

Mexico Inflation Flash

December's biweekly inflation: Inflation Falls Below 4% as Banxico expected

General: Actual: 0.27% f/f vs. BBVA: 0.70% f/f Consensus: 0.39% f/f

Core: Actual: 0.26% f/f, vs. BBVA:0.68% f/f, Consensus:0.32% f/f

- **Inflation fell below 4% driven by lower non-core pressures and some positive outcomes within core prices.**
- **Core inflation reached 3%, mainly because the low inflation of its services component and fewer than expected pressures within processed food**
- **Inflation has behaved as the Central Bank Expected, as the shocks that previously affected it continue fading and telecommunication services are having a very intense downwards contribution. The inflation risk balance has improved substantially, however public and agricultural and livestock prices could show new upwards pressures early in 2013.**

December's biweekly inflation dropped from 4.2% in November to 3.8% y/y. Core inflation dropped from 3.3% to 3.0% y/y thanks to a sharp decrease in the prices of services from 1.7% to 1.3% y/y. Non core inflation reduced from 7.1% to 6.2% y/y. As widely expected core inflation contributed the most to the biweekly change in inflation.

Core inflation fell to 3.0% y/y as the inflation of services keeps falling and pressures seem to be slowly easing within processed food. Merchandise prices increased 0.35% f/f, lower than expected due to easing pressures within processed food as the prices of grains globally remain stable although at high levels. The inflation of the rest of Merchandise reached 4.2% y/y and has been increasing consistently since November 2011, this is a consequence of a weak peso and a recovering economy. Services prices increased 0.18% f/f and reached 1.3% y/y its lowest annual rate in history. The housing and education service subcomponents remain unpressured at 2.1% y/y and 4.5% y/y respectively. The rest of services component continues performing very favorably, reaching -0.49% y/y its lowest annual rate in history. Telecommunication services, particularly mobile phone services are the main driver of this positive outcome, as competition has increased in the sector. Core inflation will remain bounded due to economic slack, as unemployment remains high and it prevents consumption from pressuring prices, the increasing competition in the telecommunications sector has already pushed inflation to 3%, so core inflation is becoming an anchor for the CPI to remain within Banxico's range. However merchandise prices remain pressured and the shocks affecting it seem very persistent.

Non Core inflation keeps falling as the shocks that affected it earlier this year have eased. Agricultural and livestock prices inflation reduced from 13.0% in November to 10.4% y/y, thanks to sharp decrease in the prices of several vegetables such as papaya, peppers and onions, and stable poultry prices, however beef products remain pressured by high grain prices and it's slowing down the fall of the inflation of this component. Public prices remained stable at 3.9% the inflation of energy prices and tariffs set by local governments stayed flat at 5.8% y/y and 0.5% y/y. Non core inflation keeps falling as supply shocks continue fading, however some risks prevail as we can't rule out new supply shocks and/or public tariffs could increase more than expected at the beginning of 2013.

Bottom line: Inflation has behaved as the Central Bank Expected, as the shocks that previously affected it continue fading and telecommunication services are having a very intense downwards contribution. The inflation risk balance has improved substantially, however public and agricultural and livestock prices could show new upwards pressures early in 2013.

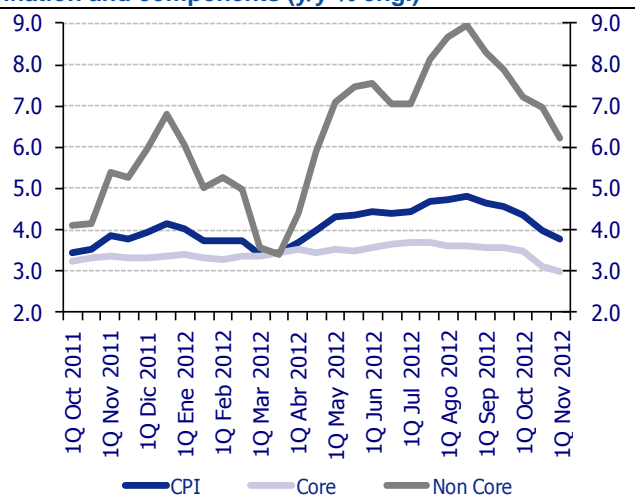
Table 1

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

	Bi-weekly % chg.			Annual % chg.		
	1F Dic 2012	Consensus	BBVA Research	1F Dic 2012	Consensus	BBVA Research
CPI	0.27	0.39	0.70	3.76	3.88	4.20
Core	0.26	0.32	0.68	3.00	3.07	3.44
Non Core	0.32	0.62	0.77	6.22	6.54	6.69

Source: BBVA Research

Graph 1

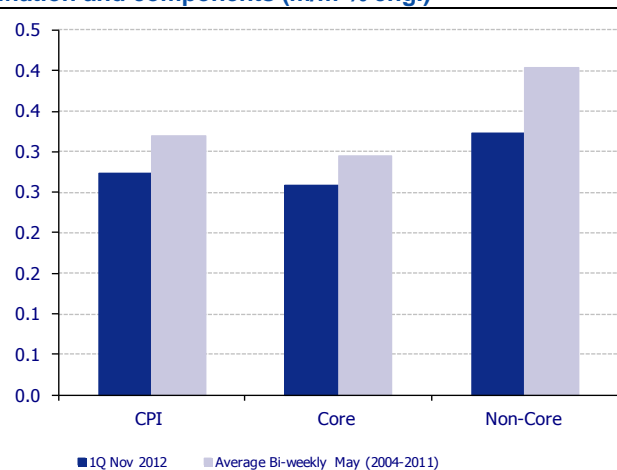
Inflation and components (y/y % chg.)

Source: BBVA Research with INEGI data.

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Graph 2

Inflation and components (m/m % chg.)

Source: BBVA Research with INEGI data.

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