

Mexico Inflation Flash

February's biweekly inflation: Inflation Increases As Mobile Fees Phone Fees Rise Again.

General: Actual: 0.24% f/f vs. BBVA: 0.20% f/f Consensus: 0.17% f/f

Core: Actual: 0.24% f/f, vs. BBVA:0.06% f/f Consensus:0.17% f/f

- Annual inflation increased for the first time in four months as widely expected by the Central Bank and the market consensus.
- Core inflation reached 2.97%, as lower merchandise inflation wasn't enough to fully offset the increase in services prices caused by higher mobile phone fees due to the end of their holiday rebates.
- The inflation risk balance remains favorable as merchandise inflation and Livestock prices continue on a lowering trend. However tariffs set by local governments remain an upwards risk and further acceleration is expected due to the weakness in local public finance. Mobile phone prices are increasing due to the end of their holiday rebates, however we do not expect them to pressure inflation in coming months, as aggressive offers suggest changes in price behavior. As widely expected by the market and Banxico inflation is rising, however this increase should be short lived as fundamentals remain favorable, hence we maintain our view that inflation will remain below 4% throughout 2013.

February's biweekly inflation increased 0.24% f/f, higher than BBVA Research and the market consensus expected, annually it rose from 3.25% y/y in January to 3.47% y/y. Core inflation increased also 0.24% f/f, and increased slightly to 2.97% y/y (2.88% y/y in January). Non-Core inflation rose from 4.5% y/y in January to 5.14% y/y.

Core inflation reached 2.97% as the decrease in merchandise inflation was not enough to fully offset the rise in services prices. Merchandise prices increased 0.17% f/f, as previous pressures keep fading causing its annual inflation to fall from 5.2% y/y in January to 4.67% y/y. Both of its components processed food and rest of merchandise remain on a lowering trend thanks to stable grain prices, a stronger peso and a still feeble demand. The prices of services increased from 1.6% y/y in January to 2.15% y/y as the inflation of air transport increased and the recent drops in mobile phone prices are reversing due to the end of holiday discounts. The prices of merchandise remain on clear lowering trend, which if no new shocks arise, should continue in coming months; this will compensate some increases within services inflation that we consider will be moderate, setting up the scenario for core inflation to remain in check all year.

Non Core inflation increased thanks to agricultural prices and local government tariffs. Agricultural and livestock prices inflation increased from 5.5% in January to 6.8% y/y, thanks to an increase in the inflation of fruits and vegetables driven by higher green tomatoes, onions and potatoes prices. Livestock inflation remains on a lowering trend as previous supply shocks continue fading. We must mention that marginal effects are expected from the recent avian flu outbreak in Guanajuato as this state only produces around 3.2% of Mexico's egg production. Public prices reached to 4.2% y/y (3.9% y/y January) as the inflation of tariffs set by local governments keeps accelerating. Non-Core inflation will increase slightly in coming months as the normalization of livestock markets and lower electricity inflation, might not fully compensate the increases in gasoline prices and the acceleration of local tariff inflation. As usual agricultural prices will cause the bigger oscillations in non core inflation during the year, but we don't expect extraordinary pressures in this sub-index.

Bottom line: The inflation risk balance remains favorable as merchandise inflation and Livestock prices continue on a lowering trend. However tariffs set by local governments remain an upwards risk and further acceleration is expected due to the weakness in local public finance. Mobile phone prices are increasing due to the end of their holiday rebates, however we do not expect them to pressure inflation in

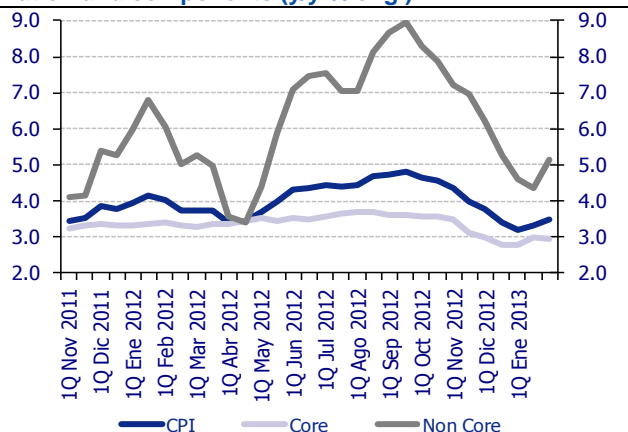
coming months, as aggressive offers suggest changes in price behavior. As widely expected by the market and Banxico inflation is rising, however this increase should be short lived as fundamentals remain favorable, hence we maintain our view that inflation will remain below 4% throughout 2013.

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

	Bi-weekly % chg.			Annual % chg.		
	1F Feb 2013	Consensus	BBVA Research	1F Feb 2013	Consensus	BBVA Research
CPI	0.24	0.17	0.20	3.47	3.40	3.43
Core	0.24	0.17	0.06	2.96	2.88	2.77
Non Core	0.22	0.17	0.66	5.14	5.08	5.60

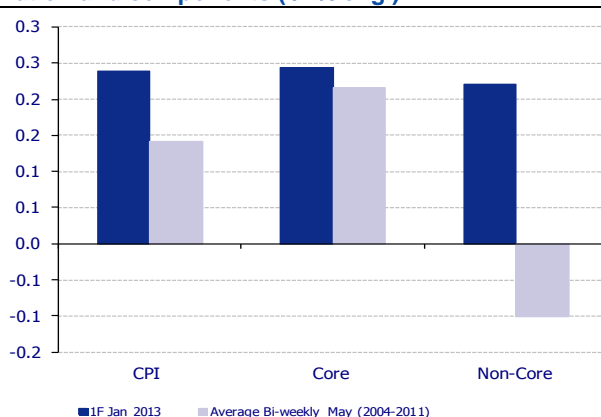
Source: BBVA Research

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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