

## Mexico

## Economic Watch

March 9, 2011

## Inflation: no surprises in February, and it should stop dropping in March

## Economic Analysis

## February 2010 inflation

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- The CPI rose by 0.38% m/m and continued to slow down in annual terms from 3.78% in January to 3.57% in February
- The core index rose by 0.40% m/m (BBVA Research: 0.44%; market: 0.43%), and the price of the tortilla was once again one of the main factors driving inflation up.
- Non-core inflation was 0.28% m/m, falling in annual terms from 5.39% in January to 4.53% in February. Agricultural prices were hit by the frost spell in the State of Sinaloa.
- In March inflation will reach 3.3%, rising in 2Q11 to 4% in 3Q11 and 3.9% in 4Q11. This scenario is characterized by an upward trend due to higher-than-expected increases in the price of imported commodities. However, lower inflation in 2011 than in 2010.

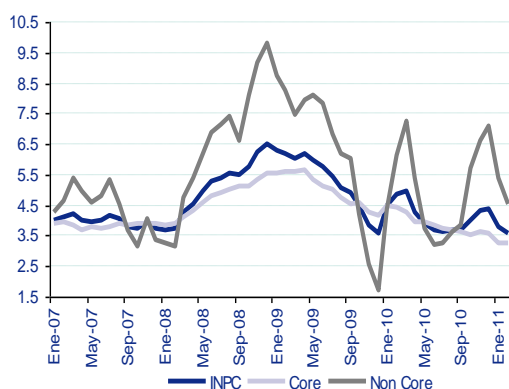
Inflation in February was 0.38% (3.57% y/y), in line with our estimate and with the market's forecast. Some pressures on its two main sub-indices prevented inflation from falling more intensely in annual terms, given the favorable effect of comparison with the previous year, when prices were affected by changes to fiscal policy.

Core inflation was 0.4% m/m and 3.26% y/y, so it remained stable compared to January (3.27%). The prices of processed foodstuffs rose by 0.68% m/m and were once again affected by the price of the tortilla (2.1% m/m). Non-food goods rose by 0.43% due to the end of various sales offered in January by a number of retail outlets. Services rose by 0.3% m/m, equivalent to 2.9% y/y, and continued to slow down from the peak reached last September (3.82%). Core inflation was affected recently by temporary factors such as increased scarcity of corn worldwide, which has driven up the prices of high-impact products like the tortilla; however, weak demand and the appreciation of the peso should contribute to keep it in check.

Non-core inflation was 0.28% m/m, an increase higher than its historical trend for February (0.0%). This result was due to adverse weather conditions in the north of the country, which affected the prices of agricultural products like the tomato, which rose by 17.5% m/m. This prevented agricultural prices from falling more intensely (-0.86% m/m). Public and energy prices rose by 0.45% m/m reaching an annual rate of 5.32%, below the 6.15% recorded in January.

Increased scarcity of corn worldwide and the frost spells in the north of Mexico have affected inflation in the first months of 2011. In addition, the pressures on other grain markets and the rise in the prices of imported commodities are factors to be considered as potential upward pressures. The fundamental factors for keeping inflation moderate, such as the scope for preventing demand recovery from generating pressures on prices and on the appreciation in the exchange rate, still subsist. Thus, despite a context of greater uncertainty, we believe that there is room for maintaining our inflation forecast for the upper band of the variability range set by Banxico for the price stability target, with 2011 closing at 3.9% y/y. However, given the possible continuity of these risks, we have given our forecast an upward bias, with greater likelihood of inflation exceeding the forecast, rather than not reaching it. At any rate, even if the risks of inflation rising do materialize, it should be lower in 2011 than in 2010.

Chart 1  
**General inflation and components**  
(% y/y change)



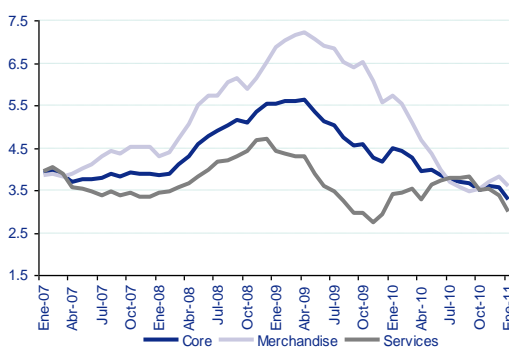
Source: BBVA Research with Banxico data

Table 1  
**Inflation breakdown**  
(% m/m and y/y change)

	Weight	MoM % Chg.				YoY % Chg.		
		Feb-09	Feb-10	Feb-11	Average Feb 03-09	Dic-10	Ene-11	Feb-11
<b>CPI</b>	<b>100.00</b>	<b>0.22</b>	<b>0.58</b>	<b>0.38</b>	<b>0.35</b>	<b>4.40</b>	<b>3.78</b>	<b>3.57</b>
<b>Core</b>	<b>74.77</b>	<b>0.47</b>	<b>0.41</b>	<b>0.40</b>	<b>0.42</b>	<b>3.58</b>	<b>3.27</b>	<b>3.26</b>
<b>Merchandise</b>	<b>37.03</b>	<b>0.60</b>	<b>0.43</b>	<b>0.53</b>	<b>0.44</b>	<b>3.82</b>	<b>3.60</b>	<b>3.71</b>
Processed Food	14.67	0.30	0.42	0.68	0.51	4.35	4.51	4.78
Other Merchandise	22.35	0.84	0.44	0.43	0.40	3.38	2.88	2.86
<b>Services</b>	<b>37.74</b>	<b>0.35</b>	<b>0.40</b>	<b>0.29</b>	<b>0.40</b>	<b>3.36</b>	<b>3.00</b>	<b>2.89</b>
Housing	17.86	0.52	0.42	0.20	0.44	2.64	2.34	2.12
Education	5.20	0.40	0.26	0.14	0.32	4.64	4.62	4.49
Other Services	14.68	0.17	0.43	0.43	0.38	3.58	3.06	3.07
<b>Non-Core</b>	<b>25.23</b>	<b>-0.56</b>	<b>1.11</b>	<b>0.28</b>	<b>0.11</b>	<b>7.09</b>	<b>5.39</b>	<b>4.53</b>
Farm Produce	8.07	-1.37	0.90	-0.01	-0.39	6.96	4.03	3.09
Fruits/Vegetables	3.27	-5.64	1.74	-0.86	-2.18	14.00	7.50	4.76
Meats	4.80	1.33	0.33	0.60	0.84	2.46	1.77	2.04
<b>Energy &amp; Govt.</b>	<b>17.17</b>	<b>-0.05</b>	<b>1.24</b>	<b>0.45</b>	<b>0.41</b>	<b>7.16</b>	<b>6.15</b>	<b>5.32</b>
Energy	7.77	-0.39	0.79	0.57	0.16	6.44	6.12	5.88
Govt. Fees	9.39	0.52	1.99	0.24	0.86	8.39	6.20	4.38

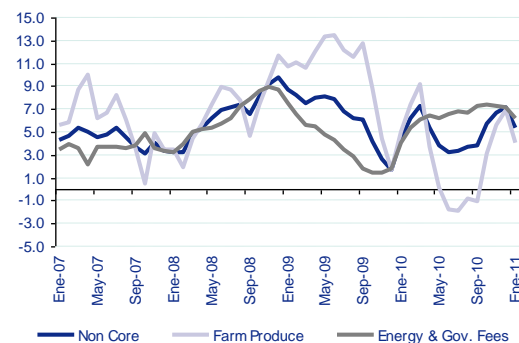
Source: BBVA Research with Banxico data and the Banamex survey data

Chart 2  
**Core inflation and components**  
(% y/y change)



Source: BBVA Research with Banxico data

Chart 3  
**Non-core inflation and components**  
(% y/y change)



Source: BBVA Research with Banxico data

Table 2  
**Inflation forecast breakdown for March**  
(% m/m and y/y change)

	Peso	Var. % mensual				Var. % anual		
		prom. Mar 2003-09	09	Ene-11	Feb-11	Mar-11	Ene-11	Feb-11
<b>INPC</b>	<b>100.0</b>	<b>0.44</b>	<b>0.49</b>	<b>0.38</b>	<b>0.43</b>	<b>3.78</b>	<b>3.57</b>	<b>3.28</b>
<b>Subyacente</b>	<b>76.7</b>	<b>0.39</b>	<b>0.46</b>	<b>0.40</b>	<b>0.38</b>	<b>3.27</b>	<b>3.26</b>	<b>3.29</b>
Mercancías	34.5	0.39	<b>0.73</b>	<b>0.53</b>	0.40	3.60	3.71	3.88
Alimentos	14.8	0.45	<b>1.41</b>	<b>0.68</b>	0.51	4.51	4.78	5.15
Otras merc.	19.7	0.34	<b>0.20</b>	<b>0.43</b>	0.31	2.88	2.86	2.89
Servicios	42.2	0.40	<b>0.23</b>	<b>0.29</b>	0.37	3.00	2.89	2.80
Habitación	18.7	0.39	<b>0.23</b>	<b>0.20</b>	0.18	2.34	2.12	2.06
Educación	18.4	0.11	<b>0.31</b>	<b>0.14</b>	0.07	4.62	4.49	4.49
Otros serv.	5.1	0.50	<b>0.21</b>	<b>0.43</b>	0.65	3.06	3.07	2.89
<b>No subyacente</b>	<b>23.3</b>	<b>0.60</b>	<b>0.57</b>	<b>0.28</b>	<b>0.59</b>	<b>5.39</b>	<b>4.53</b>	<b>3.24</b>
Agropecuarios	8.5	0.80	<b>-0.27</b>	<b>-0.01</b>	0.77	4.03	3.09	0.32
Agrícolas	3.7	0.76	<b>-0.82</b>	<b>-0.86</b>	1.16	7.50	4.76	-2.29
Pecuarios	4.8	0.86	<b>0.18</b>	<b>0.60</b>	0.47	1.77	2.04	2.29
Públicos	14.8	0.48	<b>0.98</b>	<b>0.45</b>	0.49	6.15	5.32	5.01
Energéticos	9.5	0.50	<b>0.92</b>	<b>0.57</b>	0.57	6.12	5.88	5.75
Tarifas	5.3	0.44	<b>1.11</b>	<b>0.24</b>	0.26	6.20	4.38	3.69
					Revisión Quincenal			Revisión Quincenal

Source: BBVA Research with Banxico data

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