

Fueling Chemical Prices Jump, Fear of Inflation

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In a move that may fuel inflation in consumer goods ranging from plastic wrap to diapers to food, [Dow Chemical](#) Co. said it will boost prices of its products by as much as 20% because of soaring energy prices.

Dow Chemical, one of the largest chemical manufacturers in the world, uses oil-based products and natural gas as raw materials and is also a heavy user of energy to power its manufacturing plants. The Midland, Mich., company said its oil- and gas-related costs in the first quarter were up 42% from a year earlier. It used Wednesday's pricing announcement as an opportunity to blast Washington for energy policies it blames for those higher costs.

Typically, spiking energy prices don't immediately raise concerns about long-term inflation. Food and energy are volatile and so don't show up as part of the federal government's measure of core inflation. Indeed, overall consumer prices rose 3.9% in April from the year before, but the "core" rate, which excludes food and energy, was a tamer 2.3%.

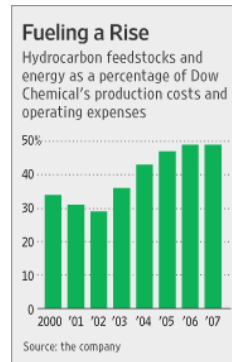
But now there are signs that rising oil prices, as they make their way through the economy, will drive up inflation, at least in the short run. The consumer price index will be up 5.1% in August, J.P. Morgan economist Michael Feroli predicts. That would be the biggest year-over-year increase since 1991.

Federal Reserve officials expect inflation to moderate next year, as the weak economy and sagging labor market act as a check on price increases. But there's a risk to that scenario: rising inflation expectations. As consumers and businesses see prices rising around them, they may demand higher wages and product prices, respectively.

Varying Price Increases

Dow Chemical will raise prices for all its products by 20% due to rising oil and natural gas prices. MarketWatch's Christopher Hinton reports. (May 28)

Dow Chemical said the size of its price increases will vary by product, but the price of its commodity chemicals and plastics, such as caustic soda, polyethylene and polypropylene, will probably go up the most, according to company spokesman Chris Huntley.



Keen competition in the markets for these basic chemicals -- the building blocks used to make many more-complex compounds -- keeps margins on them low, leaving them more sensitive to changes in energy costs. However, the company may also adopt double-digit price increases for specialty chemicals, which perform such functions as making plastics lighter and stronger, fabrics more durable and paints more fade-resistant.

Over the past months, Dow and other chemical companies have been raising product prices to pass on higher raw-material costs to their customers, but the increases have been usually confined to one product or one region. The company's decision to increase prices for all its products world-wide is nearly unprecedented, analysts said.

Wednesday, Dow Chemical's shares rose 60 cents, or 1.5%, to \$40.83 in 4 p.m. composite trading on the New York Stock Exchange.

Analysts said that other chemical producers are likely to take their cue from Dow Chemical and announce their own major price increases. "This is a significant action, and I would anticipate that other companies in the chemistry industry that are paying high hydrocarbon costs will follow suit," said Frank Mitsch, managing director at BB&T Capital Markets.

LyondellBasell Industries said it recently increased prices for many of its polymers and chemicals, but it didn't specify by how much. Although there has traditionally been a lag between oil-price increases and product price increases, "in this kind of volatile environment that is not sustainable," says the company's Chief Executive Volker Trautz. "We absolutely have to pass along price increases."

Chemical maker [DuPont](#) Co. said it didn't expect its price increases to be as steep as Dow's.

'Difficult Discussions'

Dow Chemical is being forced to have "difficult discussions with customers," said Andrew N. Liveris, Dow's chairman and CEO. But the increases won't come as a total shock to clients, he said: "They see \$4-a-gallon gasoline."

Some customers are likely to balk at the price increases, said Hassan Ahmed, an analyst at HSBC Securities. Dow Chemical will have some leverage to push through the increases because it can clearly point to energy prices as the reason for the rise, he said. But it will have to negotiate with powerful industries that have their own leverage in setting limits on what they will pay. The company's customers include consumer-product giants such as [Procter & Gamble](#) Co. and [Unilever](#).

For at least some customers, the price increases might not kick in for a while. [Alcon Laboratories](#) Inc., a maker of eye-care products, buys chemicals through contracts typically lasting a year or longer with fixed prices or other conditions that protect it from short-term market fluctuations, said Doug MacHatton, an Alcon spokesman. The company is a Dow Chemical customer, but Mr. MacHatton declined to comment on any details of its arrangements with any of its suppliers.

Trickling Down

Dow Chemical's latest price increases will also likely take time to trickle down to consumers, many of whom are already paying more for household goods. Kimberly-Clark, maker of Kleenex tissues and Scott toilet paper, said it will raise prices on some products by 6% to 8% this summer, on top of 4% to 7% increases announced in February.

At Procter & Gamble, "we're also under pressure from rising raw-material costs," said spokeswoman Lisa Jester, adding that the company hasn't announced any price increases since February, when it said it would raise prices on some products, including soap, fabric softeners and diapers, by 4% to 8%. Unilever couldn't be reached for comment.

Dean Hemstreet, a 41-year-old software engineer who lives in a Salt Lake City suburb, has seen his bills for everything from food to diapers go up in the past few months. He and his wife have made it a strict household policy to only buy in bulk, including diapers for their 4-month-old son.

"You can get diapers in 10 packs, but we won't touch it if it's not a 120-pack box," says Mr. Hemstreet, who estimates that this saves him about \$15 dollars a month. He is also buying food in bulk and is carpooling to work for further savings.

Slowing Demand

Demand for some of Dow Chemical's products has slowed along with the economy. Mr. Liveris warned that Dow is starting to see what he called "demand destruction" in the U.S. For the first quarter, Dow Chemical reported that sales volumes fell 2% in North America, although previous price increases helped to boost revenue by 14% from a year earlier. Net income in the quarter fell 3.3% to \$941 million, or 99 cents a share, from \$973 million, or \$1 a share.

Dow Chemical estimates it will spend \$32 billion on fossil fuels and energy this year, up from \$8 billion in 2002. The soaring costs have pushed much of its production in recent years to parts of the world where oil and natural gas are cheaper, notably the Middle East. In the U.S., natural-gas prices have risen more than 50% over the past year to about \$12 per million British thermal unit.

As energy prices have climbed in recent years, Dow Chemical has emerged as one of the most vocal critics of U.S. energy policy, with its chairman, Mr. Liveris, cultivating the role as energy commentator. Mr. Liveris, who became CEO in 2004, has been aggressively lobbying to shape U.S. policy to Dow's advantage.

Wednesday, Mr. Liveris said that energy policy should focus on increasing local supply of oil and natural gas by increasing permits for drilling and developing alternatives, including renewable energy, coal and nuclear power. He also called for measures to encourage energy efficiency.