

Inflation 2017 – Increase in minimum wage will have a small, but not negligible effect

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- The *CONASAMI* announced that the minimum wage will increase in 2017 from MXN73.04 per day to MXN80.04 per day, which represents a 9.85% rise on an annual basis
- In our opinion, the rise in the minimum wage will have an additional 30bps impact on inflation in 2017, so we now expect inflation at 4.3% (from previous 4%)
- Inflation in 2017 will be explained mainly by:
 - (1) Exchange rate pass-through to prices that will add 70bps to the inflation rate
 - (2) Deregulation of gasoline prices which will begin on January 1st will add another 50bps to the headline figure
 - (3) Another 30bps will rise as a result from the increase in the minimum wage, as already mentioned
 - (4) Nevertheless, the base effect will deduct 30bps from inflation, along with lower prices of telecommunication services and the change in methodology that will subtract an additional 20bps

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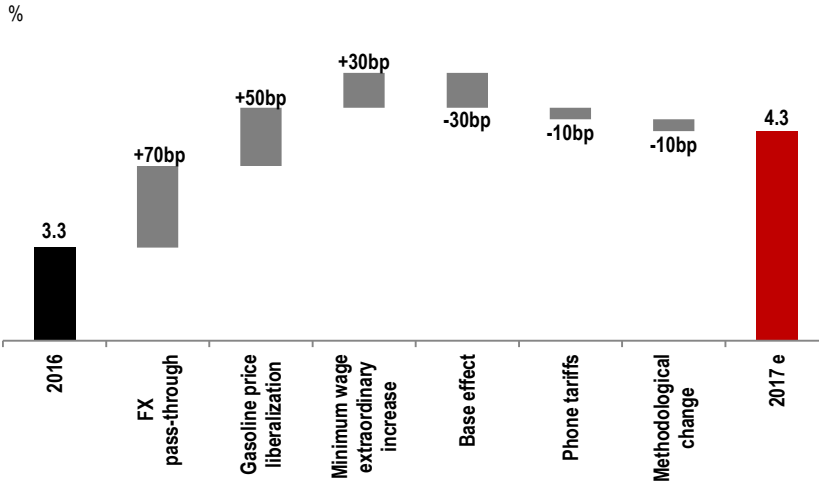
A significant increase in minimum wages. On December 1st, the National Commission of Minimum Wages (*CONSASAMI*), announced an increase in minimum wages for 2017. The rise is comprised of two components: (1) An increase –MXN4 pesos per day (5.4%)–, known as the *Independent Recovery Amount* (MIR), which is designed to compensate Mexican households from purchasing power loss; and (2) another MXN3 pesos per day (3.9%) increase in line with next year’s inflation expectation. With this revision, the minimum wage will amount to MXN 80.04 per day. In this context, we expect that the impact from the increase will positively impact, albeit in a marginal way, the price trajectory which will add 30 bps on headline inflation by YE17.

In our view, this increase will add 30bps to inflation in 2017. Using the methodology described by Card and Krueger (1993) as well as Kiel and McClain (1995), we estimated an econometric model of difference in differences using the homologation of minimum wages in October of 2015 from two zones to one. It is worth mentioning that before this date, zone “A” had a 2.7% higher salary than zone “B”. In this sense, we can use this event to forecast the impact from the actual increase in the minimum wage over next year, since it serves as a natural experiment of a federal policy targeting an improvement of purchasing power on price dynamics. The results of our econometric model suggest that the impact of the homologation in salaries on annual inflation amounted to 12.2bps. Considering that the actual salary increase is 2.6 times that of October 2015, the contribution from an MXN 80.04 per day minimum wage will be around 30bps.

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Inflation will reach 4.3% by YE17. We consider that inflation in 2017 will be explained mainly by: (1) Exchange rate pass-through to prices will add 70bps to the inflation rate; (2) deregulation of gasoline prices which will begin on January 1st will add another 50bps to the headline figure; (3) as previously mentioned, 30bps will rise as a result from the increase in the minimum wage. Nevertheless, (4) the base effect will deduct 30bps from inflation, along with lower prices of telecommunication services (-10bps) and the change in methodology that we estimate will subtract an additional 20bps from total CPI variation next year (see chart below).

Inflation forecast 2017



Source: Banorte-IXE

References

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