

Mexico

# Economic Watch

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## Economic Analysis

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## Inflation: downside surprise

### Inflation for the first two weeks in March 2011

- **The CPI rose by 0.05% q/q and continued to slow down in annual terms from 3.57% y/y in February to 3.09% y/y in the first two weeks of March.**
- **The core sub-index rose by 0.24% q/q, very much in line with BBVA Research's estimate, 0.21%. The price of the *tortilla* was once again one of the main factors driving inflation up, as a result of frost spell in the State of Sinaloa.**
- **Non-core inflation dropped by 0.58% q/q. This decline was the result of falls in the prices of various agricultural products and ownership collection in some cities.**

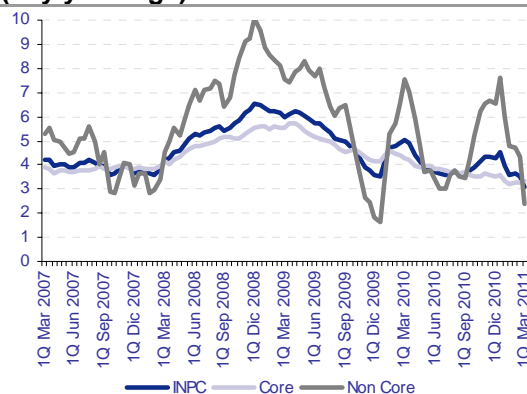
Inflation in the first two weeks of March was 0.05% (3.09% y/y), a surprise downturn for the market. The lower inflation rate was the result of the performance of the non-core sub-index, including the reduction in the prices of various agricultural prices and local public prices.

The core sub-index rose by 0.24% q/q (3.31% y/y), in line with BBVA Research and market forecasts, 0.21% in both cases. The rise in the price of the *tortilla* (2.47% q/q) determined to a great extent the higher growth rate in the goods sub-index (0.27% q/q) and was reflected in its processed foodstuffs component (0.51% q/q). However, the result of core inflation can be considered positive, since in bimonthly terms inflation figures for its two sub-indexes, goods and services, kept close to its average for the 2003-2009 period. In addition, services continued to slow down, dropping from 3.82% y/y last September to 2.81% y/y.

Non-core inflation fell by 0.58% q/q, a figure very different from the average for the 2003-2009 period, which recorded a 0.34% q/q increase. Moreover, such a pronounced reduction in this component during the first two weeks of March has not been observed over the last 10 years. This decline was the result of falls in the prices of various agricultural products and ownership collection in some cities. The prices of agricultural products fell by 2.15% q/q, and vehicle paperwork by -3.46% q/q. One factor that has attracted the attention of both the financial authorities and the market was the potential spread of the increase in the international price of oil to the price of energy products. During the first two weeks of March, the consumer price of energy products rose moderately (0.49% q/q), when compared with its average growth in the 2003-2009 period (0.35% q/q).

There is still a great deal of uncertainty surrounding the inflation outlook. On the one hand, commodity prices remain high, particularly oil prices, and therefore the increase in the price of imported commodities is a factor to be considered as a potential upward pressure. On the other hand, recent events in Japan, the uncertainty persisting in Europe, and a potential negative effect on the world economy if oil prices remain high for an extended period of time generate uncertainty on the extent of recovery, which could moderate inflation. Despite this uncertainty, recent data on the performance of prices leads us to believe that inflation this year will be lower than last year, and the year should close within the target set by the Bank of Mexico (3% +/-1%).

Chart 1  
General inflation and components  
(% y/y change)



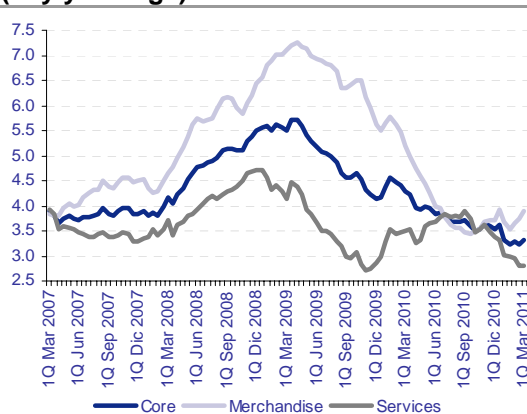
Source: BBVA Research with Banxico data

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

	Bi-weekly Avg. March 2003-2009	Bi-weekly March 2010	Bi-weekly March 2011	YoY % chg. Bi-weekly March 2011
<b>CPI-Mx</b>	<b>0.24</b>	<b>0.46</b>	<b>0.05</b>	<b>3.09</b>
<b>Core-Mx</b>	<b>0.21</b>	<b>0.17</b>	<b>0.24</b>	<b>3.31</b>
<b>Goods</b>	<b>0.21</b>	<b>0.12</b>	<b>0.27</b>	<b>3.91</b>
Food products	0.26	0.08	0.51	5.38
Other goods	0.17	0.15	0.08	2.77
<b>Services</b>	<b>0.21</b>	<b>0.22</b>	<b>0.22</b>	<b>2.81</b>
Rent	0.21	0.08	0.09	2.06
Education	0.04	0.03	0.02	4.46
Other serv.	0.27	0.41	0.40	2.94
<b>Non Core-Mx</b>	<b>0.35</b>	<b>1.37</b>	<b>-0.58</b>	<b>2.36</b>
Farm products	0.43	2.85	-2.15	-2.02
Fruits//Vegetables	0.37	6.73	-4.88	-6.73
Meat//Eggs	0.47	0.19	-0.16	1.55
<b>Public managed</b>	<b>0.31</b>	<b>0.42</b>	<b>0.30</b>	<b>5.00</b>
Energy	0.35	0.56	0.49	5.87
Government Authorized	0.24	0.19	-0.05	3.53

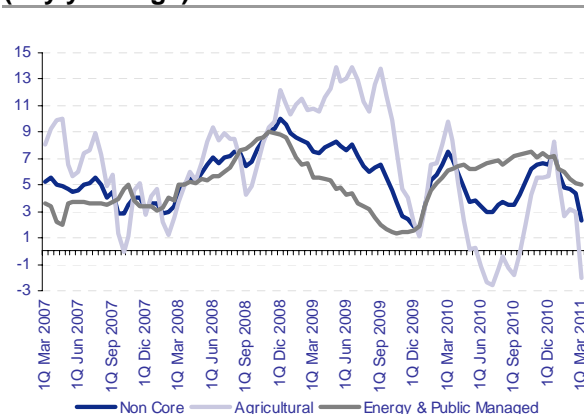
Source: BBVA Research with Banxico data and the Banamex survey data

Chart 2  
Core inflation and components  
(% y/y change)



Source: BBVA Research with Banxico data

Chart 3  
Non-core inflation and components  
(% y/y change)



Source: BBVA Research with Banxico data

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