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Statistics Agency Reports a Sharp Increase in Mexicoâ€™s Inflation in 2017

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Mexico's annual inflation rate reached its highest level in nearly two decades during 2017, reflecting in part the end of subsidies for gasoline prices at the beginning of the year.

In a report published in early January, the government statistics agency (Instituto Nacional de Estadística y Geografía, INEGI) placed annual inflation for 2017 at 6.77%.

INEGI measures annual inflation levels each month relative to the same month the previous year. According to the institute, the last time the inflation rate was higher than the one reported in December was in May 2001, when the rate reached 6.95%.

The December rate, which in effect represents a measurement of inflation for calendar year 2017, was twice as high as the 3% rate that the central bank (Banco de México, BANXICO) had targeted for the year.

INEGI acknowledged that high gas prices were a major contributing factor to the surge in the country's inflation rate. The liberation of prices resulted in increases of as high as 20% for magna, the most popular grade of gasoline, sparking widespread protests around the country (SourceMex, Jan. 4, 2017, and Feb. 8, 2017). The impact of the liberalization of the gasoline market eventually subsided, and so did the citizen protests (SourceMex, July 5, 2017).

Even though gasoline prices were higher in January 2018 than they were before the market was freed, the fluctuations occur on a daily basis rather than monthly. Additionally, service stations are free to set their own prices based on market conditions. A common price for magna was quoted at 16.79 pesos (US$0.91) per liter in Mexico City in January, compared with a national average price of 15.99 pesos (US$0.86) per liter in January of 2017.

"This is not an increase like we had last January, but it does reflect the pressures on the gasoline market," columnist Enrique Quintana wrote in the daily business newspaper El Financiero.

The bottom line is that the cost of gasoline in Mexico is now directly linked to the behavior of global prices and the impact of supply and demand. Several foreign companies have opened service stations in Mexico, but this has not increased supplies significantly because a lack of infrastructure has prevented the foreign companies from importing supplies. Instead, many have had to rely on the limited supplies provided by PEMEX (SourceMex, Nov. 8, 2017).

The increase in the price of fuel resulted in higher transportation costs, which contributed to an increase in the price of some vegetables last year, particularly products like tomatoes and zucchini. On average, the cost of fruits and vegetables rose 17.5% in 2017, compared to a 5.4% average annual increase over the previous five years, Guillermo Aboumrad, director of market strategies for brokerage firm Finamex, said in an interview.

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The increased inflation and the rise in fuel prices also had a negative effect on sales of motor vehicles. Domestic car sales in 2017 declined by about 4.6% from 2016, the worst drop since the financial crisis of 2008-2009 (SourceMex, Oct. 1, 2008), according to Mexico's main automobile industry association (Asociación Mexicana de la Industria Automotriz, AMIA).

"Inflation is what hit us the most," José Luis Salas, general manager of Grupo Surman, which operates 13 General Motors dealerships in Mexico, said in an interview with Reuters. "Most people want to buy with credit, and financial institutions and banks weren't able to cover the market."

Retail sales have also been sluggish because of inflation. According to Mexico's largest retailers organization (Asociación Nacional de Tiendas de Autoservicio y Departamentales, ANTAD), the growth in sales for members was the smallest in three years, after inflation is taken into account.

"Inflation is the most predatory tax there is," said ANTAD president Vicente Yáñez. "It punishes everyone the same."

Uncertainty in 2018

The budget that Congress approved for 2018 projects a decline in inflation back to a level of about 3% for this year, and there were hopeful signs in January. The consumer-price index rose 0.24% in the first two weeks of the year, pushing the annual rate down to 5.51% from 6.77% at the end of December, INEGI reported.

Prices for magna gasoline rose by only 1.475% in the first two weeks of January, compared with an increase of 16.8% in the same period in 2017. Prices were also lower for fresh fruits and vegetables and for other goods and services, said the INEGI report.

However, analysts are not certain that the short-term decline in inflation will hold, particularly with certain economic uncertainties looming in the background, including the fate of the North American Free Trade Agreement (NAFTA). Mexican, Canadian, and US negotiators appear to be far apart on key provisions, and the US has threatened to withdraw from the accord if an agreement is not reached (SourceMex, Oct. 18, 2017, and Jan. 10, 2018).

The uncertainty about NAFTA and the possibility of trade restrictions on the part of US President Donald Trump's administration has contributed to the volatility of the Mexican peso, which fell as low as 20.80 pesos per US$1.00 immediately after Trump's election (SourceMex, Nov. 16, 2016). The peso rebounded sharply to about 17.90 per US$1.00 by the summer (SourceMex, Aug. 2, 2017) before slumping again in the fourth quarter of 2017. The setback in October-December was not sufficient to derail the momentum of the Mexican currency, which recorded an increase in value of about 4.75%, the first positive result since 2014, according to El Financiero.

BANXICO is expected to continue to play an important role in keeping inflation down. The bank, under newly appointed Chief Governor Alejandro Díaz de León, boosted interest rates in December, and all indications are the bank will take the same action in February.

In an interview with the daily newspaper Milenio, Díaz de León said that even though an increase in interest rates might tend to discourage consumption and investment, adjusting monetary policy helps slow down inflation and therefore leads to greater confidence in the economy as a whole.

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Still, analysts are worried that inflation levels might not be held in check sufficiently to boost the purchasing power of Mexicans. That factor, along with tight credit and uncertainties related to NAFTA and the presidential election, could put a damper on consumption.

“Instead of going on vacation for two weeks, they go for one week; instead of buying the automobile this year, they wait a little bit to see how things go ... That is serious in the sense that private consumption has been, so far, the main engine of growth,” economist Alberto Ramos of Goldman Sachs told Reuters.

And the link of fuel prices to the free market could add an additional inflationary pressure for Mexican consumers. Pablo González Córdova, president of the gasoline retailers association (Asociación Mexicana de Empresarios Gasolineros, AMEGAS) projects that prices for magna gasoline could increase to 20 pesos (US$1.08 per liter) this year because of recent increases in global prices. The higher fuel prices, in turn, would cause increases in the price of basic goods and services.

“This would be a major blow to the economy of millions of families in Mexico,” González Córdova said.

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