

Economic Analysis

Annual headline inflation is likely to remain close to 3.0% for most of the year

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Headline: actual: -0.09% MoM (BBVAe: -0.08%; consensus: -0.07%)**Core: actual: -0.03% MoM (BBVAe: 0.02%; consensus: 0.02%)**

- **Today's print supports our annual inflation year-end forecast (2.9%)**
- **In a context of weak demand and ample economic slack, pass-through should be contained**

Headline inflation decreased 0.09% MoM in January. This print was broadly in line with expectations (BBVAe: -0.08%; consensus: -0.07%). In annual terms, inflation declined to 3.07% from 4.08% in December (BBVAe: 3.07%; consensus: 3.09%). Core inflation was -0.03% MoM, surprising on the downside (BBVAe: 0.02%; consensus: 0.02%). In annual terms, core inflation declined to 2.34% from 3.24% in December. This report supports our annual inflation year-end forecast (BBVAe: 2.9%; consensus: 3.1%).

Core inflation continues to reflect the absence of demand side pressures or FX pass-through. The core goods component increased 0.22% MoM (BBVAe: 0.23%), as the second fortnight core goods inflation print was -0.05% FoF. Peso's continued weakness did not prevent the seasonal decline in the price of core goods with the start of winter sales. This thus suggests that demand side pressures remain absent that there have not been FX pass-through effects yet, likely because domestic demand remains rather weak. The source of the surprise was core services prices which decreased -0.24% MoM (BBVAe: -0.15%), as telecomm prices declined somewhat more than we anticipated. This report supports our annual core inflation year-end forecast (BBVAe: 2.8%; consensus: 2.9%).

Non-core inflation was favored by energy-related price deflation and a sharp decrease in fruit and vegetable prices; pressures on meat and eggs prices continue. Non-core inflation was -0.27% MoM (BBVAe: -0.42%), pushed down by the decrease in electricity tariffs (-2.05% MoM) and natural gas prices (-8.42% MoM), which together contributed with -0.08 pp of the monthly deflation. Fruit and vegetable prices decreased slightly less than we expected (-5.33% MoM; BBVAe: -5.90%), driven mainly by the large decrease in tomato prices (-38.70% MoM) which contributed with -0.24 pp of the monthly inflation decline. In contrast, meat and eggs prices increased 1.77% MoM (BBVAe: 1.61%) as pressures on beef prices continued (1.78% MoM), while eggs and poultry prices increased more than what our price-tracker suggested (4.70% and 1.91% MoM, respectively). With no more increases in gasoline prices for the remainder of the year, annual non-core inflation should gradually approach the annual headline inflation level.

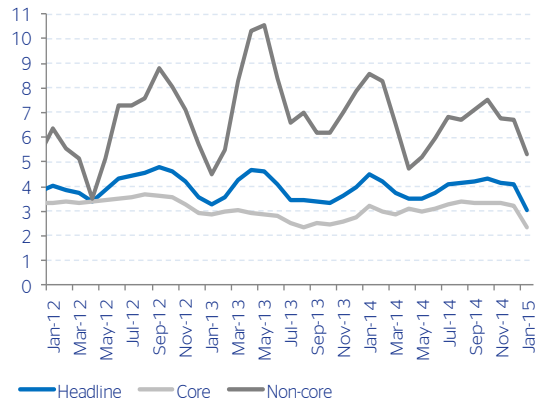
Bottom line: Today's print supports our view that annual inflation is likely to remain close to Banxico's target (3.0%) for most of the year, before declining to 2.9% by year-end. Although there are some risks due to the recent increase in the exchange rate, the outlook remains favorable as the pass-through should be contained in a context of weak domestic demand.

Table 1
Inflation (MoM and YoY % change)

Inflation					
	MoM % change			YoY % change	
	Jan-15	BBVAe	consensus	Jan-15	Dec-14
Headline	-0.09	-0.08	-0.07	3.07	4.08
Core	-0.03	0.02	0.02	2.34	3.24
Non Core	-0.27	-0.42	-0.37	5.34	6.70

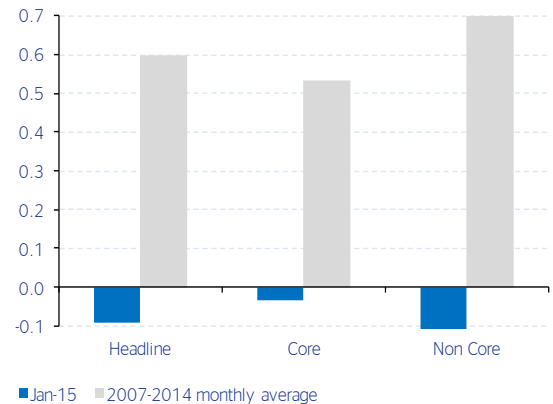
Source: BBVA Research, INEGI

Graph 1
Inflation and components (YoY % change)



Source: BBVA Research, INEGI

Graph 2
Inflation and components (MoM % change)



Source: BBVA Research, INEGI

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