BBVA | RESEARCH

Mexico Inflation Flash

March's CPI: Supply Shocks Push Headline Inflation Upwards; However Core Inflation Remains Bounded

General: Actual: 0.73% m/m vs. BBVA: 0.67% m/m Consensus: 0.68% m/m
Core: Actual: 0.30% m/m, vs. BBVA:0.34% m/m Consensus:0.35% m/m

- **Annual inflation accelerated more than expected as supply shocks affecting its non-core component strengthened in March, such as the disruptions in poultry and some fruit markets. None the less we expect most of this disruptions will be shortlived.**
- **Core inflation reached 3.02%, as the decrease merchandise inflation wasn't enough to fully offset the increase in services prices.**
- **The inflation risk balance remains stable as merchandise inflation keeps falling and services inflation seems to be approaching its peak. Tariffs set by local governments remain an upwards risk because acceleration is still expected due to weak subnational government finances and some recently announced transport price increases. Agricultural and livestock supply shocks intensified in March however as most of them are caused by minor production disruptions we consider most of them should be shortlived. As expected inflation is rising, but as its fundamentals remain favorable, we consider it will descend below 4% in the summer and that it will remain below that threshold the rest of the year.**

March's inflation increased 0.73% m/m, above our forecast and market consensus, annually it rose from 3.55% y/y in February to 4.25% y/y. Core inflation increased 0.30% m/m, and accelerating from 2.96% y/y to 3.02%. Non-Core inflation rose from 5.5% y/y in February to 8.3% y/y.

Core inflation reached 3.02% as the decrease in merchandise inflation was not enough to fully offset the increase in services prices. Merchandise prices increased 0.21% m/m, as previous pressures keep fading causing its annual inflation to fall from 3.9% y/y in February to 3.8% y/y. Its processed food component remained stable at 4.6% y/y the same reading as in the previous month. The inflation of the rest of merchandise component reduced from 3.3% in to 3.2% thanks to a stronger peso and a still feeble demand. The prices of services increased from 2.2% y/y in February to 2.35% y/y as the inflation of the rest of services rose from 0.3% y/y in January to 2.0% y/y, this acceleration was caused by the end of holiday rebates in Mobile Telephony prices, which should stabilize in coming months. The prices of merchandise keep falling, a trend that will continue in coming months if the peso remains strong and no supply disruptions causes grain prices to increase again; 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, as economic slack prevents demand from pressuring prices upwards.

Non Core inflation increased thanks to price acceleration in all of its components. Agricultural and livestock prices inflation increased from 7.5% in February to 14.3% y/y, thanks mostly to an unfavorable base effect and sharp increases in the prices of green tomatoes, red tomatoes, eggs, chicken and lemons. Some of these shocks were caused by uncommon supply disruptions like the avian flu outbreak in Guanajuato and the Yellow Dragon plague in Colima which affects lemon production. Public prices reached to 5.0% y/y (4.4% y/y February) as the inflation of tariffs set by local governments keeps accelerating as local governments seek to increase their revenues. Non-Core inflation will continue increasing in coming months as the normalization of fruit and livestock markets should take some more time, gasoline prices could keep adjusting upwards and the acceleration of local tariff inflation will continue, therefore we expect non-core inflation will fall until the second half of the year.

Bottom line: The inflation risk balance remains stable as merchandise inflation keeps falling and services inflation seems to be approaching its peak. Tariffs set by local governments remain an upwards risk

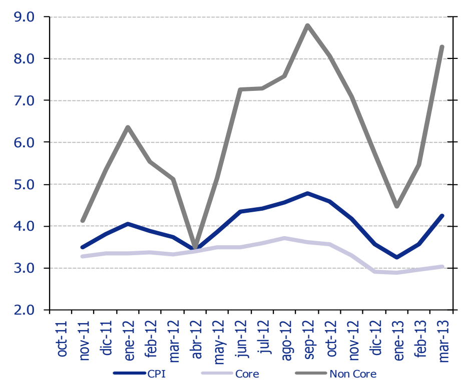
because acceleration is still expected due to weak subnational government finances and some recently announced transport price increases. Agricultural and livestock supply shocks intensified in March however as most of them are caused by minor production disruptions we consider most of them should be shortlived. As expected inflation is rising, but as its fundamentals remain favorable, we consider it will descend below 4% in the summer and that it will remain below that threshold the rest of the year.

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

	m/m % Change			y/y % Change	
	mar-13	Consensus	BBVA Research	feb-13	mar-13
CPI	**0.73**	**0.68**	**0.67**	3.55	**4.25**
Core	**0.30**	**0.35**	**0.34**	2.96	**3.02**
Non Core	**2.11**	**1.77**	**1.76**	5.47	**8.29**

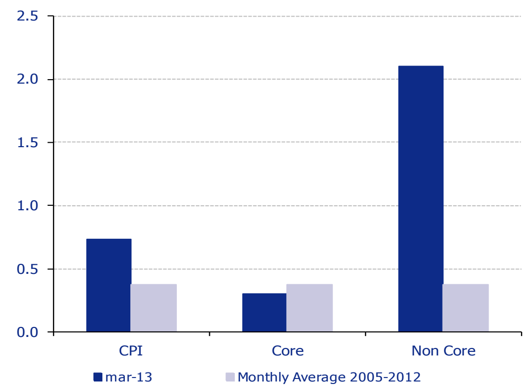
Source: BBVA Research

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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