



## Favorable surprise in January annual inflation thanks to non-core prices; inflation of merchandise and services in line with estimates.

- Headline inflation in January (0.23%) was much better than estimated (0.32% with a bias toward 2.7%), which allowed inter-annual inflation to drop from 6.53% in December to 6.28% in January. In turn, the change in core prices (0.43% monthly) was in line with our estimates, with inter-annual change (5.76%) maintained at similar levels to that of one month before.
- The decline in inflation is due to volatile components, particularly: (i) agricultural, which reduced their inter-annual change from 10.58% in December to 6.91% in January; and (ii) government-regulated prices, which fell from 8.03% to 5.8% in the same period. Thus, both dynamics explain the overall decline of headline inflation in January. In view of the seasonality of these prices, it is foreseeable that the reduction in their annual inflation will continue during this quarter and the next, although the volatile nature of these prices leads us to be cautious for the moment.
- Inflation of core prices presents—as foreseeable—a greater resistance to decline, which could translate into inter-annual variations even higher than that of the NCPI during the third quarter of the year. We believe the important factor is the dynamic shown by the main components of core inflation. Prices of merchandises (both food and others) still showed high variations compared to what was usually seen in January in recent years. This could imply that despite the slowdown in domestic demand, the supply shocks seen in previous months (v.gr. exchange rate and inputs of food and energy products) have not been fully diluted. In counterpart, annual inflation in services (in all its components) show an inflection point with which it would seem that they touched their highest levels in December of last year. It is very important to note that inflation in services in January (0.08%) was historically the lowest for that month, which is explained by the monthly contraction of prices of services linked to tourism, and to a low expansion of housing services. In contrast with merchandises, we believe that these prices are beginning to be incorporated in the cycle of lower economic growth.
- Perspective 2009: the trend continues to point to a cycle of decline in headline inflation which should be seen more clearly in March—in the absence of renewed exchange rate shocks—and which could sharpen in the second half of 2009.

Mexico: Inflation 2009

	Monthly change (%)		Annual change (%)		Dif. (pp)
	Avg. Dec 2003-08		Dec-08	Jan-09	
	08	Jan-09	Dec-08	Jan-09	
<b>CPI-Mx</b>	<b>0.43</b>	<b>0.23</b>	<b>6.53</b>	<b>6.28</b>	<b>-0.25</b>
<b>Core-Mx</b>	<b>0.39</b>	<b>0.43</b>	<b>5.73</b>	<b>5.76</b>	<b>0.03</b>
Goods	0.41	0.80	6.45	6.80	0.35
Food products	0.82	1.10	9.46	9.70	0.25
Other Goods	0.11	0.55	4.07	4.48	0.41
Services	0.38	0.08	5.07	4.80	-0.27
Rent	0.40	0.27	4.22	3.95	-0.27
Education	0.32	0.23	5.76	5.66	-0.11
Other serv.	0.38	-0.21	5.77	5.44	-0.33
<b>Non Core-Mx</b>	<b>0.55</b>	<b>-0.29</b>	<b>8.72</b>	<b>7.71</b>	<b>-1.00</b>
Farm products	-0.22	-0.68	11.63	10.67	-0.96
Fruits//Vegetables	-2.25	-4.06	10.58	6.91	-3.67
Meat//Eggs	1.23	1.58	12.34	13.19	0.85
Public managed	0.93	-0.08	7.27	6.25	-1.02
Energy	0.97	-1.42	8.03	5.80	-2.23
Controlled prices	0.89	1.39	6.44	6.74	0.30

