

Economic Watch

Mexico

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Economic Analysis

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The downward surprise in the first half of May slows the annual increase in inflation

Inflation for the first two weeks in May 2011

- **With bigger than expected reductions in electricity tariffs and agricultural products the National CPI fell by 0.75% in the first half of May to 3.3% year-on-year (3.4% in April)**
- **Core inflation was up 0.07% on the previous half-month, less than the expected figure (0.12% consensus and BBVA Research) due above all to limited rises in non-food goods**
- **This favorable surprise in inflation in a month that is particularly significant due to the annual comparison effect, eases the Banxico balance of risks and makes it more likely that inflation will be within a range of 3.6-3.9% at the end of the year, rather than the 4.1% forecast up to now**

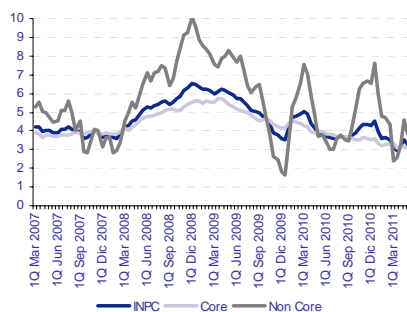
The National CPI fell by 0.75% in the first half of May on the previous half-month, more than expected by BBVA Research (-0.50%) or by the consensus of analysts (-0.42%). The main elements supporting this reduction were in the non-core index, where there were surprising falls in electricity tariffs and agricultural products. On the core inflation side, despite persistent pressure from food prices, other goods remain well in check (0.13% up on the previous half-month), which helped reduce core inflation to 3.07% year-on-year (3.18% in April).

In contrast, food prices increased by 0.28% in the half-month. However, it is important to note that for the first time in a number of half-months, the price of tortillas was not among the biggest rises. Prices of other goods remained practically stable (0.01% on the half-month), supported by a reduction of 0.38% in car prices. Prices of services continued favorable (up only 0.02% in the half-month), as expected, with a seasonal reduction in prices of tourist services of 2.21% following the Easter holiday. Apart from pressure from processed foods, caused by increases in commodity prices on international markets, core inflation is still on the positive trend it has shown so far this year, supported by continued sluggish domestic demand and a stable and strengthened exchange rate.

The non-core element of the National CPI fell by 3.49% in the half-month, thanks to the reduction of 6.75% in agricultural prices and 18.81% in electricity services. These are seasonal falls that were already expected, although their size was not. Prices of livestock products were under pressure and increased by 0.35% in the half-month, which could reflect the pressure on prices of basic supplies for the industry, such as corn.

Thus the falls in the basket of non-core prices propped up the positive performance of most of the core components, and annual inflation fell by 3.4% in April to 3.3% in the first half of May, thus breaking a series of rises that had been discounted by the market. The chance of inflation closing the year at below 4% has therefore increased. In a context of exchange-rate stability and declining slack in factor markets this represents a downward bias on Banxico's balance of inflationary risks.

Chart 1

Headline inflation and components (% y/y change, bi-weekly series)


Source: BBVA Research with Banxico data

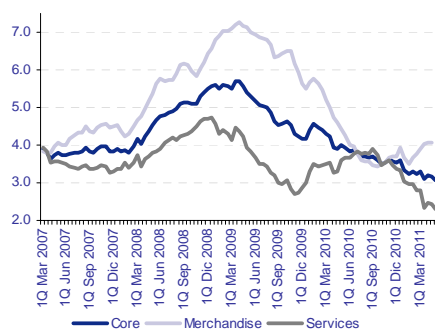
Table 1:

Inflation breakdown (% y/y and m/m change)

	Bi-weekly Avg. May 2003-2009	Bi-weekly May 2010	Bi-weekly May 2011	YoY % chg. Bi-weekly May 2011
CPI-Mx	0.02	-0.75	-0.75	3.29
Core-Mx	0.17	0.07	0.07	3.07
Goods	0.17	0.13	0.13	4.01
Food products	0.22	0.28	0.28	6.11
Other goods	0.14	0.01	0.01	2.39
Services	0.16	0.02	0.02	2.30
Rent	0.16	0.09	0.09	2.14
Education	0.06	0.00	0.00	4.43
Other serv.	0.19	-0.03	-0.03	1.67
Non Core-Mx	-0.50	-3.49	-3.49	3.82
Farm products	0.13	-2.70	-2.70	4.40
Fruits/Vegetables	0.34	-6.75	-6.75	7.39
Meat/Eggs	0.04	0.35	0.35	2.62
Public managed	-0.89	-3.95	-3.95	3.53
Energy	-1.50	-6.36	-6.36	4.29
Government Authorized	0.15	0.30	0.30	2.83

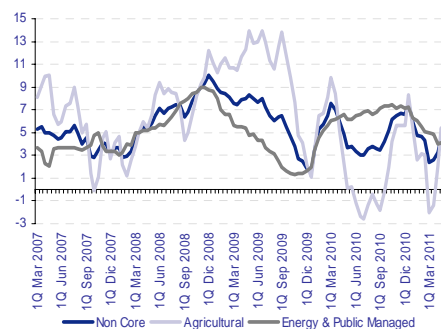
Source: BBVA Research with Banxico data

Chart 2

Core inflation and components (% y/y change, bi-weekly series)


Source: BBVA Research with Banxico data

Chart 3

Non-core inflation and components (% y/y change, bi-weekly series)


Source: BBVA Research with Banxico data

Chart 1

Inflation forecast for May (% y/y and m/m change)

	Peso (%)	Monthly change (%)				Annual change (%)			
		2003- 2009	Mar-11	Abr-11	May-11	Mar-11	Abr-11	May-11	
CPI-Mx	100.0	-0.31	0.19	-0.01	-0.66	3.04	3.36	3.33	
Core-Mx	74.8	0.24	0.30	0.08	0.12	3.21	3.18	3.06	
Goods	37.0	0.33	0.48	0.35	0.23	3.97	4.07	4.07	
Food products	14.7	0.48	0.90	0.58	0.55	5.55	5.98	6.28	
Other Goods	22.4	0.22	0.17	0.17	0.00	2.75	2.60	2.37	
Services	37.7	0.16	0.15	-0.15	0.03	2.57	2.44	2.24	
Rent	17.9	0.28	0.21	0.20	0.17	2.10	2.19	2.11	
Education	5.2	0.10	0.04	0.07	0.03	4.46	4.47	4.41	
Other serv.	14.7	0.07	0.11	-0.56	-0.11	2.34	1.93	1.56	
Non Core-Mx	25.2	-2.18	-0.16	-0.28	-3.26	2.46	3.90	4.03	
Farm products	8.1	-0.48	-1.25	3.06	-2.25	-1.69	3.70	4.99	
Fruits/Vegetables	3.3	-1.21	-3.05	7.22	-6.00	-6.36	5.71	8.43	
Meat/Eggs	4.8	0.02	0.05	0.16	0.60	1.86	2.33	2.97	
Public managed	17.2	-3.21	0.44	-2.11	-3.84	4.96	4.04	3.50	
Energy	7.8	-5.20	0.76	-3.25	-6.20	5.96	5.00	4.27	
Controlled prices	9.4	0.10	-0.15	-0.03	0.32	3.27	2.62	2.81	
					Bi-weekly Revision			Bi-weekly Revision	

Source: BBVA Research with Banxico data

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