

Mexico

Economic Watch

February 24, 2011

Inflation in the first two weeks of February: in line with expectations but pressures persist

Economic Analysis

Inflation for the first two weeks of February 2011

- **Inflation increased 0.21% over two weeks, in annual terms; it fell from 3.78% in January to 3.63% in the first two weeks of February.**
- **Core inflation increased 0.21% over two weeks driven by the persistent increase in tortilla prices and higher than expected service prices.**
- **Non-core inflation rose 0.15% q/q due to the increase in some agricultural prices which were partially offset by falls in other prices, as well as lower-than expected government rates.**

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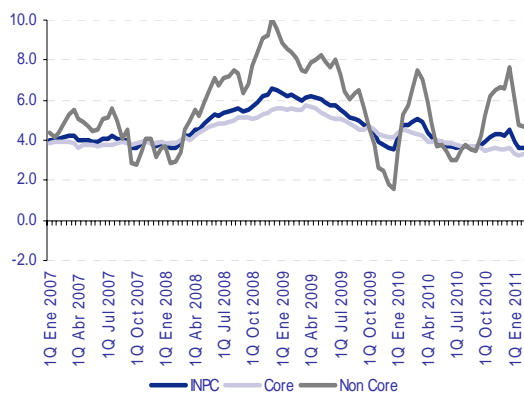
Inflation in the first two weeks of February 2011 was in line with market forecasts (0.22%) and BBVA Research (0.21%), increasing by 0.21% over two weeks, coming in at an annual rate of 3.63% (vs. 3.71% in January).

Non-core inflation increased by 0.22% over two weeks, placing the annual rate at 3.28% and remaining stable with regard to January (3.27%/y). The increase was due to the persistent increases in tortilla prices, which contributed to the processed food index rising 0.34% over two weeks – higher than expected. In turn, services rose 0.11% over two weeks due to increases seen in dinners and cafeterias as well as upward moves in cell phone service. Core inflation was affected in recent weeks by increases in tortilla prices; however, while international price hikes in other grains such as wheat are not passed on to other processed foods, the rate should stabilize in coming weeks. In turn, while the consumer recovery remains sluggish, the prices of other goods and services should remain stable.

Non-core inflation increased 0.15% over two weeks, this component reduced annually from 5.4% in January to 4.7% in the first two weeks of February. Agricultural product prices were expected to increase due to losses in production in Sinaloa state thanks to recent frost spells. However, this failed to materialize since this was partially offset by falls in product prices from other areas of the nation such as limes, zucchini, potatoes, string beans, vegetable pears and prickly pears. The agricultural products index thus fell -1.12%. Livestock products increased 0.67% over two weeks which could reflect increases to production costs due to higher grain prices across the world. Government tariffs saw a good performance, increasing 0.16% over two weeks thanks to moderate rises in electricity, water and urban transport prices. The reduced agricultural offer is set to moderate the intensity of the fall in those prices in the first quarter; however, this could be temporary since increases in affected products creates incentives to intensify sowing in other regions, thus production could improve in coming cycles. The moderate increases in government tariffs are favorable for inflation moves which, if they continue, could partly offset the increases in energy and agricultural product prices.

Although inflation has started the year under the effects of some climate and external factors, we believe that as long as these are temporary it may still end the year under 4%. However, we see an upward bias while uncertainty in international and domestic markets intensifies. We maintain our forecast that inflation will be around 3.9% at the end of the year.

Chart 1
General inflation and components
(% change y/y, bi-weekly series)



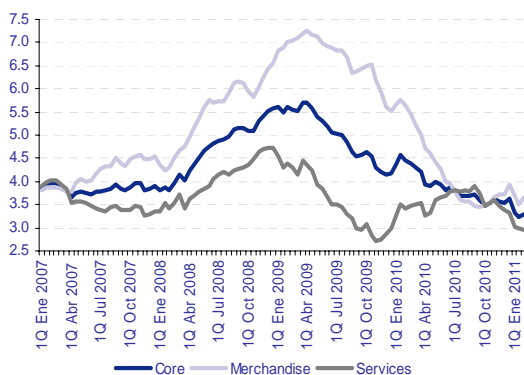
Source: BBVA Research with Banxico data

Table 1
Inflation breakdown
(% change bi-weekly)

	Avg bi-week 2003-2009	Bi-weekly Feb 2011	Bi-weekly Feb 2011	YoY % chg. Bi-weekly Feb 2011
CPI-Mx	0.16	0.18	0.21	3.63
Core-Mx	0.23	0.17	0.22	3.28
Goods	0.25	0.23	0.37	3.66
Food products	0.27	0.15	0.34	4.63
Other Goods	0.24	0.29	0.38	2.89
Services	0.20	0.11	0.11	2.97
Rent	0.25	0.18	0.10	2.18
Education	0.19	0.13	0.04	4.50
Other serv.	0.17	0.05	0.13	3.18
Non Core-Mx	-0.04	0.24	0.15	4.71
Farm products	-0.35	-0.61	-0.08	3.18
Fruits/Vegetables	-1.61	-1.59	-1.12	4.86
Meat/Eggs	0.48	0.06	0.67	2.17
Public managed	0.15	0.77	0.28	5.51
Energy	0.00	0.72	0.34	5.82
Government Authorized	0.41	0.87	0.16	4.99

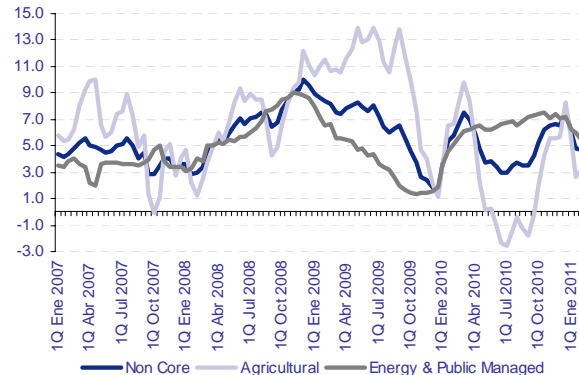
Source: BBVA Research with Banxico data and the Banamex survey data

Chart 2
Core inflation breakdown
(% change y/y, bi-weekly series)



Source: BBVA Research with Banxico data

Chart 3
Non-core inflation breakdown
(% variation y/y, bi-weekly series)



Source: BBVA Research with Banxico data

Table 2
Inflation forecast breakdown for February
(% variation bi-weekly and y/y)

	Peso							
	Average (%)	Monthly change (%)			Annual change (%)			Feb-11
		2003-2009	Dic-10	Ene-11	Feb-11	Dic-10	Ene-11	
CPI-Mx	100.0	0.31	0.50	0.49	0.38	4.40	3.78	3.58
Core-Mx	74.8	0.42	0.43	0.46	0.43	3.58	3.27	3.29
Goods	37.0	0.43	0.48	0.73	0.51	3.82	3.60	3.68
Food products	14.7	0.50	1.08	1.41	0.61	4.35	4.51	4.71
Other Goods	22.4	0.39	-0.02	0.20	0.44	3.38	2.88	2.88
Services	37.7	0.41	0.39	0.23	0.36	3.36	3.00	2.96
Rent	17.9	0.48	0.17	0.23	0.23	2.64	2.34	2.14
Education	5.2	0.35	0.00	0.31	0.26	4.64	4.62	4.61
Other serv.	14.7	0.37	0.74	0.21	0.53	3.58	3.06	3.16
Non Core-Mx	25.2	-0.06	0.70	0.57	0.22	7.09	5.39	4.46
Farm products	8.1	-0.63	1.41	-0.27	-0.26	6.96	4.03	2.84
Fruits/Vegetables	3.3	-2.93	2.64	-0.82	-1.11	14.00	7.50	4.48
Meat/Eggs	4.8	0.94	0.55	0.18	0.40	2.46	1.77	1.83
Public managed	17.2	0.29	0.25	0.98	0.49	7.16	6.15	5.36
Energy	7.8	0.00	0.25	0.92	0.52	6.44	6.12	5.84
Controlled prices	9.4	0.78	0.25	1.11	0.34	8.39	6.20	4.49
								<i>Biweekly Revision</i>

Source: BBVA Research with Banxico data

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