

Mexico Inflation Flash

Inflation surprises downwards during September's first half due to favorable outcomes within core inflation.

General: Actual: 0.22% f/f vs. BBVA: 0.25% f/f Consensus: 0.32% f/f

Core: Actual: 0.12% f/f, vs. BBVA: 0.20% f/f, Consensus: 0.25% f/f

- **Unexpectedly core inflation reduced in annual terms during September's first fortnight due to lower pressures within its merchandise component and very positive outcomes within its services component**
- **Pressures within livestock prices keep pushing Non-core inflation upwards; however they seem milder than in the previous months.**
- **We expect inflation will reduce in the 4Q12, and end the year around 4%, however if further supply shocks arise, it might reduce less than we expect.**

During September's first fortnight inflation turned out lower than expected increasing 0.22% f/f, in annual terms it reached 4.73% an increase from the 4.6% y/y registered in August. Core inflation was lower than expected and increased only 0.12% f/f, reducing in annual terms from 3.7% y/y in August to 3.6% y/y in the fortnight. Non-core inflation keeps increasing in annual terms from 7.6% in August to 8.66% in September's first fortnight.

Core inflation reduced in annual terms due to easing pressures within its merchandise component and a reduction in the other services subindex. The prices of merchandise remained stable in annual terms during the first half of September at 5.2% thanks to easing pressures in the prices of processed food and in the rest of merchandise, this might be a signal that food producers have already accounted their high prices of grains globally in their prices and that demand remains weak in order for them to fully pass through the higher costs to consumers. The services component reduced from 2.4% y/y in August to 2.3% in the fortnight thanks to the stable prices of housing whose inflation remains very low at 1.96% y/y, and a strong reduction in the inflation of its other services subindex from 2.5% y/y last month to 1.96% y/y in September's first half, caused by reductions in the prices of land line telephonic services, mobile telephonic services and airline tickets. Core inflation may reduce further in coming months given that the external factors that have affected it in previous months seem to be already accounted for, and, that the slow recovery in private consumption, prevents demand from being an upwards pressure factor allowing the inflation of services to remain very low.

Non core inflation remains affected by the high prices of livestock; however pressures in those prices seem to be easing. Livestock prices have increased from 13.7% y/y in August to 16.8% in the first half of September, due mostly to the increase in the prices of eggs that occurred since July when an outbreak of avian flu was detected in Jalisco, however the increases in these prices seem to be losing strength. Agricultural prices reached 14.98% y/y, but if no climate shocks appear in the remainder of the year, they should reduce in coming months. Energy reduced from 8.3% y/y to 8.1% in the fortnight driven by lower prices of domestic gas. Meanwhile the tariffs set by local governments remain at a 0% y/y inflation partially compensating the pressures in other Non-core components.

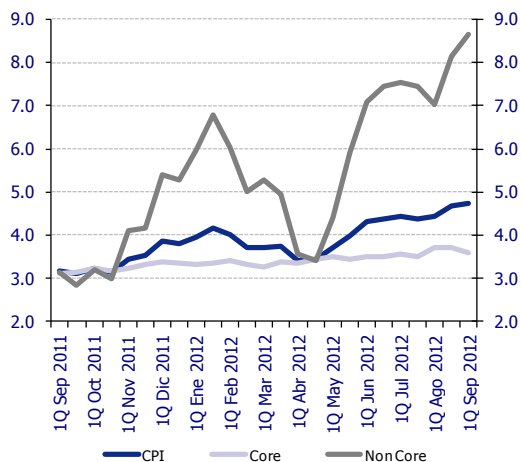
Bottom line: September's first fortnight inflation had a positive outcome due to core components, proving that the recent increases of inflation above 4% were the consequence of supply and external shocks and not of generalized pressures across all prices. We expect inflation will reduce in the 4Q12, and end the year around 4%, however if further supply shocks arise, it might reduce less than we expect.

Table 1
Inflation (y/y and f/f % change)

	Bi-weekly % chg.			Annual % chg.		
	1F Sep 2012	Consensus	BBVA Research	1F Sep 2012	Consensus	BBVA Research
CPI	0.25	0.32	0.22	4.73	4.80	4.70
Core	0.12	0.25	0.20	3.60	3.74	3.68
Non Core	0.68	0.55	0.29	8.66	8.51	8.23

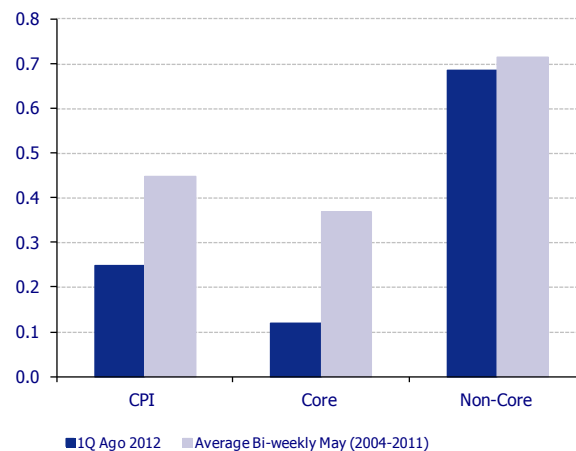
Source: BBVA Research

Graph 1
Inflation and components (y/y % chg.)



Source: BBVA Research with INEGI data.

Graph 2
Inflation and components (f/f % chg.)



Source: BBVA Research with INEGI data.

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