

Economic Analysis

A strong core print was offset by non-core deflation

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Headline: actual: 0.11% FoF (BBVAe: 0.11%; consensus: 0.14%)**Core: actual: 0.28% FoF (BBVAe: 0.14%; consensus: 0.16%)**

- **Core inflation increased more than expected driven by the other core goods component**
- **Deflation in the non-core component offset the upside surprise in core prices**

Headline inflation increased 0.11% FoF in the first fortnight of February, in line with our forecast (BBVAe: -0.11%, consensus: 0.14%). However, it was driven by a stronger-than-expected core print (actual: 0.28% FoF, BBVAe: 0.14%; consensus: 0.16%) which was countered by lower-than-anticipated non-core inflation (actual: -0.42% FoF, BBVAe: 0.02%). Annual headline inflation remained stable at 3.04% (vs. 3.05% in the second fortnight of January), but core inflation increased to 2.42% from 2.25% in the previous fortnight.

First signs of FX pass-through to core goods? The core goods component increased 0.36% FoF, driven by a strong other core goods inflation print (0.59%). Although this strong print might suggest that there are some initial signs of FX pass-through, the other core goods component had decreased in three of the previous five fortnights and had averaged a 0.02% FoF over that period i.e., today's strong reading could be offsetting the negligible increase observed since the exchange rate (ER) began to increase sharply (November 2014). Considering that the ER could remain close to current levels in the near future, core goods inflation is likely to accelerate over the course of the year. However, pressures should remain contained in a context of weak domestic demand and ample economic slack. Meanwhile, core services prices also increased slightly more than we were expecting (0.21% FoF), driven by a 3.4% FoF increase in mobile phone tariffs following last month's decline. January likely marked the low point for core inflation in 2015 (2.34%), and a gradual upward trend throughout the year is the most likely scenario. We forecast that core inflation will stay below 3.0% throughout the year, and will close 2015 at 2.9%.

Declines in perishable food and energy prices offset the higher-than-anticipated core inflation Non-core inflation was -0.42% FoF (BBVAe: 0.02%), pushed down by the 3.38% FoF decrease in fruit and vegetable prices, driven mainly by the 27.9% FoF drop in tomato prices, and the 0.16% FoF decrease in energy prices. Meat and eggs increased 0.27% FoF, driven by a new increase in beef prices (0.46% FoF). Gasoline prices had a small drop (-0.09% FoF), while electricity tariffs declined -0.37% FoF. With the favorable performance of energy prices, annual non-core inflation should gradually approach the annual headline inflation level.

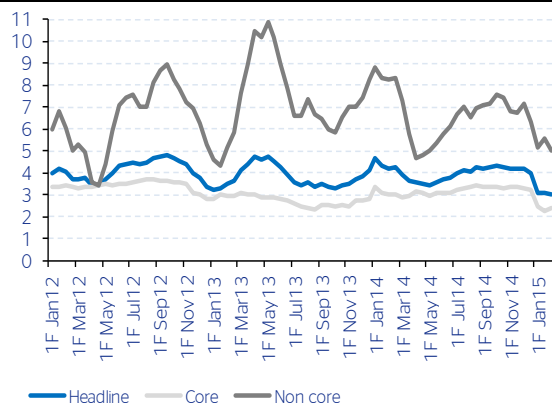
Bottom line: Today's report supports our view that annual inflation headline inflation will stay at close to 3.0% throughout the year, and will close 2015 at 2.9%. Although there are some FX pass-through related risks, the inflation outlook remains favorable as the pass-through should be contained in a context of weak domestic demand.

Table 1
Inflation (FoF and YoY % change)

CPI Inflation						
	Bi-weekly % change			Annual % change		
	1 F Feb 2015	BBVAe	Consensus	1 F Feb 2015	BBVAe	Consensus
Headline	0.11	0.11	0.14	3.04	3.04	3.07
Core	0.28	0.14	0.16	2.42	2.27	2.29
Non Core	-0.42	0.02	0.07	4.98	5.45	5.50

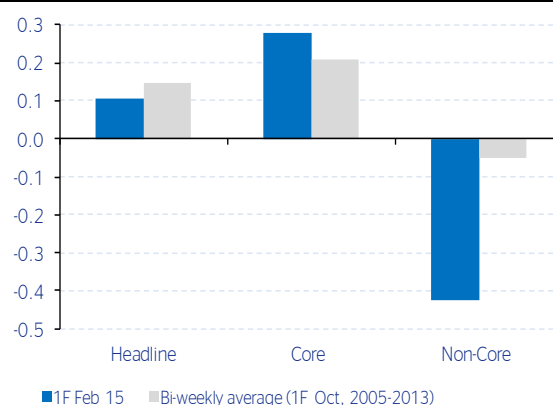
Source: BBVA Research, INEGI

Graph 1
Inflation and components (YoY % change)



Source: BBVA Research, INEGI

Graph 2
Inflation and components (FoF % change)



Source: BBVA Research, INEGI

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