

Inflation Observatory

January 16, 2008

Luis Arregoces

luis.arregoces@bbvausa.com

Consumer prices (December)

- Core prices increased in a year-over-year basis, more than expected, by 2.4 percent in December, up from 2.3 percent in November
- Headline consumer prices increased at a seasonally adjusted annual rate of 5.6 percent in the fourth quarter of 2007
- One of the largest contributors to the overall increase in price levels continued to be the energy index, which rose by 17.4 percent in 2007 compared to 2.9 percent increase in 2006, after seasonal adjustment

In December, consumer prices were 4.1 percent higher than a year ago, before seasonal adjustment. This is the second largest 12-month increase since June 2006, when the CPI-U reached 4.2 percent. On a seasonally adjusted basis, the CPI-U increased 0.3 percent in December following a 0.6 percent increase in November, according to the Bureau of Labor and Statistics latest release. In addition, the CPI-W (Index for Urban Wage Earners) increased by 0.3 percent in December, on a seasonally adjusted basis, and it was 4.3 percent higher than a year ago.

The index for energy rose by 0.9 in December following a 5.7 percent increase in November. The index for energy services rose by 0.5 percent while the food index remain unchanged, down from 0.3 percent in the previous month, contributing less to overall inflation in December compared to last month.

The consumer price index excluding food and energy increased by 0.2 percent in December, down 0.3 percent in November; on year over year basis core CPI increased by 2.4 percent in December, before seasonal adjustment; this is consistent with a scenario of moderate inflation expectations.

In addition, the slight downward movement on core inflation readings is, mainly, due to a lower index for shelter combined with a small decrease in the index for apparel during the last month. Overall, headline consumer prices are gaining some momentum but core inflation appears to be contained.

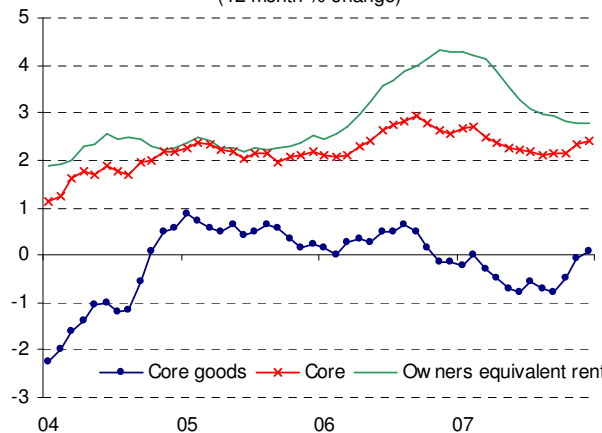
Our current forecast for January includes a scenario of moderation of energy prices, consistent with a 4.5 percent year-over-year rate. We expect core inflation to increase by 2.5 percent in January.

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 moderate wage inflation.

Consumer prices (sa, %)

	Dec	Nov	Oct	3-month change	12-month change
CPI	0.3	0.9	0.3	6.2	4.3
Core	0.2	0.3	0.2	2.7	2.4
Excl. shelter	0.2	0.3	0.2	2.7	1.9
Energy	0.9	5.7	1.4	37.1	17.4
Food	0.1	0.3	0.3	2.4	4.9
By expenditure					
Food & Beverages	0.0	0.2	0.3	2.3	4.9
Housing	0.3	0.5	0.3	4.4	3.1
Shelter	0.3	0.3	0.1	2.8	3.1
Rent of prim. resid.	0.4	0.4	0.5	5.0	4.0
Owners' eq. rent	0.3	0.3	0.2	3.4	2.8
Apparel	0.2	0.8	0.0	4.1	-0.4
Transportation	0.5	2.9	0.4	16.3	8.3
New vehicles	0.0	0.1	-0.2	-0.5	-0.3
Gasoline	1.1	9.3	1.4	57.8	29.6
Medical Care	0.3	0.4	0.6	5.1	5.2
Recreation	0.0	0.1	0.3	1.8	0.8
Education & Comm.	0.3	0.1	0.4	3.0	3.0
Other Goods & Serv.	0.3	0.3	0.2	3.0	3.3
Commodities	0.2	1.5	0.3	8.1	5.2
Excl. food & energy	0.0	0.2	0.0	0.8	0.1
Services	0.3	0.3	0.3	4.0	3.3
Excl. energy	0.3	0.3	0.2	3.5	3.3

Consumer Price Index
(12 month % change)



Trends

Labor Costs

Average Hourly Earnings

(Year-over-year % change)



Labor costs pressures are losing momentum

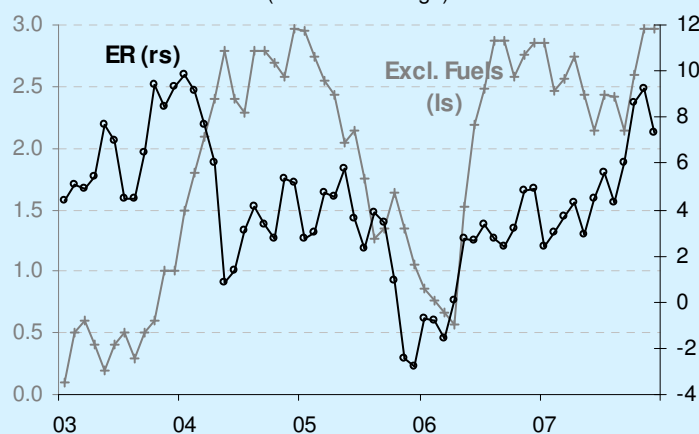
Average hourly earnings (AHE) increased 3.7 percent in December, down a bit from 3.8 percent in November. Growth in AHE has moderated after reaching a peak of 4.3 percent in December 2006; however, it remains relatively high.

Currently, labor costs create downward pressure on business profits; in our view, these pressures are likely to continue for some time, but should retreat somewhat in 2008 as economic slack increases.

Import prices

Import Prices & Effective Exchange Rate

(12-month change)



The dollar weakness continues creating upward pressure in core import prices

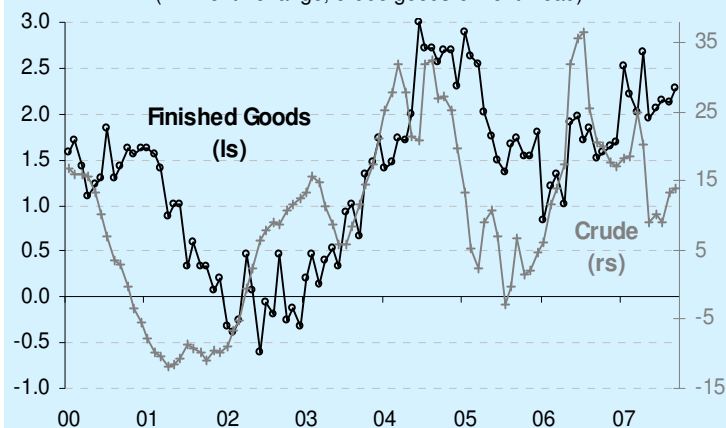
Record high energy and commodity prices continue to force the upward trend in import prices. Overall, the import price index excluding energy and commodity prices continues with a strong upward trend; most of the pressure on import prices is due to the dollar weakness.

Until recently, firms have been carrying the burden of higher import prices and the pass-through effects from import prices to core consumer prices has been limited. We expect this situation to continue in the near-term.

Producer prices

Core Producer Prices

(12-month change, crude goods 6-month lead)



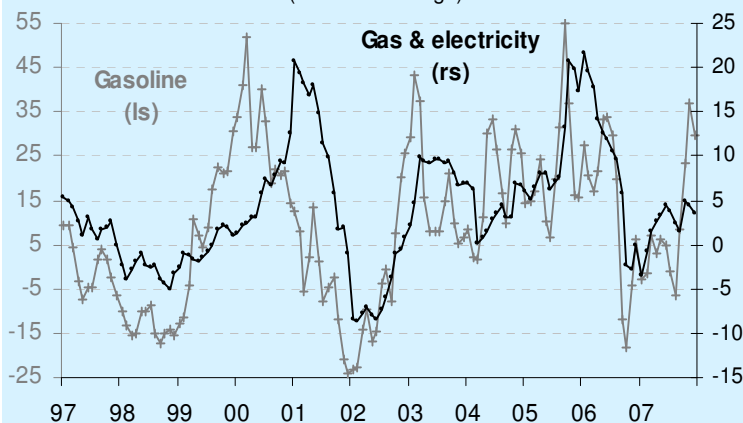
Elevated pipeline pressures continue to be one of the biggest risks to inflation in 2008

Finished core producer prices decreased more than previously expected, by 3.8 percent in December on a month-to-month basis; however, they remain relatively high compared to the long-term average. Also, in December crude core producer prices surprised on the upside continuing with the upward trend.

Under a scenario of declining corporate profits, on a year-to-year basis, and upward pressures on labor costs firms are more likely to increase final prices. In our view, slower economic growth should offset the rising cost of production, thus we expect final prices to remain contained in the near term.

Energy prices

Gasoline & Gas & Electricity
(12-month change)



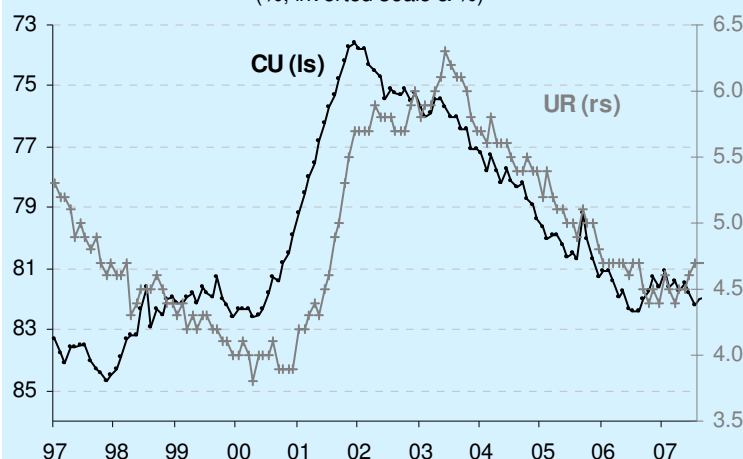
According to our expectations pressures from energy prices retreated in December

Electricity prices decreased by 0.2 percent and gasoline prices increased by 1.1 percent in December, significantly less than the 9.3 percent observed in November. Natural gas prices lost momentum increasing by 2.3 percent in December.

Overall, energy prices moderated in December; however, high-energy prices have the potential to push upwards core inflation. In our view, energy prices should soften as economic activity slows down in coming quarters.

Economic slack

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



Unemployment rate continues with a soft upward trend; this could ease inflationary pressures from labor markets

The unemployment rate (UR) reached 5.0 percent in December, remaining at relatively low levels; the UR is likely to increase in the near-term as the economy cools down.

Currently, the capacity of the service sector to absorb all the workers released from the goods producing sector is limited; however, it is clear that a slower pace of economic growth will result in higher economic slack, which in turn should contain some of the inflationary pressures.

Forecasts

		CPI		Core	
%		12-month	M/M*	12-month	M/M*
2007	Dec	4.1	0.3	2.4	0.2
2008	Jan	4.5	0.8	2.5	0.4
	Feb	3.8	0.0	1.8	0.2
	Mar	2.7	0.1	1.5	0.4
	Apr	2.0	0.1	1.6	0.3
	May	2.0	0.6	2.0	0.2
	Jun	2.1	0.4	2.0	0.0
	Jul	2.5	0.1	2.0	0.1
	Aug	3.0	0.3	2.2	0.3
	Sep	3.1	0.4	2.2	0.3
	Oct	2.7	-0.3	2.3	0.6
	Nov	2.2	0.0	2.4	-0.1
	Dec	2.3	-0.3	2.4	-0.3
Average	2007	2.9		2.3	
	2008	2.7		2.1	

Forecasts in bold; *sa

Core CPI
12-month change

