Mexico Inflation Flash

May's biweekly inflation: annual inflation remains close to 4.7% as non-core shocks prove more resilient than expected

General: Actual: -0.35% f/f vs. BBVA: -0.51% f/f Consensus: -0.43% f/f
Core: Actual: 0.14% f/f, vs. BBVA:0.14% f/f Consensus:0.10% f/f

- **Annual inflation remained close to 4.7% y/y as supply shocks in livestock and energy markets, and further increases in tariffs set by local governments, prevented non-core inflation from falling.**
- **Core inflation remained at 2.9% as both its goods and services components do not show signs of pressure given the economic slack and exchange rate appreciation.**
- **Inflation might take longer to fall below 4.0% as supply shocks in non-core inflation are proving to be more resilient. However as production in these markets will eventually normalize, and as favorable fundamentals such as a stronger peso, lower international commodity prices and the ample availability of resources within the economy prevail, inflation will fall in coming months, and will end the year well below 4.0%.**

May's biweekly inflation fell -0.35% f/f, above our forecast (-0.51% f/f) and the market consensus (-0.43% f/f), annually it rose slightly from 4.65% y/y in April to 4.72%. Core inflation increased 0.14% f/f in line with our estimate and above market consensus, falling in annual terms from 2.95% y/y in April to 2.89% y/y. Non-Core annual inflation rose from 10.3% y/y in April to 10.9% y/y as some of the supply shocks that have been affecting it recently persist.

Core inflation remains below 3.0% as the inflation of both of its components goods and services remained stable. Goods prices increased 0.14% f/f, causing its annual inflation to fall from 3.6% y/y in April to 3.5% y/y. Its processed food component fell from 4.5% y/y in the previous month to 4.4% y/y. Meanwhile, the inflation of the rest of goods component fell from 2.95% y/y in April to 2.87% y/y, thanks to the stronger peso and the still feeble domestic demand. The prices of services remained stable around 2.35% y/y as in April. Its education and housing components remained stable at 4.5% y/y and 2.10% y/y, respectively. The other services component fell from 2.0% y/y in April to 1.90%. This decrease was caused by rebates in touristic prices given the long off-season which pushes prices down in order to maintain demand. Strong fundamentals such as the stronger peso, lower international grain prices and persistent economic slack will continue favoring low core inflation, which in case of further deceleration of the economy could fall even further.

Non Core inflation increased as lower agricultural prices could not offset pressures within the livestock, energy and tariffs components. Agricultural inflation decreased from 25.1% y/y in April to 19.1% y/y thanks to lower green tomato and lemon prices which had been affected in previous months by bad weather and a plague, respectively, and were the main cause of the spike in agricultural inflation. Livestock inflation rose from 12.6% y/y in April to 14.3% y/y as poultry markets remain affected by avian flu which has been persistent this year. Energy prices rose from 6.5% y/y in April to 8.3% y/y despite the favorable trend in electricity prices that decreased -4.3% y/y. The inflation of premium gasoline and heating gas remain increasing strongly as the government is subsidizing less the prices of energy this year given the high fiscal cost paid last year. Finally, the inflation of tariffs set by local governments increased from 6.3% y/y in April to 6.5% y/y as the weakness in local government finance remains an upwards inflation risk. Agricultural prices will continue falling in coming weeks and as livestock prices are expected to normalize soon, we consider non-core inflation is at its highest for 2013, as a favorable base effect will enable it to fall in coming months.

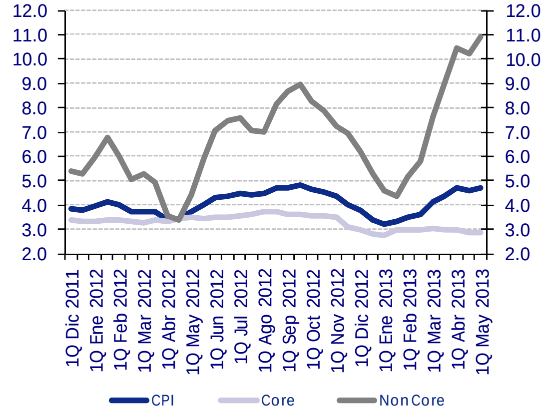
Bottom line: In the short term, inflation remains vulnerable to supply shocks within its non-core component, which could delay inflation convergence below 4.0% during the next months. However if production in these markets normalizes soon and favorable fundamentals such as a stronger peso, lower international commodity prices and the ample availability of resources within the economy prevail, inflation will decrease sharply in coming months, and will end the year well below 4.0%.

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

	Bi-weekly % change			Annual % change		
	1F May 2013	Consensus	BBVA Research	1F May 2013	Consensus	BBVA Research
CPI	-0.35	-0.43	-0.51	4.72	4.63	4.55
Core	0.14	0.10	0.14	2.89	2.85	2.89
Non Core	-1.93	-2.25	-2.74	10.91	10.54	9.99

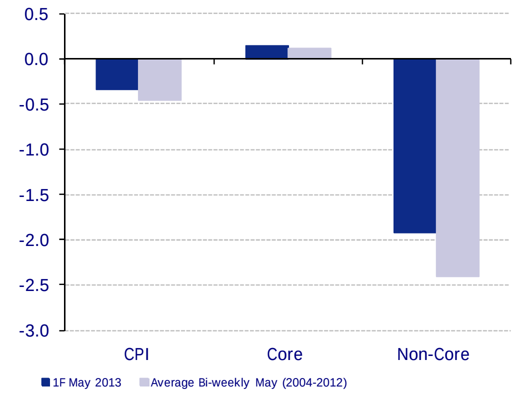
Source: BBVA Research

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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