

# Inflation Observatory

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## Consumer prices (November)

- Core prices increased in a year-over-year basis, more than expected, by 2.3 percent in November, up from 2.2 percent in October
- Consumer prices increased at a seasonally adjusted annual rate of 4.2 percent during the first eleven months of 2007 compared to 2.6 percent during 2006
- One of the largest contributors to the overall increase in price levels was the energy index, which rose by 18.1 percent in the first eleven months of 2007 compared to 2.9 percent increase in 2006, after seasonal adjustment

In November, consumer prices were 4.3 percent higher than a year ago, before seasonal adjustment. This is the largest 12-month increase since June 2006, when the CPI-U reached 4.2 percent. On a seasonally adjusted basis, the CPI-U increased 0.6 percent in November following a 0.3 percent increase in October, according to the Bureau of Labor and Statistics latest release. In addition, the CPI-W (Index for Urban Wage Earners) increased by 0.9 percent in November, on a seasonal adjustment basis, and it was 4.6 percent higher than a year ago.

The index for energy rose by 5.7 in November following a 1.4 percent increase in October. The index for energy services rose by 3.2 percent while the food index rose by 0.3 percent, contributing the same to overall inflation in November compared to last month.

The consumer price index excluding food and energy increased by 2.3 percent in November, up from 2.2 percent in October, on year over year basis; this is consistent with a scenario of moderate inflation expectations.

In addition, the slight upward movement on core inflation readings is, mainly, due to a higher index for shelter combined with an increase in the index for apparel during the last month. Overall, the CPI-U is gaining some momentum but core inflation appears to be contained.

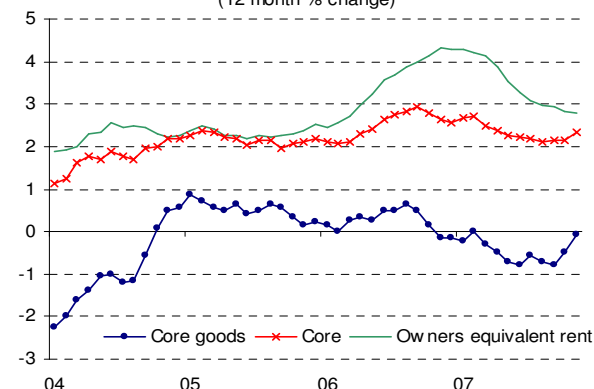
Our current forecast for December includes a scenario of moderation of energy prices, consistent with a 3.3 percent year-over-year rate. We expect core inflation to remain unchanged at 2.3 percent in December.

Going forward our assessment of inflation risks remains tilted towards the upside given an environment of high commodities and oil prices, along with dollar weakness and slower corporate profit growth higher core producer prices and high wage inflation.

## Consumer prices (sa, %)

	Nov	Oct	Sep	3-month change	12-month change
<b>CPI</b>	0.8	0.3	0.3	5.6	4.3
<b>Core</b>	0.3	0.2	0.2	2.6	2.2
<b>Excl. shelter</b>	0.3	0.2	0.1	2.3	1.8
Energy	5.7	1.4	0.3	33.8	21.4
Food	0.3	0.3	0.5	4.3	4.8
<b>By expenditure</b>					
Food & Beverages	0.3	0.3	0.5	4.1	4.7
Housing	0.4	0.2	0.3	3.6	3.1
Shelter	0.3	0.1	0.3	3.0	3.1
Rent of prim. resid.	0.4	0.5	0.3	4.7	4.0
Owners' eq. rent	0.3	0.2	0.3	3.4	2.8
Apparel	0.8	0.0	0.3	4.1	-0.4
Transportation	2.9	0.4	0.1	14.4	9.6
New vehicles	0.1	-0.2	-0.3	-1.4	-0.4
Gasoline	9.3	1.4	0.4	53.4	37.1
Medical Care	0.4	0.6	0.3	5.2	5.0
Recreation	0.1	0.3	0.3	3.0	0.6
Education & Comm.	0.1	0.4	0.1	2.2	-0.1
Other Goods & Serv.	0.3	0.2	0.4	3.7	3.7
Commodities	1.5	0.3	0.2	8.2	1.4
Excl. food & energy	0.2	0.0	0.0	0.5	0.0
Services		0.3	0.3	3.8	3.3
Excl. energy	0.3	0.2	0.3	3.5	0.1

Consumer Price Index  
(12 month % change)



# Trends

## Labor Costs

**Average Hourly Earnings**  
(Year-over-year % change)

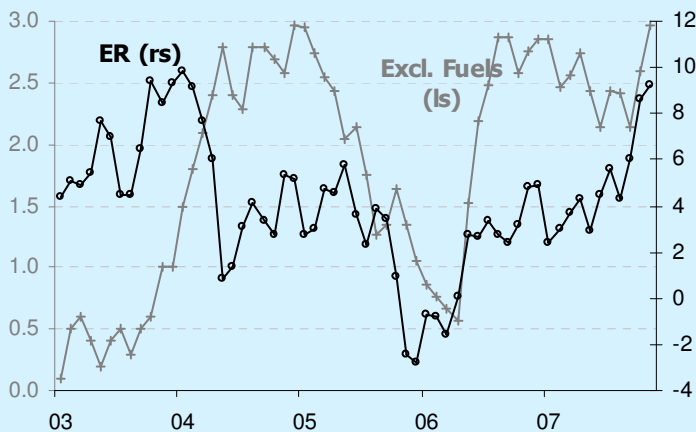


### Continued labor costs pressures

Average hourly earnings increased 3.8% in November from 3.6% in October. AHE growth has moderated from its last peak of 4.3% in December 2006; yet, it continues to be relatively high. Although labor cost continue to pressure businesses profits; they are likely to recede somewhat in 2008 as economic slack increases.

## Import prices

**Import Prices & Effective Exchange Rate**  
(12-month change)

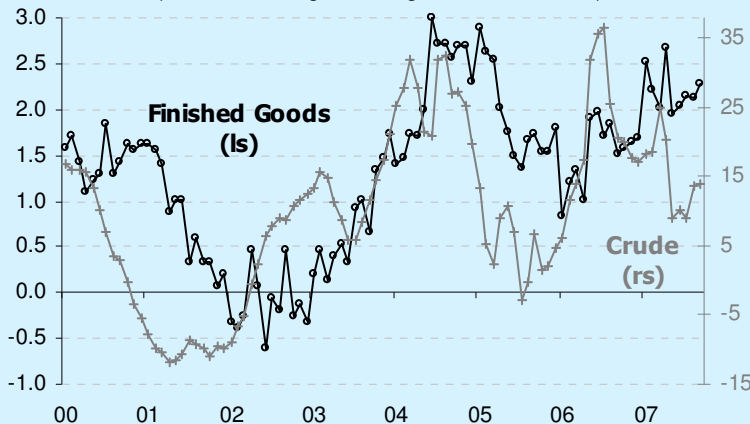


### Ongoing dollar weakness jeopardizes core import prices

Elevated energy and commodity prices continue pressuring import prices. However, even excluding energy and commodity prices, import prices inflation have soared, reflecting ongoing dollar weakness. Pass-through effects from import to core consumer prices may be limited if competitive pressures from abroad force firms to absorb rising import prices.

## Producer prices

**Core Producer Prices**  
(12-month change, crude goods 6-month lead)

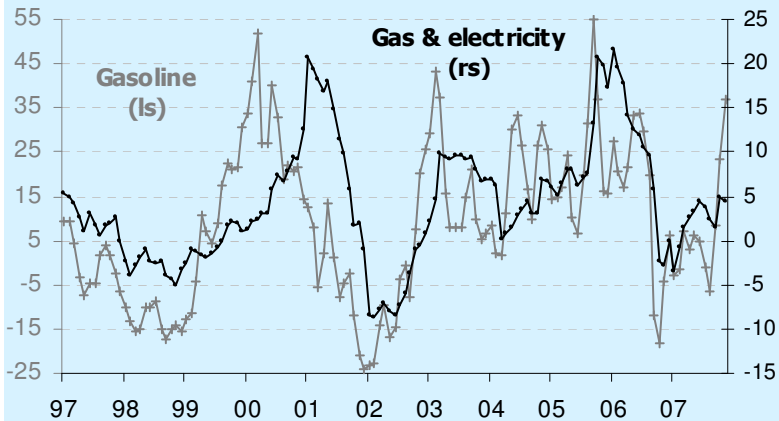


### The biggest inflation risks stems from elevated pipeline pressures

Both finished and crude core producer prices continue surprising on the upside. The former have risen to 2.3% in November 2007 from 0.8% in January 2006, when they reached their lowest rate since 2003. The latter have moderated from the rates seen in 2006; yet, the 12-month change remains at almost 15%. These trends highlight the major risks to our inflation outlook. With corporate profits already declining on a year-to-year basis and continuing pressures on labor costs firms could be more willing to increase final prices. In our base scenario, slower economic growth will help to contain these pressures.

# Energy prices

**Gasoline & Gas & Electricity**  
(12-month change)

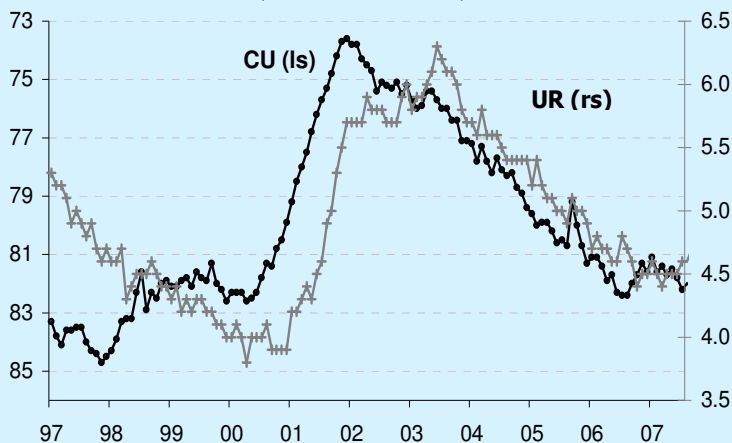


## Pressures from energy prices in November are unlikely to continue in December

In November, month-to-month change in gas and electricity prices was 0.7%, while that of gasoline was 9.3%. On a year-over-year basis, they increased 4.4% and 37.1% respectively. Higher energy prices have the potential to push upwards core inflation; however, they could soften as economic activity slows down in the coming quarters.

# Economic slack

**Capacity Utilization & Unemployment Rate**  
(%, inverted scale & %)



## A higher unemployment rate could ease inflationary pressures from labor markets

Although the unemployment rate remains at relatively low levels, it is likely to increase in coming months as a result of lower employment gains. However, this increase will be small as participation rate remain at their current low levels. The biggest uncertainty is how the economy will react to the existing divergence in labor market conditions between goods producing and services sectors. In our base scenario, a slower pace of economic growth will result in higher economic slack, which should help containing inflationary pressures.

# Forecasts

	CPI		Core	
	%	M/M*	12-month	M/M*
2006 Dec	2.5	0.5	2.6	0.2
<b>2007 Jan</b>	<b>2.1</b>	<b>0.2</b>	<b>2.7</b>	<b>0.3</b>
Feb	2.4	0.4	2.7	0.2
Mar	2.8	0.6	2.5	0.1
Apr	2.6	0.4	2.3	0.2
May	2.8	0.7	2.2	0.1
Jun	2.7	0.2	2.2	0.2
Jul	2.4	0.1	2.2	0.2
Aug	2.0	-0.1	2.2	0.2
Sep	2.8	0.3	2.1	0.2
Oct	3.5	0.3	2.2	0.2
Nov	4.3	0.6	2.3	0.3
<b>Dec</b>	<b>3.3</b>	<b>-0.1</b>	<b>2.3</b>	<b>-0.1</b>
Average 2006	3.2		2.5	
<b>2007</b>	<b>2.8</b>		<b>2.3</b>	

Forecasts in bold; \*sa

**Core CPI**  
12-month change

