



# Inflation Observatory

March 9, 2009

## Annual inflation falls in February in part as a result of non-trend components. Pressure continues in underlying inflation.

- General inflation in February (0.22%) was close to that discounted by the market (consensus 0.22% and BBVA 0.20%), while the underlying rate (0.49%) proved to be slightly higher (consensus 0.47% y BBVA 0.46%). Thus the general year-on-year inflation rate fell slightly in February (6.2% vs. 6.28% in January) with the underlying rate remaining at high levels (5.78% vs. 5.76% a month before).
- The fall in annual inflation stems partly from a monthly contraction in the prices of fruits and vegetables, much more intense than what is usual for that period (-5.64 vs. -2.48% on average in 2003-08), as well as from lower prices of administered energy products (-0.39% vs. +0.07%, the recent average). Although non-underlying annual inflation remains high (7.36%) it is highly probable it falls a level of 3.7% by the end of the year.
- In contrast underlying prices register higher monthly pressures in non-food goods (0.85 vs. 0.31% on average) caused by commodities linked to higher exchange rate costs e.g. cleaning products). Meanwhile, monthly inflation for processed foods (0.3%) was lower than its short term trend despite the sharp adjustment to exchange rates, which could be attributed to the recent fall in certain domestic raw materials (e.g. agricultural products) and to the cycle of low demand. In services the increases in housing are noticeable (they are related to the increased cost of building materials), but also the falls in other services (air transport) which stem from seasonal effects of low demand and contraction in their principal energy raw material.
- The currently difficult background could lead to an underlying inflation that is higher than general inflation in 2009, and for a relatively long time (a situation that has not been seen in Mexico). Non-underlying prices may fall sharply since the agricultural cycle presents a favourable profile this year and the policy of energy price subsidies will be very positive for the year end. In contrast, the increased cost of imported raw materials will slow down the adjustment to the fall in inflation for goods and certain services (like housing). The risk in this scenario lies in continued exchange rate shocks and the gradual recovery of the economy towards 20010 resulting in greater inflationary pressures than those estimated for the close of this and the coming year. Up to now, the fall in inflation has been based on volatile factors.

Mexico: Inflation 2009					
	Monthly change (%)		Annual change (%)		Dif. (pp)
	Avg. Feb 2003-08	Feb-09	Ene-09	Feb-09	
<b>CPI-Mx</b>	<b>0.32</b>	<b>0.22</b>	<b>6.28</b>	<b>6.20</b>	<b>-0.08</b>
<i>Core-Mx</i>	<i>0.43</i>	<i>0.49</i>	<i>5.76</i>	<i>5.78</i>	<i>0.02</i>
Goods	0.40	0.60	6.80	6.98	0.18
Food products	0.53	0.30	9.70	9.50	-0.21
Other Goods	0.31	0.85	4.48	4.97	0.49
Services	0.47	0.39	4.80	4.68	-0.13
Rent	0.47	0.52	3.95	3.89	-0.06
Education	0.35	0.40	5.66	5.88	0.22
Other serv.	0.51	0.25	5.44	5.09	-0.35
<i>Non Core-Mx</i>	<i>0.01</i>	<i>-0.51</i>	<i>7.71</i>	<i>7.36</i>	<i>-0.36</i>
Farm products	-0.50	-1.37	10.67	11.08	0.41
Fruits//Vegetables	-2.48	-5.64	6.91	5.83	-1.08
Meat//Eggs	0.88	1.33	13.19	14.42	1.24
Public managed	0.26	-0.07	6.25	5.56	-0.69
Energy	0.07	-0.39	5.80	4.97	-0.83
Controlled prices	0.47	0.26	6.74	6.20	-0.54

