



Inflation Observatory

June 5, 2009

Inflation reaches central bank's target

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- **May inflation fell 0.3%, once again below expectations.**
- **The sectors that contributed to the decline the most were health, recreation and culture and clothing and shoes.**
- **We are revising our inflation forecast for 2009 from 0.6% to 0.2%.**
- **Inflation and activity indicators hint at a 50 bp change in the MPR.**

May inflation: A drastic fall in medicine prices (-8.2%), attributed to a "price war" between pharmacies, the effect of fears of human cases of swine flu on Tourist Package prices (-2.4%), and a new price cut in clothing and shoes, contributed to the 0.3% negative inflation in May. This once again surprised analysts (who expected 0.1%) and the BBVA Research Department (which forecast 0%).

In light of this change, negative inflation of 1.1% is accrued YTD, and inflation in year-on-year terms is 3%, right in the middle of the central bank's target range.

Core inflation (IPCX), which excludes non-processed food and fuel, recorded the same change as the CPI (-0.3%), insofar as the CPIX1, which also excludes regulated prices, dropped by 0.1%.

In year-on-year terms, the CPIX was 4.4%, and the CPIX1 was 3.7%.

Wages: In April, the General Hourly Wage Index increased by 0.3%, accruing a nominal change of 7.0% over twelve months and a real change of 2.5%. The General Labor Cost Index rose by 0.4% in April, and 7.4% over 12 months. In real terms, the 12-month increase was 2.9%.

Inflation Outlook: For the months of June, July and August, we expect inflation rates of 0.1%, 0.2% and 0.3%, respectively. It is worth noting that due to the high CPI basis for comparison for these months in 2008, 12-month inflation for June will fall 1.7%, below the lower limit of the central bank's target range. In addition, should our forecast prove correct, we will see negative inflation in September, October and November, ending the year at 0.2%.

Appraisal:

The Monthly Economic Activity Indicator (IMACEC) for April (-4.6%) hints that economic activity has remained flat and is contributing to the low inflation recorded in the first months of the year.

Bearing in mind both activity and inflation indicators, it is highly likely that the central bank will step up the monetary policy expansion process, cutting the monetary policy rate by 50 bp at its next meeting. We also expect the BCCh Board to announce that it will keep the rate at 0.75% for a long time, which we estimate would be until the first quarter of 2010.

INFLATION FORECASTS

BASE SCENARIO

Date: June 5, 2009

MONTHLY CHANGE			
	CPI	CPIX	CPIX1
Jan-09	-0.8	-0.2	-0.4
feb-09	-0.4	-0.3	0.2
mar-09	0.4	0.6	0.8
Apr-09	-0.2	-0.2	-0.1
may-09	-0.2	-0.3	-0.5
June-09	0.1	-0.1	
July-09	0.2	0	
Aug-09	0.2	0	
sep-09	0.4	0.2	
oct-09	0.3	0.3	
nov-09	0.2	0.1	
Dec-09	-0.2	-0.1	
Jan-10	0	0.2	
feb-10	0.4	0.4	
mar-10	-0.3	-0.3	
Apr-10	0.2	0.2	
may-10	0	0	
June-10	0.2	0.1	
July-10	0.4	0.3	
Aug-10	0.1	0.1	
sep-10	0.2	0.2	
oct-10	0.3	0.3	
nov-10	0.2	0.3	
Dec-10	-0.1	0.1	

YOY CHANGE			
	CPI	CPIX	CPIX1
Jan-09	6.3	8	6.9
feb-09	5.5	6.7	6.7
mar-09	5	6.5	6.2
Apr-09	4.5	5.5	5.3
may-09	3	4.4	3.7
June-09	1.7	3.5	
July-09	0.7	2.4	
Aug-09	0.1	1.6	
sep-09	-0.6	0.9	
oct-09	-1.1	0.6	
nov-09	-0.8	0.1	
Dec-09	0.2	-0.1	
Jan-10	1	0.3	
feb-10	1.7	0.9	
mar-10	1	0	
Apr-10	1.4	0.4	
may-10	1.6	0.8	
June-10	1.7	1	
July-10	1.9	1.3	
Aug-10	1.7	1.4	
sep-10	1.5	1.4	
oct-10	1.4	1.5	
nov-10	1.5	1.7	
Dec-10	1.6	1.9	