

Mexico Inflation Flash

April's biweekly inflation: volatile prices produce a new downwards surprise that lowers inflation to 3.4%

General: Actual: -0.42% f/f vs. BBVA:-0.08% f/f Consensus:-0.07% f/f

Core: Actual: 0.03% f/f, vs. BBVA:0.03% f/f Consensus:0.09% f/f

- **The most volatile prices push inflation further within Banxico's variability range, improving the inflation outlook for 2012.**
- **Inflation will most likely remain within Banxico's variability range all year, because it won't be pressured and it has space to absorb potential increases of its most volatile components**
- **We maintain our stand that the fondeo rate will remain unchanged next Friday April 27th. However, the possibility of a rate cut is clearly open.**

During April's first fortnight headline inflation reduced -0.42% f/f below market expectations and BBVA Research's forecast. Core inflation increased 0.03% slightly below market expectations and in line with our forecast. Therefore most of the downwards surprise was caused by non-core inflation which reduced -1.88% f/f.

Core inflation remained stable at an annual rate of 3.34%. The manufactures component raised 0.17% f/f and remained unchanged in annual terms at 4.44%. The food component reduced its annual inflation from 6.53% in the previous fortnight to 6.4%, however this was compensated by slight increases in the non-food component from 2.86% y/y to 2.94% y/y. Lower grain prices should drive manufactures further down in annual terms in coming months, because even if an exchange rate depreciation should occur it will have limited effects on this prices. The services subindex remained practically unchanged (3.44% from the 3.47% in the previous fortnight) as its housing component (1.9% y/y), while the education and other services components reduced slightly and reached 4.32% y/y and 2.43% y/y respectively. Core inflation is performing according to the lack of demand pressures in the economy, lower grain prices and limited exchange rate pass through, so at this point we expect it to consolidate around its current level in annual terms.

Non core inflation reduced from 4.96% y/y in the previous fortnight to 3.57% y/y. This strong reduction was caused by the continued favorable performance of agricultural (-2.36% f/f) and livestock (0.05% f/f) prices both of which reduced in the period. Energy prices reduced -3.65% in the fortnight due to the seasonal decreases in electric tariffs that take place during spring.

The most volatile prices are pushing inflation further within Banxico's variability range (3% +-1%), and despite they drove inflation upwards at the end of 2011, their recent behavior has already improved the outlook for 2012. Inflation will most likely remain within Banxico's variability range all year, because it won't be pressured by its core component until the economy starts growing at a pace that generates demand pressures. In this way it has space to resist possible offer shocks that could cause spikes in the non core component without forcing general inflation above the 4% bound.

In light of today's inflation figure we maintain our stand that the fondeo rate will remain unchanged next Friday April 27th. It is undeniable that the inflation scenario that arises from this downward prices surprise supports the view of the Board Members that consider a rate cut advisable. However, as it was stressed in previous publications, the debate about the credibility costs that could arise from a rate cut as inflation remains above the 3% target is an element that cannot be dismissed. In addition, we do not expect that the FED statement that will be released tomorrow changes significantly the domestic tightening with respect to other countries'. Therefore, **we claim that the monetary pause will remain, but we expect a more dovish Banxico statement that stresses the possibility of a rate cut.**

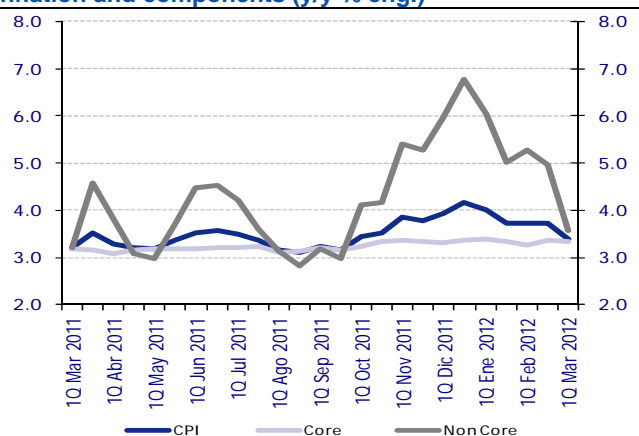
Table 1

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

	Bi-weekly % chg.			Annual % chg.		
	1F Abr 2012	Consensus	BBVA Research	1F Abr 2012	Consensus	BBVA Research
CPI	-0.42	-0.07	-0.08	3.40	3.76	3.75
Core	0.03	0.09	0.03	3.34	3.41	3.35
Non Core	-1.88	-0.60	-0.44	3.57	4.92	5.09

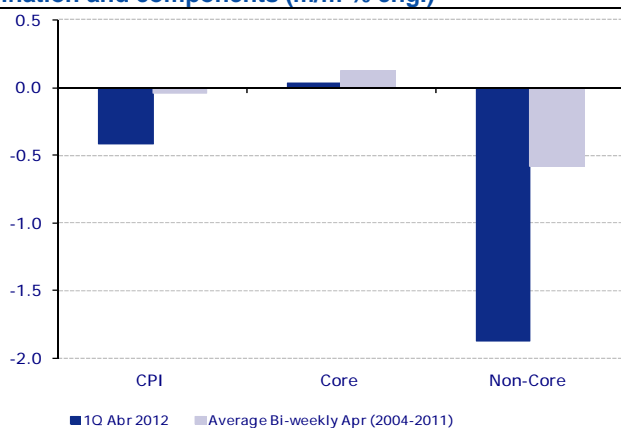
Source: BBVE Research

Graph 1

Inflation and components (y/y % chg.)

Source: BBVA Research

Graph 2

Inflation and components (m/m % chg.)

Source: BBVA Research

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