

10-3-2007

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Recommended Citation

LADB Staff. "Calderon Freezes Energy Prices Through December to Ease Inflation." (2007). <https://digitalrepository.unm.edu/sourcemex/5151>

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Calderon Freezes Energy Prices Through December to Ease Inflation

by LADB Staff

Category/Department: Mexico

Published: 2007-10-03

The decision by President Felipe Calderon's administration and the Congress to impose a tax on gasoline and diesel as part of the recently approved reforms to the tax code unleashed a wave of speculation that caused consumer inflation to rise rapidly in Mexico.

Some of the changes to the tax code were to go into effect during the fall, but Calderon issued an executive order to freeze fuel and electricity prices at current levels until the start of 2008, in effect suspending implementation of the gas tax. The president announced the decision to freeze energy prices to help reduce inflationary pressures, as consumer prices rose at a much faster rate than anticipated during September.

The tax reform, which closes corporate loopholes in addition to boosting the gasoline tax, was approved overwhelmingly in Congress in September (see SourceMex, 2007-09-19). Some merchants started to increase prices in anticipation of higher fuel costs down the road, which prompted the administration to announce the freeze on energy prices for the rest of 2007.

The Banco de Mexico reported the consumer price index increase (indice nacional de precios al consumidor, INPC) at 0.62% in the first half of September, a slightly higher rate than the 0.50% anticipated by economists and market experts. The increase was on par with the 0.60% reported in the first half of 2006.

Increases respond to tax reform approved by Congress

The increase in the INPC for the first half of September came before the Congress voted on the tax reform. There was some concern that some wholesalers and retailers were beginning to raise prices in anticipation of higher fuel costs.

Because of this speculation, economic observers like Moody's Economy projected annual inflation for Mexico at 4% for all of 2007, a full percentage point above the government's target of 3%.

Similarly, economists interviewed by Bloomberg news service now anticipate the annual inflation rate for 2007 at 3.81%, compared with an earlier forecast of 3.65%. A surge in the global cost of grain late last year and early this year had already made the government's target unlikely. The high cost of grain was attributed to increased demand for corn in the US from producers of ethanol fuel (see SourceMex, 2007-01-10).

Accumulated inflation through August was only at about 1.42%, but some observers said the rate reported by the Banco de Mexico (central bank) did not reflect market realities. "The reports from

the central bank show a much different reality than what we see in the markets," said a report broadcast by Fuerza Informativa Azteca. For example, said the report, the price of tomatoes has increased by 500% during the course of this year to 25 pesos (US\$2.29) per kg, compared with 5 pesos (US\$0.45) at the start of the year.

While energy costs and speculation are behind the increase, the cost of tomatoes is also susceptible to weather-related factors (see SourceMex, 2006-10-11). Similarly, the cost of tortillas is up 41%, and the increase would have been higher had the government not intervened with price controls at the beginning of the year. Analysts said tight supplies of basic agricultural products like wheat, corn, rice, lentils, and sorghum will also be factors in a higher consumer price index in Mexico the rest of the year.

The Banco de Mexico said a rise in food prices during the first half of September was largely the result of speculation. The bank said the cost of basic products like bread, milk, and eggs during the 15-day period was much higher than in recent 15-day periods.

Some members of the private sector acknowledged that speculation was driving up the cost of some food items. "There was a temporary rush toward speculation, even before the tax reform was in place," said Luis Antonio Mahbub Sarquis, president de la Confederacion de Camaras Nacionales de Comercio, Servicios y Turismo (CONCANACO-SERVYTUR).

Mahbub noted that prices rose sharply on only five of the 80 products used to compile the INPC. "Wheat is the one product that we know has been subject to speculation," said the CONCANACO-SERVYTUR official. "But the Secretaria de Economia has authorized additional imports to help bring down prices, just as it did with corn and tortillas earlier in the year."

Finance Secretary reiterates pledge to control inflation

Finance Secretary Agustin Carstens, in testimony before Congress in early October, reassured legislators that the Calderon administration was taking steps to prevent a surge in inflation. "Inflation is not out of control, nor is it in danger of heading in that direction," Carstens told members of the Chamber of Deputies.

Carstens said, however, that Mexico could not isolate itself from trends in the global economy and therefore would continue to be affected by higher prices overseas. At the same time, the finance secretary pledged that the Calderon government would not remain passive in the face of unjustified price increases. "The government will act firmly in this regard," he said, pointing out that the 2008 budget would contain some measures to combat speculation.

Carstens' comments echoed Calderon's pledge to keep prices of consumer goods affordable for most Mexicans. "It is a priority to prevent a surge in prices that would harm our country," the president said in a short televised address announcing the freeze on fuel prices. Calderon credited the country's largest retailer organization, the Asociacion Nacional de Tiendas de Autoservicio y Departamentales (ANTAD) for working with the government to freeze prices of certain basic products like the popular bolillo roll.

The president's freeze on energy prices for the rest of the year will mean that the government could lose out on a potential 8 billion pesos (US\$730 million) in revenues this year. Therefore, Calderon said, the price controls will not become permanent.

Opposition parties divided on Calderon's action

Calderon's decision to freeze gasoline prices and fight speculation received a strong endorsement from his Partido Accion Nacional (PAN) and from the opposition Partido Revolucionario Institucional (PRI). Sen. Manlio Fabio Beltrones, one of the PRI's top leaders in the upper house, called the president's decision "sensible."

Similarly, Deputy Emilio Gamboa Patron, the PRI's floor coordinator in the lower house, said the measure offered the administration a golden opportunity to act against speculators. PAN Sen. Hector Larios echoed Beltrones' comments, praising the president for taking steps to control prices for basic goods. "[Calderon] has shown an enormous social sensibility," said the senator.

The center-left Partido de la Revolucion Democratica (PRD) had a different take on Calderon's action. "This is a short-term measure that is not going to resolve the problem," said Sen. Carlos Navarrete, in reference to the freeze on gasoline prices. He repeated the PRD's position that the increase in gas taxes should be removed entirely from the tax-reform plan, but clarified that the party does not oppose other sections of the legislation.

Deputy Javier Gonzalez Garza, who heads the PRD delegation in the Chamber of Deputies, said the problem goes beyond the cost of fuel. "[This price freeze] does not change anything," said Gonzalez Garza. "The problem is that our country's [capitalistic] economic model is totally flawed." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Oct. 3, reported at 10.90 pesos per US\$1.00]

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