

Economic Analysis

Core inflation leads the downside surprise

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Headline: actual: 0.18% FoF (BBVAe: 0.32%; consensus: 0.25%)**Core: actual: 0.15% FoF (BBVAe: 0.25%; consensus: 0.20%)**

- **Inflation increased less than we expected driven by the favorable performance of the other core goods component and meat and poultry prices**
- **Pass-through is likely to be limited**

Inflation came in milder than expected, remaining at its lowest level in almost nine years (2.97%). Headline inflation increased 0.18% FoF (BBVAe: 0.32%, consensus: 0.25%). The downside surprise was primarily driven by core inflation which increased less than expected (actual: 0.15% FoF; BBVAe: 0.25%; consensus: 0.20%), while non-core inflation was also lower than expected. Up to now firms have not passed on higher costs resulting from the peso's depreciation to consumers (prices of other goods rose much less than in the first half of February). Following today's surprise we have revised our March headline and core inflation forecasts down by around 0.1pp, while our year-end forecasts remain at 2.9% and 2.8%, respectively. The March print is likely to confirm weak core inflation during the first quarter against a backdrop of a depreciating currency, which suggests that internal demand remains rather weak.

No evidence of FX pass-through. The source of the downside surprise was core goods prices which increased 0.13% FoF in the first fortnight of March (vs. 0.36% in the first fortnight of February). Inflation of the other core goods component was 0.20% FoF (vs. 0.59% in the first fortnight of February). As we argued last month, the upside surprise in February seems to have just compensated the negligible increases observed since the exchange rate (ER) began to increase sharply (November 2014): until that time, other goods prices had decreased in three of the previous five fortnights and had averaged a 0.02% FoF increase over that period. The average fortnightly increase of other goods prices November 2014 to date (0.12%) is similar to the one observed over the previous nine fortnights (0.08%). This confirms that there have not been FX pass-through effects yet, likely because domestic demand remains rather weak. Continued weakness of domestic demand still makes it less likely that higher import costs, due to a weaker peso, will be fully passed on to consumers. Core services prices increased 0.16% FoF.

Declines in meat and poultry prices more than offset a mild increase in fruit and vegetable prices. Non-core inflation was 0.28% FoF, pushed down by the 0.36% FoF decrease in meat, eggs and poultry prices, driven mainly by the 2.64% FoF drop in pork prices and the 1.04% FoF decrease in poultry prices; beef prices also decreased (-0.25% FoF). Gasoline prices had a significant increase (low octane prices jumped 1.68% FoF while high octane prices increased bounced 1.78% FoF). The recent increase in US gasoline prices seems to be the reason behind this increase as four of the five cities with higher inflation were border cities. However, increases in gasoline prices cannot be greater than 3.0% throughout the year which puts a limit on possible increases in the coming months.

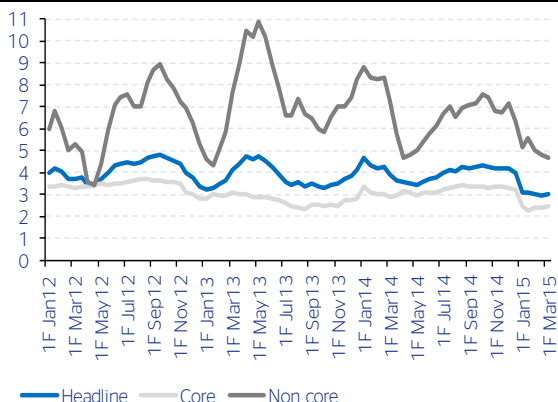
Bottom line: Today's report supports our view that pass-through is likely to be low and annual headline inflation will stay at close to 3.0% throughout the year, and will close 2015 at 2.9%.

Table 1
Inflation (FoF and YoY % change)

CPI Inflation						
	Bi-weekly % change			Annual % change		
	1F Mar 2015	BBVAe	Consensus	1F Mar 2015	BBVAe	Consensus
Headline	0.18	0.32	0.25	2.97	3.12	3.04
Core	0.15	0.25	0.20	2.42	2.53	2.47
Non Core	0.28	0.56	0.42	4.69	4.98	4.84

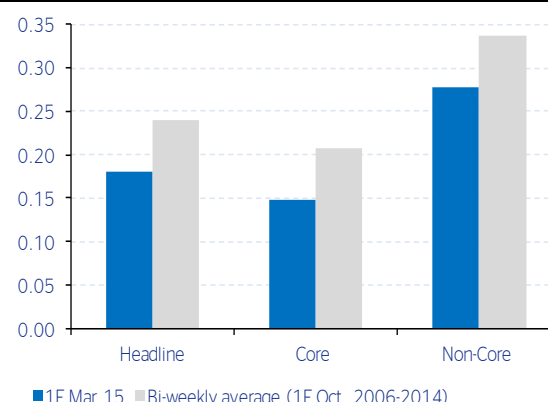
Source: BBVA Research, INEGI

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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