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Economic Analysis
October 24, 2012

Mexico Inflation Flash

October's biweekly inflation: inflation starts falling despite the continuity of supply shocks

General: Actual: 0.45% f/f vs. BBVA: 0.48% f/f Consensus: 0.48% f/f
Core: Actual: 0.17% f/f, vs. BBVA:0.23% f/f, Consensus:0.16% f/f

- **Non core inflation remains affected by supply shocks although they were weaker in the first half of October.**
- **Core inflation remains well bounded by lack of demand pressures, and the recent appreciation of the peso.**
- **Inflation will remain above 4% for a few more months; however this is the result of increases within volatile prices rather than of a generalized inflationary process.**

October's biweekly Inflation dropped to 4.6% y/y from 4.8% in September. Core inflation remained at 3.6% y/y. Meanwhile Non core inflation fell from 8.8% to 8.3% y/y and thus was the main contributor to the decrease in general inflation.

Core inflation remained stable at 3.6% y/y, however the behavior of merchandise prices was better than expected. Merchandise prices increased 0.17% f/f due to a lower than expected increase in the prices of processed food whose inflation fell to 6.7% y/y from 6.9% y/y. This might be a consequence of producers not being able to transfer the higher costs they are facing caused by the spike in grain prices globally, given that demand remains weak. The inflation of the rest of merchandise remained stable around 4%, we expect this prices to remain bounded in coming months given the recent appreciation in the exchange rate. The prices of services remained stable at 2.25% y/y with all of its components practically unchanged in an annual basis. The positive outcome in services inflation continues to signal the absence of demand pressures given the prevailing slack in the economy. Core inflation will reduce slightly in the fourth quarter thanks to a better performance by the prices of merchandise and the absence of pressures to services inflation.

Non core inflation reduced slightly as the supply shocks that have affected it seem to be weakening. The prices of fruits and vegetables increased from 13.4% y/y in September to 14.3% y/y despite experiencing a -1.4% reduction in the fortnight, this signals that production conditions in general are worse this year than in 2011. The prices of livestock increased 0.22% f/f reducing its annual inflation from 17.7% to 17.2% y/y, this was caused by a favorable basis effect and by the fact that the supply shocks caused by the avian flu outbreak are weakening. Despite this favorable outcome we must monitor the prices of livestock since its other components (pork and beef) are facing higher costs caused by the spike of grain prices. Energy prices fell from 7.5% y/y in September to 5.9% y/y despite the increase of electricity fees that occurs in October and November caused by the end of the summer season subsidies. This decrease was due in part by lower production costs, but it might also be caused by the new fairer billing policy of CFE which causes a drop in the effective prices paid by households along the mid consumption range. This immediate effect should dissipate in coming months although it will effectively help annual electricity inflation to decrease for 12 months.

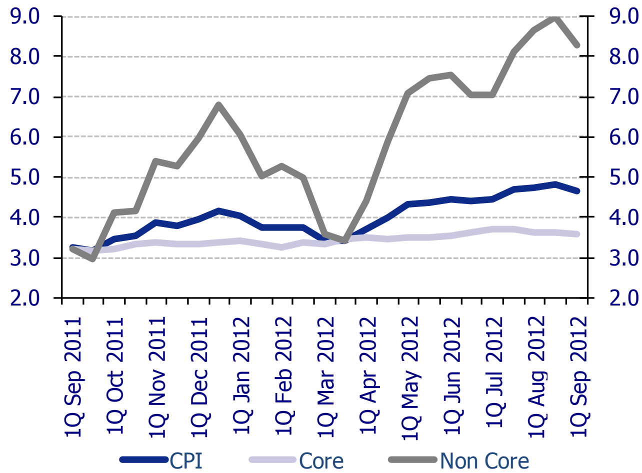
Bottom line: Inflation has begun decreasing, although the pace of this drop will be slow. Further acceleration of the prices of fruits, vegetables and livestock cannot be ruled out, and poses the main upwards risk to inflation. Tariffs set by local governments could also push inflation upwards at the beginning of 2013. Inflation will remain above 4% for a few more months; however this will be the result of increases within volatile prices rather than of a generalized inflationary process.

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

	Bi-weekly % chg. 1F Sep 2012	Consensus	BBVA Research	Annual % chg. 1F Sep 2012	Consensus	BBVA Research
CPI	0.45	0.48	0.48	4.64	4.68	4.68
Core	0.17	0.16	0.23	3.58	3.57	3.64
Non Core	1.38	1.54	1.30	8.27	8.44	8.19

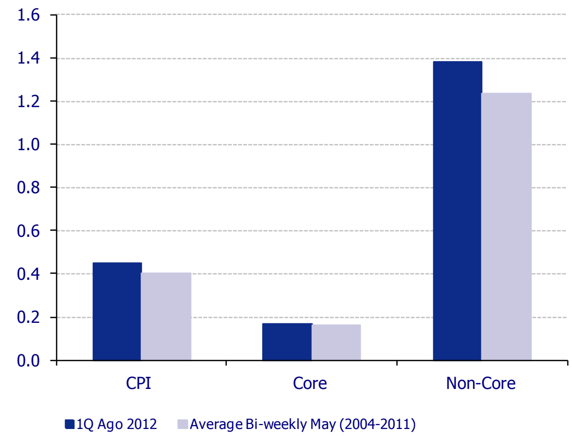
Source: BBVA Research

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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