

Mexico Inflation Flash

February's CPI: Inflation Accelerated As Widely Expected; But It's Risk Balance Remains Positive.

General: Actual: 0.49% m/m vs. BBVA: 0.58% m/m Consensus: 0.52% m/m

Core: Actual: 0.51% m/m, vs. BBVA: 0.53% m/m Consensus: 0.52% m/m

- Annual inflation increased for the first time in four months as widely expected by the Central Bank and the market consensus.
- Core inflation reached 2.96%, 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 and livestock inflation keep falling. Tariffs set by local governments remain an upwards risk and further acceleration is still expected due to weak subnational governments finances. Mobile telephony prices increased due to the end of their holiday rebates, however we do not expect them to pressure inflation in coming months, as they fell slightly in February's second half. As widely expected by the market and Banxico inflation is rising, however this increase will be short lived as fundamentals remain favorable, hence we maintain our view that inflation will remain below 4% throughout 2013.

February's inflation increased 0.49% m/m, below our forecast and line with market consensus, annually it rose from 3.25% y/y in January to 3.55% y/y. Core inflation increased 0.51% m/m, and accelerating slightly to 2.96% y/y (2.88% y/y in January). Non-Core inflation rose from 4.5% y/y in January to 5.5% y/y.

Core inflation reached 2.96% as the decrease in merchandise inflation was not enough to fully offset the rise in services prices. Merchandise prices increased 0.15% m/m, as previous pressures keep fading causing its annual inflation to fall from 4.4% y/y in January to 3.9% y/y the first time it falls below 4% in 22 months. Both of its components processed food and rest of merchandise keep falling 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 2.2% y/y as the housing inflation has accelerated from 2% in October to 2.1% in February and the inflation of the rest of services rose from 0.3% in January to 1.7%, this acceleration was caused by the end of holiday rebates in Mobile Telephony prices, however we don't expect further increases in this prices at the moment as they decreased slightly in February's second half. The prices of merchandise remain falling, which if no new shocks arise, should continue in coming months; this will compensate some increases within services inflation that 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 7.5% y/y, thanks mostly to a unfavorable base effect of the inflation of fruits and vegetables and increases in the prices of green tomatoes, onions and potatoes. Livestock inflation keeps falling as previous supply shocks continue fading. We must mention that at this point the recent avian flu outbreak in Guanajuato has not caused significant pressures, as this state only produces around 3.2% of Mexico's egg production. Public prices reached to 4.4% y/y (3.9% y/y January) as the inflation of tariffs set by local governments keeps accelerating, most notably the water supply prices. Non-Core inflation will continue increasing 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 and livestock inflation keep falling. Tariffs set by local governments remain an upwards risk and further acceleration is still expected due to weak subnational governments finances. Mobile telephony prices increased due to the end of their

holiday rebates, however we do not expect them to pressure inflation in coming months, as they fell slightly in February's second half. As widely expected by the market and Banxico inflation is rising, however this increase will be short lived as fundamentals remain favorable, hence we maintain our view that inflation will remain below 4% throughout 2013.

Table 1

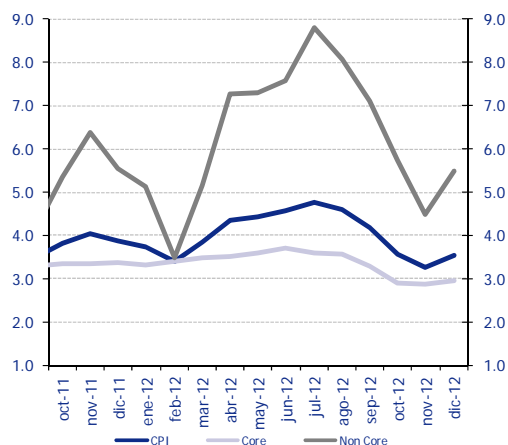
Inflation (y/y and m/m % change)

	m/m % Change			y/y % Change	
	feb-13	Consensus	BBVA Research	Jan 2013	feb-13
CPI	0.49	0.52	0.58	3.25	3.55
Core	0.51	0.52	0.53	2.88	2.96
Non Core	0.44	0.52	0.74	4.47	5.47

Source: BBVA Research

Graph 1

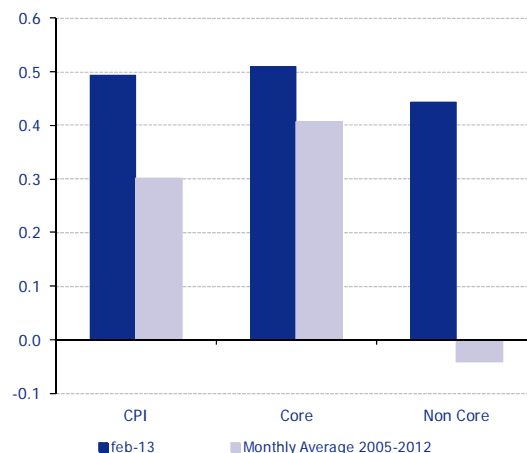
Inflation and components (y/y % chg.)



Source: BBVA Research with INEGI data.

Graph 2

Inflation and components (m/m % chg.)



Source: BBVA Research with INEGI data.

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