

Economic Analysis

Annual inflation fell for the second month in a row and will show a sharp slowdown in January

Javier Amador Díaz

Headline: actual: 0.49% MoM (BBVAe: 0.52%; consensus: 0.51%)**Core: actual: 0.23% MoM (BBVAe: 0.26%; consensus: 0.26%)**

- **We expect headline inflation to show a sharp slowdown in January (to 3.6% YoY) and to close 2015 at 3.3%**
- **In a context of weak demand and ample economic slack, pass-through should be contained. We expect core inflation to decline to 2.7% in January and to remain below 3.0% for most of the year**

Headline inflation increased 0.49% MoM in December. This print was broadly in line with expectations (BBVAe: 0.52%; consensus: 0.51%). In annual terms, inflation fell for the second consecutive month to 4.08% from 4.17% in November. Core inflation was 0.23% MoM, also slightly below expectations (BBVAe: 0.26%; consensus: 0.26%). In annual terms, core inflation declined to 3.24% from 3.34% in November. In a context of weak demand, there are no signs of price pressures.

Core inflation remains low and stable. The soft core inflation print continues to reflect the absence of demand side pressures. We expect annual core inflation to slow to 2.7% in January, to remain below 3.0% for most of the year, to average 2.8% in 2015 and to close the year at 3.0%. Although pass-through risks have risen given peso's continued weakness, our models suggest that pass-through has been declining over the years and is now very limited. Besides, domestic demand remains rather weak.

The fall in headline inflation would have been even larger over the last two months of 2014, as we had expected, had it not been for a sharp increase in food inflation. Non-core inflation was 1.28% MoM in December (BBVAe: 1.38%), pushed up by sharp increase in fruit and vegetable prices (6.56% MoM), mainly driven by a 41.1% MoM increase in tomato prices, and the persistent pressures on beef prices which increased 2.0% MoM in December. Perishable food prices increased 5.0% over the last two months of the year.

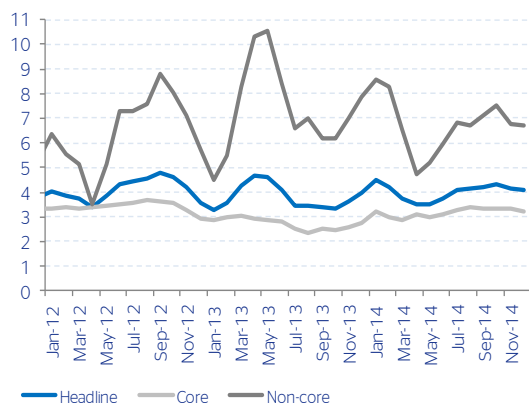
Bottom line: Today's print confirms that annual inflation is on a downward trend. We expect a sharp slowdown in January. Although there are some risks due to the recent sharp increase in the exchange rate, the outlook remains favorable as the pass-through should be contained in a context of weak demand.

Table 1
Inflation (MoM and YoY % change)

Inflation					
	MoM % change			YoY % change	
	Dec-14	BBVAe	consensus	Dec-14	Nov-14
Headline	0.49	0.52	0.51	4.08	4.17
Core	0.23	0.26	0.26	3.24	3.34
Non Core	1.28	1.38	1.33	6.70	6.78

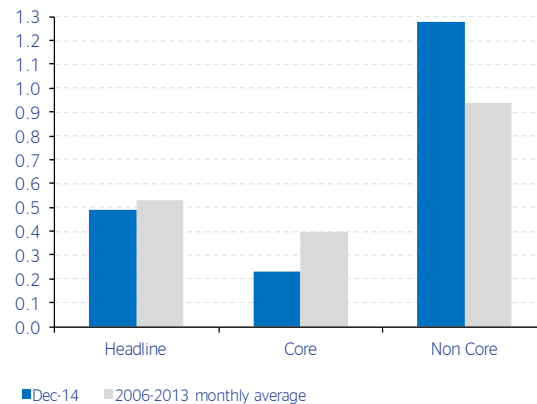
Source: BBVA Research, INEGI

Graph 1
Inflation and components (YoY % change)



Source: BBVA Research, INEGI

Graph 2
Inflation and components (MoM % change)



Source: BBVA Research, INEGI

Disclaimer

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research and BBVA Bancomer S. A., Institución de Banca Múltiple, Grupo Financiero BBVA Bancomer on behalf of itself and is provided for information purposes only. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA Bancomer, and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.