

Inflation Flash

Mexico

December 2011 inflation, above market consensus: the raise in costs outweighs the lack of pressure from domestic demand

- **CPI: Observed: 0.82% mom vs BBVA: 0.71% mom Consensus: 0.72% mom**
- **Core: Observed:0.51% mom vs BBVA: 0.44% mom Consensus:0.48% mom**
- **Inflation ends 2011 accentuating its recent upwards trend driven by its more volatile components. The pressure from rising import costs and energy prices outweighs the lack of demand pressures.**
- **The merchandise subindex accelerates and not just because of food prices, reflecting the impact of exchange rate in prices of other merchandise.**
- **However the services subindex remains well bounded, reflecting that demand is not the main pressure source over prices**
- **For 2012, in a moderate growth scenario, inflation will end up adjusting towards Banxico's price stability objective, despite that the CPI inflation might break over 4% during the second and third quarters.**

During December inflation raised 0.82% mom closing the year at 3.82% yoy. Despite its recent acceleration, the annual outcome is a success given that all through 2011, prices remained below 4% which is the upper bound of Banxico's variability range for its 3% objective.

Core inflation raised 0.51% mom reaching 3.35% yoy. Within its components food prices remained pressured and raised 0.99% mom, despite its annual rate dropped due to the effect of the increase in taxes for cigarettes (IEPS) in December 2010. Additionally the prices of the rest of merchandise were pressured and increased 0.42% mom, causing its annual rate to accelerate from 2.0% yoy in November to 2.4% yoy in December which indicates a trend change in the component. On the other hand services prices raised 0.37% mom reaching an annual rate of 2.4 yoy the same it had in November, showing that services prices keep responding to a demand that grows slowly. Core prices have accelerated slightly because merchandises are being affected by the high cost of commodities and exchange rate pass through, however, given that domestic demand is not an upwards pressure factor yet, this upturn will be limited.

Non Core Inflation raised 1.86% mom reaching an annual rate of 5.3% yoy an increase from November's 4.1% yoy. Within it agricultural prices are increasing since we are near the low yield of the two year crop cycle. Additionally the prices of livestock are reacting to the high prices of commodities in combination to the Peso depreciation. Finally within the Public Prices subindex, there is a divergence between energy prices (upwards, particularly electric tariffs) and the tariffs set by local governments which remain low and stable at 2.4% yoy. Non Core prices will remain pressured in the near term because of supply shocks in agricultural markets, the high prices of commodities globally and the Peso depreciation, because of this we estimate they will be the main upwards factor to inflation.

Inflation keeps accelerating in annual terms, however we consider that this growth is caused mainly by volatile factors (supply shocks, higher imports costs), that will impact prices with greater strength during the second and third quarters of 2012. However despite that the possibility of inflation breaking over 4% during lapses of 2012 is high, we consider it fundamentally bounded given that internal demand will not constitute an upwards pressure factor, and because of this we consider that inflation will close 2012 within Banxico's variability range. On average inflation for 2012 could be around 4%, 0.6 pp above the 2011 average.

Table 1

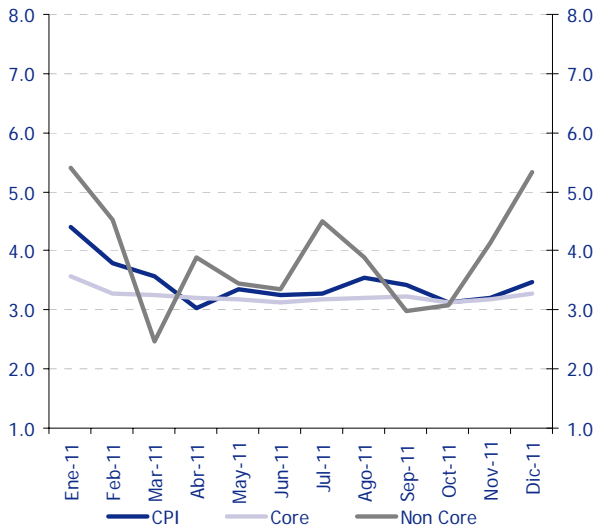
Inflation (m/m and y/y % change)

	mom % Change			yoy % Change	
	Dic-11	Consensus	BBVA	Nov-11	Dic-11
CPI	0.82	0.72	0.71	3.48	3.82
Core	0.51	0.48	0.44	3.28	3.35
Non Core	1.86	1.51	1.60	4.13	5.34

Source: BBVA Research with INEGI data

Chart 1

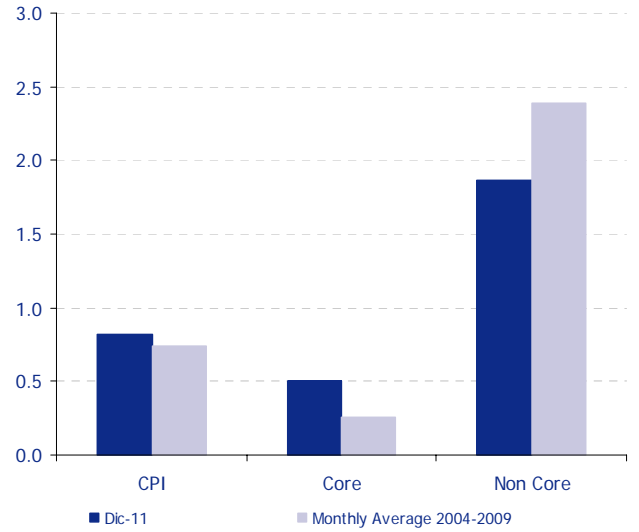
General Inflation and Components (y/y % change)



Source: BBVA Research with INEGI data

Chart 2

General Inflation and Components (m/m % change)



Source: BBVA Research with INEGI data

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