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Increase in Value-Added Tax Boosts Consumer Prices in January-April

by LADB Staff

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President Ernesto Zedillo's decision to raise the value-added tax (IVA), effective on April 1, contributed to an increase of 8% in the consumer price index (Indice Nacional de Precios al Consumidor, INPC) during April. The increase in the IVA to 15% from the previous 10% was part of a package of drastic economic measures designed to address the effects of the devaluation of the peso. The measures also included such unpopular steps as higher costs for gasoline and electricity and tight restrictions on internal credit (see SourceMex, 03/15/95). The INPC rate of 8% for April compares with a rate of 5.9% during March.

In its report announcing the April inflation rate, the Banco de Mexico (central bank) said the INPC for that month would have reached only 6% if the Zedillo administration had not decided to raise the IVA. Because of the increase in the IVA, however, inflation in April was the highest for that month since 1987, when the rate was reported at 8.7%. Indeed, according to the daily newspaper *Reforma*, the INPC for April was reported at 1% or less each year between 1991 and 1994. In 1994, the April INPC was reported at 0.5%. For April of this year, the Banco de Mexico reported that the highest increases during the month were for beverages, tobacco, clothing, footwear, housing (including rent and utilities), domestic furniture, medical expenses, transportation, and education. Among food items, prices increased the most for such items as chile peppers, bread, tortillas, meat, eggs, cooking oil, lemons, and mangos.

The rate for the basic basket of consumer goods, which is normally higher than the INPC, was reported at 10.4% for April. The highest price increases in April were reported in the cities of Puebla, Queretaro, Torreon, Cuernavaca, Tlaxcala, Tampico, and Monterrey. The average INPC increased between 8.4% and 9.8% in those cities. On the other hand, the cities of Ciudad Juarez, Matamoros, La Paz, Chetumal, Villahermosa, Chihuahua, and Campeche reported the lowest increases. Because of the sharp increase in April, the accumulated inflation rate for January-April was reported at 23.6%, creating some doubts about whether the Zedillo administration will be able to meet its most recent target of 42% annual inflation for 1995. According to some calculations, consumer inflation would have to average 2.3% each month between May and December for the 42% rate to be attained.

The Zedillo administration itself is already forecasting an INPC of about 4% for May, which means that monthly inflation from June to December would have to average about 2%, at best. Indeed, in an interview on the cable television network CNBC, Mexico's ambassador to the US, Jesus Silva Herzog, said the administration plans to issue a revised and more realistic target of 50% sometime before the end of June. For now, the Zedillo administration continues to insist that the 42% rate is attainable. Speaking to reporters, Zedillo's chief economic spokesman, Alejandro Valenzuela, said the increase of 20% in the value of the peso in recent weeks has reduced pressure on prices, which will eventually become evident as a lower inflation rate. He said monthly inflation rates of 2% are

possible in the second half of the year if the administration is able to continue to limit spending and reduce the supply of money in circulation. In forecasts released during late April and early May, a number of US and Mexican financial analysts agreed with the Zedillo administration's predictions that the inflation rate would begin to decline.

"Inflation will decline at a faster rate than expected during the next several months," said economist Robert Gay of Bankers Trust. However, Gay and other analysts said the declines would not be sufficient to meet the targeted annual inflation rate of 42%. Instead, they predicted the rate could approach or surpass 50%. On a related matter, because of the present economic crisis, Mexico earned the ill-fated distinction as the country with the highest rate of inflation throughout Latin America during the first quarter of the year. Mexico's accumulated inflation rate of 14.5% in January-March was more than five percentage points higher than in Venezuela, the runner up in Latin America where accumulated inflation for the first quarter totalled 9%. (Sources: United Press International, 05/02/95; La Jornada, 05/05/95; Agence France-Presse, 05/09/95, 05/10/95; Associated Press, El Norte, Excelsior, Reforma, 05/10/95; Wall Street Journal, 05/10/95, 05/11/95; Notimex, 05/11/95, 05/14/95)

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