

Mexico Inflation Flash

Inflation in the first fortnight of January

Headline: Actual: 0.68% FoF (BBVAe: 0.55%; consensus: 0.62%)

Core: Actual: 0.69% FoF (BBVAe: 0.50%; consensus: 0.54%)

- Core inflation was higher than both consensus and our forecast as new taxes affected core food prices as anticipated while food-related services registered stronger-than-expected increases
- Although today's print suggests that the impact from the fiscal reform is relatively in line with our expectations, we adjusted our year-end core inflation forecast to 3.46% and the general inflation to 3.92% to account for the upward surprise in food-related services

Headline inflation came in above expectations, increasing 0.68% FoF in the first fortnight of January (BBVAe: 0.55%, consensus: 0.62%). In annual terms, inflation accelerated to 4.6% from 4.1% in the second fortnight of December. Both the core and non-core inflation increased due to new taxes as anticipated -on sodas, junk food and fuels-, but the upward surprise was mainly by a higher-than-expected increase in the core component, mostly driven by unexpected strong increases in food-related services. Core inflation was 0.69% FoF, higher than both consensus and our forecast (BBVAe: 0.50%, consensus: 0.54%). The higher-than-expected print pushed up annual core inflation to 3.33% from 2.80% in the previous fortnight.

Core inflation reflected the effect of the new taxes and surprised on the upside driven higher by unexpected strong increases in food related services, increasing to 3.33% from 2.80% in the previous fortnight. Within its components, core goods increased 1.14% FoF, mostly driven higher by a large increase in core food prices (2.0% FoF), as soda prices rose 11.40% FoF (contributing with 0.124 pp of the bi-weekly increase in headline inflation) and junk food also registered large increases as expected. These increases suggest that almost 100% of the new tax burden was transferred to consumers as we expected due to the inelastic demand of those products. Other goods increased 0.42% FoF, suggesting a low impact from the increase in the VAT border rate, as we were expecting. The upward surprise was mainly driven by two factors: the expectation of strong core readings in both the first and the second fortnights (we are now expecting a much lower increase in the second fortnight), and strong increases in restaurant services (1.23% FoF) and other food-related services (1.39% FoF) were registered. These increases were probably to some extent influenced by the new tax on sodas but were likely mainly driven by past strong increases in perishable food which surged in 4Q13. We were expecting a 0.69% MoM increase in core prices in January, but following today's upward surprise we now expect a 0.77% MoM reading.

Non-core inflation was driven up by energy and regulated prices as expected. Non core inflation rose 0.63% FoF, reaching 8.84% in annual terms. The strong increases in the energy component (1.8% FoF) and regulated prices (1.15%) were partially offset by a larger-than-anticipated reduction in fruit and vegetable prices (-4.2% FoF). Our daily price monitoring points to a partial reversal of that reduction in the second fortnight. In sum, we are now expecting a 0.91% MoM increase in headline inflation in January.

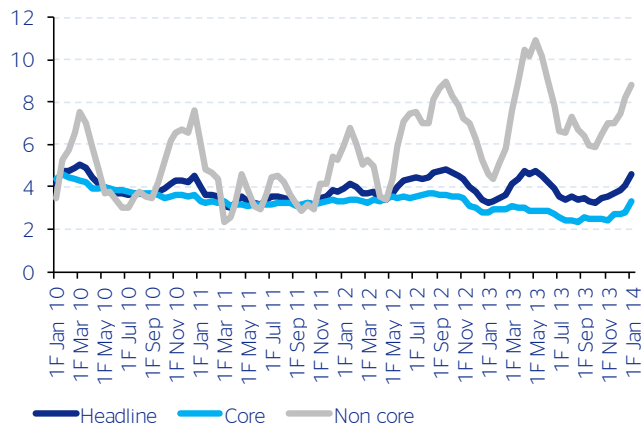
Bottom line: Taking into account the higher-than-expected increase in core prices, we now expect core inflation to increase 0.77% in January and to reach 3.46% by year-end. Annual headline inflation should begin to trend downwards in February (base effects) following January's fiscal shock but should accelerate after May (base effects) and is likely to remain above 4.0% from June to November. Although we do not expect inflation to enter an acceleration process as it should continue to benefit from the ample economic slack, risks would tilt to the upside if economic activity rebound more strongly than currently anticipated.

Table 1
Inflation (FoF and YoY % change)

CPI Inflation						
	Bi-weekly % change			Annual % change		
	1F Jan 2014	BBVAe	Consensus	1F Jan 2014	BBVAe	Consensus
Headline	0.68	0.55	0.62	4.63	4.50	4.57
Core	0.69	0.50	0.54	3.33	3.18	3.13
Non Core	0.63	0.72	0.89	8.84	8.94	9.13

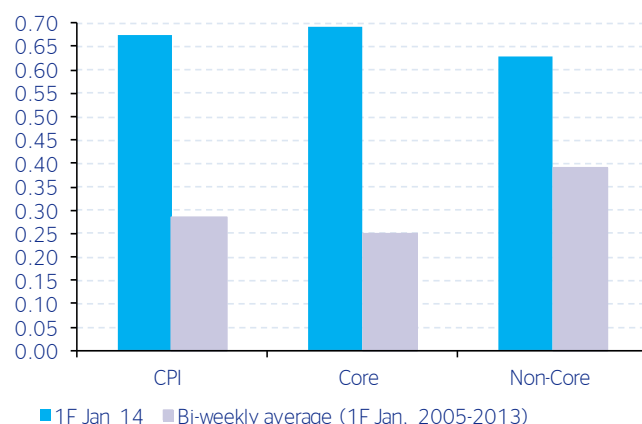
Source: BBVA Research, INEGI

Chart 1
Inflation and components (YoY % change)



Source: BBVA Research, INEGI

Chart 2
Inflation and components (FoF % change)



Source: BBVA Research, INEGI

Javier Amador
 javier.amadord@bbva.com



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

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