



12 Jan 2017

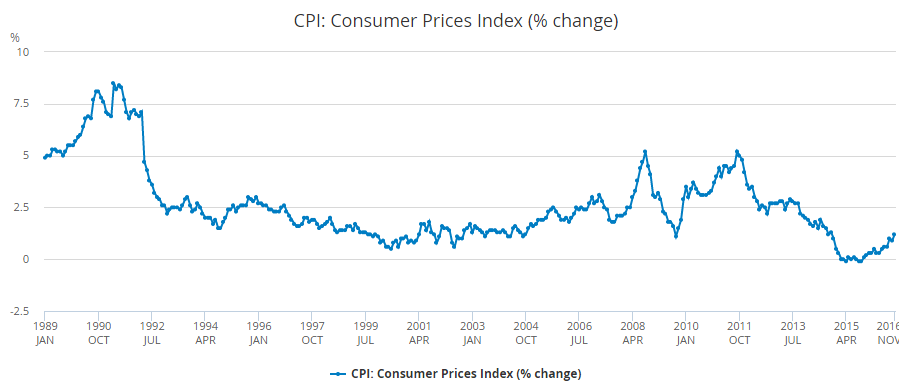
INFLATION: FRIEND OR FOE?

After years in the shadows, inflation may be making something of a come-back. Here we consider whether that is altogether bad news:

Hello Inflation My Old Friend...

Background:

- Many consumers have little or no first-hand experience of inflation
- The two 5% spikes in 2008 and 2011 were 'aberrations'
- We were in short pants (or not born) in the 20% plus days of the 1970s
- Nobody's suggesting we're going back there but there's a rumble in the price jungle



Source: ONS

RIP deflation – here's a Brave New World. Velcro vs Teflon:

- Deflation's not a thing anymore
- So remember, when costs fall, you cut prices slowly (and not by much)
- When costs rise, you pass them on (plus a bit) like a hot spud

Only the Lonely – AKA Bad Inflation:

- If only your costs rise, you may not be able to pass higher costs on
- Unsympathetic customers, whether B2B or B2C, may shun your products
- Examples may include single commodity price rises, single currency issues
- Or shortages due to remote events such as trebling of hard drive prices post 2011 Thai floods

Unconscious Collusion – AKA Not Bad Inflation (don't say 'Good'):

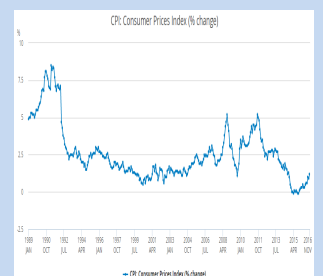
- If cost rises are widely spread...
- If they are well-flagged...

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- If they are universally 'understood'...
- If they are not the 'fault' of greedy suppliers...
- Then they may be passed on and everyone, accidentally, will make more money

Where are we now?

- It will be interesting to see if Tesco etc. 'reluctantly' accede to producer price demands
- We believe they will because, if not now, then when?
- They will seek (but perhaps fail) to maintain their 'consumer champion' status
- Pubs, bars & restaurants will put through price rises Q1
- We think these will see % margins fall but will materially widen cash margins
- Now that's fortuitous, isn't it?

All Friends Now?



Major beneficiaries:

- Low margin, high volume operators should benefit most
- However, remember these companies are most negatively exposed if rises don't stick
- But they will stick. Operators will bank profits and thank their lucky stars
- Or possibly they will pat themselves on the back & trumpet their skill, erudition

*Words & phrases to watch out for:

- Don't refer to 'enhanced margins', 'price gouging', 'take advantage' or 'good inflation'.
- Do use the words 'reluctantly', 'restraint' and 'after many years'

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