Economic Research Department

BBVA

U.S.

Inflation Observatory

November 19th 2008

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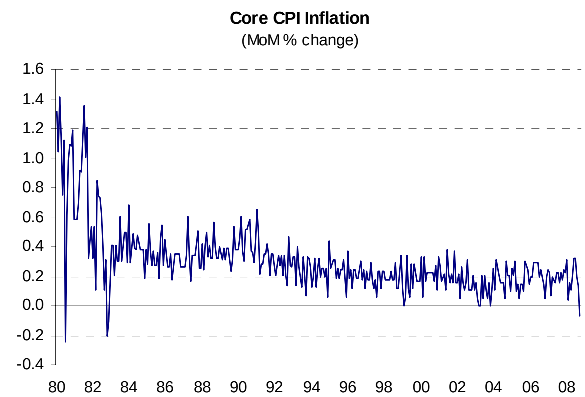
Core inflation decreased

- Headline consumer prices declined 1% in October, the biggest drop in 61 years
- Core prices fell 0.1% in October from a 0.1% increase in September, reflecting the effects of slower economic activity
- Going forward, headline inflation will drop further as energy prices remain subdued
- We expect core inflation to remain low, consistent with our forecast of weaker economic activity

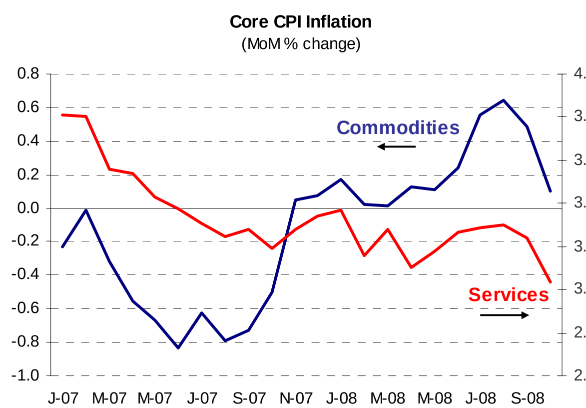
Headline inflation declined sharply

Headline consumer prices declined 1%. Food prices inflation moderated to 0.3% in October, the lowest since January 2008. This was largely the result of a reduction in the cost of dairy and fruits. Meanwhile, energy prices fell 8.6%, the sharpest drop since the series was first recorded in 1957, strongly influenced by 14.2% decline in prices of motor fuel. These trends are likely to continue in coming months as slower economic growth reduces demand for fuels. Late in November, the West Texas Intermediate averaged $59.9 per barrel, 21.9% below the average of October. Therefore, the next CPI release is likely to show another significant decline in headline inflation.



The drop in core inflation reflects slower economic activity

Excluding food and energy, consumer prices moved down 0.1%, the lowest since December 1982. The decline reflected a significant reduction in prices of new and used motor vehicles (-0.7%), public transportation (-3.3%) and apparel (-1%). Prices for shelter remained unchanged in October; weaker private demand dragged prices for lodging away from home down by 1.6%, while rising foreclosure rates may have boosted the index for rent by 0.4%, the highest since December 2007. Core commodity prices edged down 0.4%, the lowest since November 2006, while, prices of core services remained unchanged. On a year-over-year basis, core inflation softened to 2.2% from 2.5% in September.



Bottom line. October's report revealed that the ongoing economic slowdown is having a widespread effect on CPI inflation. The combination of falling energy prices and modest food prices increases will result on further declines in headline inflation. Moreover, prices of non-energy goods and services such as autos, public transportation, and clothing have decreased in response to a sluggish demand. Consistent with our scenario of a sharp slowdown in economic activity, we expect core prices to increase below recent average. Finally, core inflation trends and forecasts could open the door for a further cut in fed fund interest rates.