

Mexico

Economic Watch

January 7, 2011

December brings surprising rise in inflation. Year ends at lower end of Banxico forecast

Economic Analysis

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December 2010 inflation

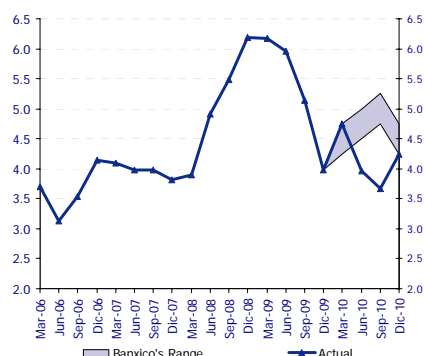
- **December saw a surprising 0.50% rise in inflation, above the consensus estimate (0.36%) and BBVA Research forecast (0.29%)**
- **In December foodstuff and agricultural product prices were the main factors that pushed inflation up.**
- **Average inflation in 4Q10 stood at 4.25%, at the lower end of the Banxico forecast for the period between 4.75% and 4.25%**

In December headline inflation rose by 0.5% mom, equivalent to 4.4% yoy, which represents a slight increase from 4.32% yoy in November. Core inflation rose by 0.47% mom, meaning that in annual terms it ended at 3.61%. This is a similar rate to the one recorded in November (3.63%). In December core inflation was affected by foodstuff price increases, with noteworthy rises in the price of cigarettes and tortillas. The rise in cigarette prices was influenced by the increase in the IEPS tax on this product, approved this year and which is to come into force in January 2011. In the non-core component, the main pressure factors were agricultural prices, driven by the rise in products such as lemons, bananas and grapes, not to mention the planned monthly increase in petrol prices. Monthly inflation in December 2010 surprised the market because, with the results for the first half of the month, which were lower than expected, it seemed that the upward inflation trend since October would come to an end.

Average inflation for the fourth quarter came in at 4.25%, right at the lower end of the latest Banxico forecast for the period between 4.25% and 4.75%. It is worth mentioning that Banxico considerably increased its forecast for 4Q10, which predicted average inflation for the quarter between 4.75% and 5.25%. Inflation performance in 2010 can therefore be described as satisfactory, because the tax increase approved at the end of 2009 and the freezing of public prices had a limited effect on the core component. Core inflation dropped constantly in annual terms between January and September, going on to stabilize around 3.60% during the remaining months. This reduction was largely due to exchange rate stabilization and persistently flat domestic demand caused by the recession.

In 2011 we expect inflation to be within the central bank's target range of 3%, +/- 1 pp. This outlook is based on a situation in which as well as no exchange pressure, we expect the exchange rate to appreciate compared to 2010, as long as the foreign capital inflow to domestic markets continues. We also expect possible demand pressure to continue to be limited. This scenario does not come risk-free, because external pressure such as increases in commodity markets could continue to gain momentum throughout the year.

Chart 1
Verified inflation and Banxico expected range (% yoy change, by quarter)



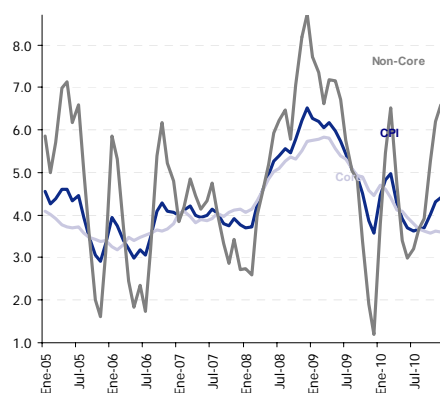
Source: BBVA Research with Banxico data

Table 1
Inflation breakdown (% yoy monthly and annual)

	Peso (%)	Monthly change (%)			Annual change (%)		Dif. (pp)
		Avg. jul 2003-09	Dic-09	Dic-10	Nov-10	Dic-10	
CPI-Mx	100.0	0.41	0.73	0.50	4.32	4.40	0.08
Core-Mx	74.8	0.50	0.34	0.47	3.63	3.61	-0.02
Goods	37.0	0.35	0.36	0.48	3.69	3.82	0.13
Food products	14.7	0.54	0.56	1.08	3.80	4.35	0.56
Other Goods	22.4	0.20	0.21	-0.02	3.59	3.37	-0.22
Services	37.7	0.63	0.32	0.47	3.58	3.41	-0.17
Rent	17.9	0.28	0.23	0.17	2.75	2.64	-0.12
Education	5.2	0.01	0.00	0.00	4.65	4.64	-0.01
Other serv.	14.7	1.31	0.57	1.00	4.07	3.76	-0.31
Non Core-Mx	25.2	0.18	1.80	0.55	6.20	6.60	0.39
Farm products	8.1	0.11	0.20	1.41	5.59	6.96	1.37
Fruits/Vegetables	3.3	-0.83	-0.02	2.64	10.15	14.00	3.85
Meat/Eggs	4.8	0.72	0.39	0.55	2.64	2.46	-0.18
Public managed	17.2	0.22	2.61	0.11	6.52	6.41	-0.12
Energy	7.8	0.46	5.29	0.25	6.67	6.44	-0.23
Controlled prices	9.4	-0.04	-0.03	-0.04	6.37	6.37	0.00

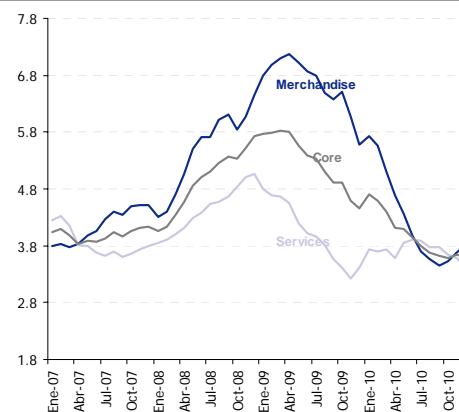
Source: BBVA Research with Banxico data

Chart 2
General inflation and components (% yoy change)



Source: BBVA Research with Banxico data

Chart 3
Core inflation breakdown (% yoy change)



Source: BBVA Research with Banxico data

Table 2
Inflation forecast for January 2011 (% yoy and mom change)

	Peso (%)	Monthly change (%)			Annual change (%)		
		Average 2003-2009	Nov-10	Dic-10	Nov-10	Dic-10	Ene-11
CPI-Mx	100.0	0.48	0.80	0.50	4.32	4.40	3.85
Core-Mx	74.8	0.40	0.25	0.47	3.63	3.61	3.39
Goods	37.0	0.41	0.35	0.48	3.69	3.82	3.53
Food products	14.7	0.73	0.54	1.08	3.80	4.35	4.44
Other Goods	22.4	0.17	0.19	-0.02	3.59	3.37	2.89
Services	37.7	0.39	0.16	0.47	3.58	3.41	3.26
Rent	17.9	0.19	0.13	0.17	2.75	2.64	2.42
Education	5.2	0.01	0.00	0.00	4.65	4.64	4.64
Other serv.	14.7	0.78	0.28	1.00	4.07	3.76	3.63
Non Core-Mx	25.2	0.70	2.31	0.55	6.20	6.60	5.12
Farm products	8.1	1.53	1.38	1.41	5.59	6.96	5.41
Fruits/Vegetables	3.3	2.00	3.08	2.64	10.15	14.00	9.99
Meat/Eggs	4.8	1.28	0.23	0.55	2.64	2.46	2.36
Public managed	17.2	0.30	2.80	0.11	6.52	6.41	4.98
Energy	7.8	0.49	5.50	0.25	6.67	6.44	5.80
Controlled prices	9.4	0.09	0.03	-0.04	6.37	6.37	4.01

Source: BBVA Research with Banxico data

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