

# Mexico Inflation Flash

July's biweekly inflation: general inflation surprises to the downside as a result of a very low core inflation.

General: Actual: 0.0% f/f vs. BBVA:0.23% f/f Consensus: 0.15% f/f

Core: Actual: 0.04% f/f, vs. BBVA:0.16% f/f Consensus: 0.15% f/f

- Inflation fell below 4.0% for the first time since March as supply shocks keep fading.
- Core inflation reaches a new historical minimum as goods inflation continues moderating in line with economic weakness.
- Inflation is now clearly within Banxico's range, very much in line with the Central Bank forecast. We consider inflation will close the year around 3.3%, however in the absence of supply shocks, and if aggressive promotions within services materialize, inflation could be even below that level at year's end.

July's biweekly inflation turned out 0% f/f, well below our forecast and the market consensus, falling in annual terms from 4.09% y/y in June to 3.5% y/y. Core inflation increased 0.04% m/m also below our estimate and market consensus, in annual terms it fell from 2.8% y/y in June to 2.6% y/y. Non-Core inflation fell -0.12% f/f, decreasing in annual terms from 8.4% y/y in June to 6.6% y/y.

**Core inflation remains well below 3.0% given the continuous moderation of its goods component.** Goods prices fell -0.06% f/f, causing its annual inflation to fall from 3.1% y/y in June to 2.8% y/y. Its processed food component fell from 3.9% y/y in the previous month to 3.6% y/y, meanwhile the inflation of the rest of goods component fell from 2.8% y/y in May to 2.5% y/y. This favorable performance is caused by a still feeble domestic demand, lower grain prices, and a stronger peso in most of the year. In addition to the previously mentioned factors, the low fortnight inflation in goods is influenced by aggressive summer offers by retailers. The prices of services fell from 2.5% y/y in May to 2.4% y/y, thanks to unexpected offers in air transportation and mobile telephony that compensated the seasonal increase in touristic services. Strong fundamentals such as lower international grain prices and economic slack will continue favoring low core inflation. However, the recent peso depreciation could partially compensate the downward behavior in core inflation caused by weaker economic activity.

**Non Core inflation fell as a result of a decrease in fruits and vegetables, and livestock prices.** Agricultural inflation decreased from -1.2% y/y in June to -6.4% y/y thanks to a fall in goods with relevant weight in the consumption basket such as tomato, green tomato and dry pepper prices, and, to a very favorable base effect. Livestock inflation fell from 15.4% y/y in June to 10.9% y/y, as poultry markets are normalizing after the avian flu outbreak; for the first time chicken prices also fell during the fortnight. Energy prices fell from 8.4% y/y in June to 8.3% y/y as lower electricity prices are compensating the increases in gasoline and heating gas, as the government is subsidizing these products less this year in order to reduce the fiscal cost paid in previous years. Finally, the inflation of tariffs set by local governments increased from 7.1% y/y in June to 7.3% y/y because of the adjustments in public transportation prices and weak revenues of local governments. Agricultural and particularly livestock prices should continue falling moderately in coming weeks, and given a favorable base effect, non core inflation will continue falling sharply in coming months. However public prices remain an upwards risk given the smaller energy subsidies and the weak local government finance.

**Bottom line: inflation is now clearly within the range of Banxico's objective, and in line with its forecast. We consider inflation will close the year around 3.3%. However, in the absence of supply shocks, and if aggressive promotions within services materialize, inflation could be even below that level at year's end.**

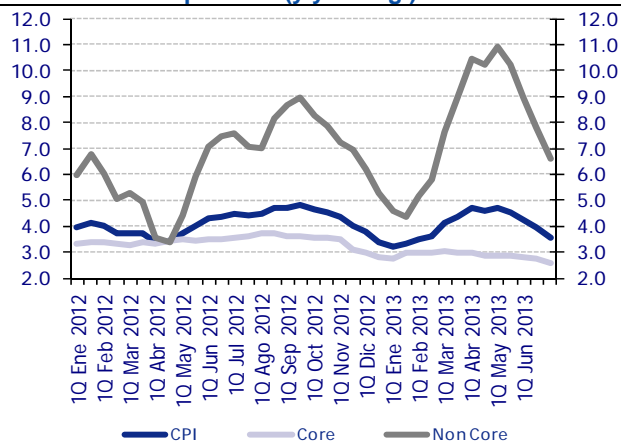
Table 1

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

	Bi-weekly % change			Annual % change		
	1F Jul 2013	Consensus	BBVA Research	1F Jul 2013	Consensus	BBVA Research
<b>CPI</b>	<b>0.00</b>	<b>0.15</b>	<b>0.23</b>	<b>3.53</b>	<b>3.68</b>	<b>3.77</b>
<b>Core</b>	<b>0.04</b>	<b>0.15</b>	<b>0.16</b>	<b>2.57</b>	<b>2.69</b>	<b>2.70</b>
<b>Non Core</b>	<b>-0.12</b>	<b>0.15</b>	<b>0.47</b>	<b>6.62</b>	<b>6.91</b>	<b>7.25</b>

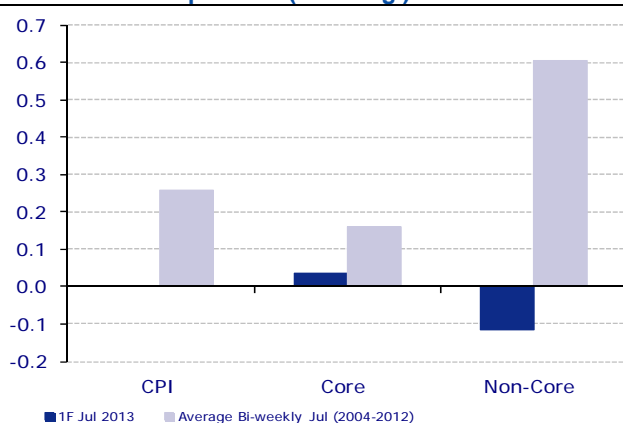
Source: BBVA Research

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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