



# Inflation Observatory

August 7, 2009

**July inflation better than expected by analysts, at 0.27% (BBVA 0.26%, consensus 0.3%), core inflation in line with forecasts at 0.34% (BBVA 0.34%, consensus 0.33%).**

- Headline inflation in July was under the consensus figure and the year-on-year rate fell from 5.74% in June to 5.44% in July. Core annual inflation showed more resistance to the downward trend, dropping from 5.39% to 5.32%. The biggest contribution to the fall in inflation was from non-core products (responsible for 80% of the reduction), particularly livestock products (sensitive to the demand cycle and the drop in international commodity prices, e.g. fodder) and administered and controlled prices (the result of greater competition in communications and a policy of a freeze in public prices). Unlike what could be seen in the previous two-month period, the downward adjustment in annual core inflation was restrained due to greater than estimated increases in tourist services.
- Core annual inflation shows a greater resistance to the downward trend and a relative inflexibility to the low economic growth cycle in some markets ("other services" and "other goods"). Although price increases in "other services" are due to holiday season factors, the size of the increase (0.94% compared with the average of 0.61% for 2003-08) was much greater than that we had considered due to the recessive phase of the economy. Other core prices posted increases similar those expected.
- Non-core controlled (telephony), administered (domestic gas) and livestock (meat and eggs) prices presented a favorable trend. Even the increases in fruit and vegetable prices in the first half of July returned in part to expected levels. Although these prices could contribute to lower inflation throughout 2009, the main risk in these areas is accelerated energy price increases for 2010 resulting from the need to boost public revenues.
- Outlook: So far, inflation movements are in line with our forecasts and the trajectory estimated by the Bank of Mexico. We believe the biggest declines in annual inflation will be seen in September and October this year. Although we consider that annual inflation could reach 3.8% by the end of 2009 or the start of 2008, we should not forget the risks related to the rigidity in domestic markets and the policy on public prices.

Mexico: Inflation and Contributions

	Var. % anual		Contribution
	Jun-09	Jul-09	
<b>CPI-Mx</b>	<b>5.74</b>	<b>5.44</b>	<b>-0.30</b>
Core-Mx	4.03	3.98	-0.05
Goods	2.54	2.51	-0.03
Food products	1.16	1.12	-0.05
Other Goods	1.34	1.37	0.03
Services	1.51	1.50	-0.02
Rent	0.58	0.55	-0.02
Education	0.30	0.29	0.00
Other serv.	0.62	0.63	0.01
Non Core-Mx	1.70	1.45	-0.24
Farm products	1.09	0.98	-0.11
Fruits/Vegetables	0.46	0.45	-0.01
Meat/Eggs	0.63	0.53	-0.10
Public managed	0.57	0.43	-0.14
Energy	0.17	0.11	-0.07
Controlled prices	0.41	0.34	-0.07

Mexico: CPI forecast by components

	Monthly change (%)			Annual change (%)		
	May-09	Jun-09	Jul-09	May-09	Jun-09	Jul-09
<b>CPI-Mx</b>	<b>-0.29</b>	<b>0.18</b>	<b>0.26</b>	<b>5.98</b>	<b>5.74</b>	<b>5.43</b>
Core-Mx	0.26	0.28	0.34	5.56	5.39	5.33
Goods	0.54	0.34	0.24	7.02	6.87	6.80
Food products	0.57	0.23	0.16	8.42	7.93	7.60
Other Goods	0.52	0.43	0.29	5.89	6.00	6.13
Services	-0.01	0.23	0.45	4.20	4.01	3.96
Rent	0.14	0.14	0.15	3.38	3.22	3.09
Education	0.10	0.07	0.11	5.77	5.67	5.60
Other serv.	-0.23	0.41	0.92	4.50	4.24	4.28
Non Core-Mx	-1.79	-0.10	0.03	7.17	6.72	5.70
Farm products	-0.03	-0.20	0.07	13.39	13.47	11.85
Fruits/Vegetab	-0.15	-0.08	1.50	13.03	14.08	12.93
Meat/Eggs	0.04	-0.28	-0.90	13.62	13.09	11.09
Public managed	-2.74	-0.03	0.00	4.01	3.32	2.58
Energy	-4.98	0.10	0.03	2.99	2.24	1.45
Controlled price	-0.43	-0.17	-0.02	5.03	4.41	3.72
	Current Forecast			Current Forecast		