very slowly (Euro zone). This divergence between the prices of goods and services is not due to:

- rents ;
- raw material prices;
- the difference between productivity gains in the United States and in the Euro zone.

It is probably due to the fact that the growth of demand for services is much stronger than the growth of demand for manufactured products.

This divergence has two consequences:

- **It can cause a "Dutch disease" type mechanism** where the economy is distorted from goods to services because of the higher profitability of the production of services than the production of goods (this higher profitability in services results from the price increase);
- **It can pose a problem for central banks**, which often look at "super-core" inflation (inflation of services excluding rents) and not total inflation to judge the real level of inflation.

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