

Mexico Inflation Flash

December's Inflation: Inflation Reaches 3.6% and Ends 2012 In Line with Banxico's Expectation

General: Actual: 0.23% m/m vs. BBVA: 0.20% m/m Consensus: 0.34% m/m

Core: Actual: 0.12% m/m, vs. BBVA:0.11% m/m, Consensus:0.22% m/m

- **Inflation fell to 3.6% y/y driven by lower non-core pressures and some positive outcomes within core prices**
- **Core inflation reached 2.9%, mainly because the falling inflation of its services component and pressures within processed food**
- **Inflation has behaved as the Central Bank expected, given that the shocks that previously affected it keep fading and the price reductions in telecommunications services have pushed core inflation below 3%. The inflation risk balance has improved substantially, however public and agricultural and livestock prices could show upwards pressures early in 2013**

December's inflation dropped from 4.2% in November to 3.6% y/y. Core inflation dropped from 3.3% to 2.9% y/y thanks to a sharp decrease in the prices of services from 1.7% y/y to 1.2% y/y. Non core inflation reduced from 7.1% y/y to 5.4% y/y.

Core inflation fell to 2.9% y/y as the inflation of services keeps falling and pressures seem to be easing within processed food. Merchandise prices increased 0.46% m/m, as pressures within processed food continue fading causing its annual inflation to fall from 6.7% y/y in November to 6.1% y/y. The inflation of the rest of Merchandise seems to be stabilizing around 4.1% although it has been increasing since November 2011, as a consequence of a weak peso in the period, and the continuous although slow recovery of consumption. Services prices decreased -0.17% m/m and reached 1.2% y/y, its lowest rate in history. The housing and education services subcomponents remain unpressured at 2.1% y/y and 4.5% y/y respectively. The rest of services component continues performing very favorably, reaching -0.72% y/y, the lowest rate in history. Telecommunication services, particularly mobile phone services are the main driver of this positive outcome as they contributed -0.16% to the monthly inflation rate, due to higher competition in the sector. Core inflation will remain bounded due to economic slack, (as unemployment remains high and prevents consumption from pressuring prices), the recent stability in global grain prices and a stronger peso. The increasing competition in the telecommunications sector has already pushed core inflation to 2.9% causing core inflation to become an anchor for the CPI to remain within Banxico's range at least in the short term.

Non Core inflation keeps falling as the shocks that affected it earlier in 2012 have eased. Agricultural and livestock prices inflation reduced from 13.0% in November to 9.2% y/y, thanks to the relative stability in the prices of fruits and vegetables and stable poultry and pork prices. However beef products remain pressured given that grain prices have been high for many months. Public prices have fell from 5.2% y/y in August to 3.8% as energy inflation has moderated from 8.3% to 5.6% in the same time span. Tariffs set by local governments stayed flat at 0.5% y/y but will increase at the beginning of the year as some local authorities will increase taxes for 2013 such as the automobile owners tax. 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, given that the shocks that previously affected it keep fading and the price reductions in telecommunication services are pushing core inflation downwards. The inflation risk balance has improved substantially, however public and agricultural and livestock prices could show upwards pressures early in 2013.

Table 1

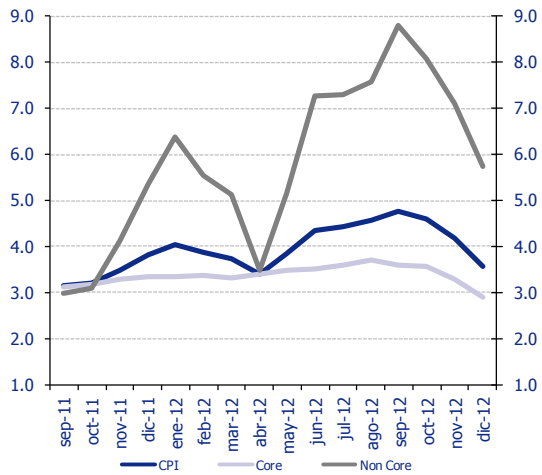
Inflation (y/y and m/m % change)

	m/m % Change			y/y % Change	
	dic-12	Consensus	BBVA	nov-12	dic-12
			Research		
CPI	0.23	0.34	0.20	4.18	3.57
Core	0.12	0.22	0.11	3.30	2.90
Non Core	0.58	0.74	0.50	7.09	5.74

Source: BBVA Research

Graph 1

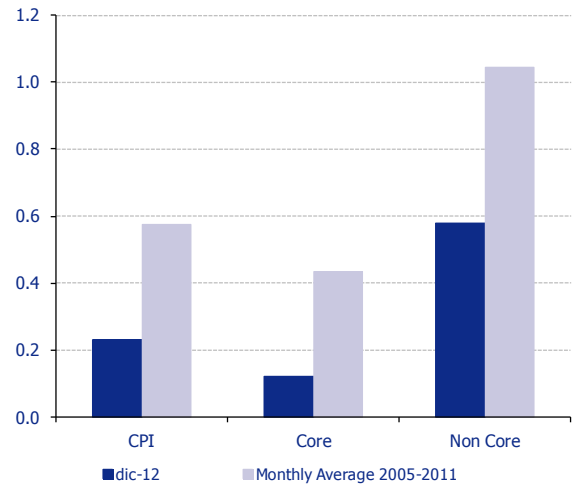
Inflation and components (y/y % chg.)



Source: BBVA Research with INEGI data.

Graph 2

Inflation and components (m/m % chg.)



Source: BBVA Research with INEGI data.

Pedro Uriz Borrás
pedro.uriz2@bbva.com



Avenida Universidad 1200, Colonia Xoco, México DF, CP 03339 | www.bbva.com

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