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LADB Staff

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The inflation rate continued to inch upward during July, with the consumer price index (Indice Nacional de Precios al Consumidor, INPC) reported at 0.96%. The high INPC for the month brought accumulated inflation for January-June to 9.32%, or less than three percentage points below the government's target of 12% for the year. In the inflation report, the Banco de Mexico (central bank) attributed the increase partly to a drought in many growing areas of Mexico this year, which raised the price of fruits and vegetables. According to one estimate, extremely dry conditions have caused several million dollars in damage to the Mexican economy (see SourceMex, 08/05/98).

Without the drought impact, said the central bank, the INPC would have increased by only 0.75% in July. Higher costs for rents, medicines, transportation, electricity, and domestic appliances also contributed to the July rise. The central bank said the rate for the basic basket of goods increased by 0.88% in July, a marked decline from the rate of 1.33% reported in June.

Volatile currency markets could boost inflation further

While the Banco de Mexico has not modified its official forecast of a 12% inflation rate for this year, bank analysts unofficially are forecasting annual inflation at close to 14.6% in 1998. But private economists believe annual inflation could approach last year's rate of 15.7% if the peso continues its recent decline. Less than a week after the release of the monthly inflation report, the Banco de Mexico tightened the country's money supply for the third time this year to deal with the continuing decline of the peso on world currency markets.

The decline in the Mexican currency to about 9.20 pesos per US$1.00 on Aug. 10 was the result of losses in the value of several Asian currencies. In explaining its decision to withdraw 20 million pesos (US$2.16 million) from circulation daily, the bank acknowledged that the developments in Asian financial markets could cause "very undesirable" inflationary pressures for the Mexican economy. A weaker peso could boost inflation by raising the price of imports. Tightening monetary policy, which reduced the funds available in the money market and raised short-term interest rates, immediately helped the Mexican currency recover to about 9.1 pesos per US$1.00 on Aug 11. But the value of the Mexican currency was 9.25 pesos per US$1.00 on Aug 12.

The increase in short-term interest rates had a negative effect on the Mexican stock exchange (Bolsa Mexicana de Valores, BMV) because of concerns of potential reductions in GDP this year. The BMV's main index (Indice Nacional de Precios y Cotizaciones, IPC) lost more than 113 points Aug 10, dropping to its lowest level since April 1997. The IPC declined by another 103 points Aug 11.

Private economists have forecast GDP growth for 1998 as low as 3% to 4%, compared with last year's rate of 7%. In addition to the impact of higher interest rates on economic growth, this year's GDP will be affected by continuing weakness in global oil markets that has reduced Mexican revenues

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from exports of crude oil. The lower oil revenues have already forced President Ernesto Zedillo's administration to reduce this year's federal budget three times.

The latest reduction was announced in mid-July (see SourceMex, 07/15/98). "The economy has enough inertia to stay strong in the third quarter, but we will start to see a real effect in the fourth quarter of this year and certainly next year," said Damian Fraser, head of Mexico analysis for SBC Warburg Dillon Read. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Aug 12, reported at 9.25 pesos per US$1.00] (Sources: El Diario de Yucatan, 08/03/98; Bloomberg news service, 08/10/98; El Financiero International, 08/10/98; Reuters, 08/07/98, 08/10/98, 08/11/98; Novedades, Excelsior, La Jornada, 08/11/98; El Universal, 08/02/98, 08/11/98, 08/12/98; El Economista, The News, 08/11/98, 08/12/98)

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