



# Inflation Observatory

July 9, 2009

## Inflation in June was better than expected due to non core prices (livestock and energy) and processed foodstuffs. The annual core inflation rate continues on its downward trend

- Headline inflation for June was 0.18% (vs. BBVA forecast of 0.23% and a market forecast of 0.21%); core inflation was 0.28% (BBVA 0.30%, market 0.29%). On a year-on-year basis, general inflation in June was 5.74% (vs. 5.98% in May) and core inflation 5.39% (vs. 5.56%). The two-month fall in the annual core inflation rate is the largest since 2001 (the last economic contraction); this suggests that the downward trend in inflation may continue over the remainder of the year, reaching 4% at the end of 2009 and/or the start of 2010.
- Average annual inflation for the second quarter of the year was 5.96% (core 5.59%), which is within the range projected by the Bank of Mexico for the period (5.75-6.25%).
- Annual core inflation continued its downward trend, supported above all by processed foodstuffs and generic service prices. The only item in core inflation which bucked the general trend was "other goods", prices for which have been rising since the end of 2007. In monthly terms, all items -except "other goods" and "other services", e.g. airline fares- recorded monthly changes which were lower than those recorded in June on a seasonal basis. This is consistent with the recessionary cycle seen over the year so far.
- Non-core controlled (telephony), administered (high consumption electricity) and livestock prices contributed most to the downward trend in bimonthly inflation. Taken together, these prices explain 60% of the decrease in annual inflation in June. The administered and controlled prices may continue contributing to lower annual inflation towards the end of 2009 due to the program of public price discounts announced by the Federal Government and intensified competitive conditions in critical markets (e.g. communication and transport). Agricultural prices continue to be volatile; however, it is still possible that they will also have a favorable effect by the end of the year.
- Outlook: whilst the reduction in inflation has not been as large as we would have expected given the recession and the recent stabilization of the exchange rate, we believe that as the year progresses there will be greater decreases in general and core inflation, and this could continue until early 2010, when it could reach levels of 3.8%. The main factors which could limit the forecast falls continue to be the downward rigidity of prices in certain markets (e.g. other goods and some services) and the volatility of agricultural prices.

### Mexico: Inflation and Contributions

	Var. % anual		Contribution
	May-09	Jun-09	
<b>CPI-Mx</b>	<b>5.98</b>	<b>5.74</b>	<b>-0.24</b>
<b>Core-Mx</b>	<b>4.16</b>	<b>4.03</b>	<b>-0.13</b>
Goods	2.60	2.54	-0.06
Food products	1.24	1.16	-0.07
Other Goods	1.32	1.34	0.03
Services	1.58	1.51	-0.07
Rent	0.60	0.58	-0.03
Education	0.30	0.30	0.00
Other serv.	0.66	0.62	-0.04
<b>Non Core-Mx</b>	<b>1.81</b>	<b>1.70</b>	<b>-0.11</b>
Farm products	1.08	1.09	0.01
Fruits/Vegetables	0.43	0.46	0.03
Meat/Eggs	0.65	0.63	-0.03
Public managed	0.69	0.57	-0.12
Energy	0.23	0.17	-0.06
Controlled prices	0.47	0.41	-0.06

