

Economic Analysis

Inflation was higher than expected: blame the tomato

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Headline: actual: 0.41% MoM (BBVAe: 0.34%; consensus: 0.32%)**Core: actual: 0.26% MoM (BBVAe: 0.35%; consensus: 0.24%)**

- **FX pass-through remains fairly modest, it should remain contained in a context of weak demand and ample economic slack**

Headline inflation came in above expectations in March, increasing 0.41% MoM (BBVAe: 0.34%, consensus: 0.32%). In annual terms, headline inflation increased to 3.14% from 3.00% in February. The upside surprise was primarily driven by tomato prices which surged 53.3% MoM accounting for around 1/3 of the monthly inflation (0.144pp). Core inflation was 0.26% MoM, broadly in line with our above-consensus forecast (BBVAe: 0.25%, consensus: 0.24%). In annual terms, core inflation edged up slightly to 2.43% from 2.40% in February. The FX pass-through remains modest as firms continue to struggle to pass onto consumer prices already increasing import prices, in line with our expectation.

The core inflation increase was mainly led by other services prices as core goods inflation was rather low as we expected. The relatively strong core inflation print was mainly driven by core services inflation (0.36% MoM; BBVAe: 0.33%). Other services prices increased somewhat more than we anticipated (0.65% MoM; BBVAe: 0.58%). As we expected, the increase was mainly driven by the seasonal increase in tourism services prices (9.51% MoM) and airfares (9.60% MoM) due to the Easter holiday season. Core goods inflation was broadly in line with our expectation (0.15% MoM; BBVAe: 0.16%). Inflation of the other core goods component was 0.26% MoM (BBVAe: 0.26%). As we have argued, 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 January, other goods prices had decreased in three of the previous five fortnights and had averaged a 0.02% FoF increase over that period. The 0.10% FoF increase in the second fortnight of March is equal to the average fortnightly increase of other goods prices November 2014 to date (0.10%) and similar to the one observed over the previous ten fortnights (0.08%). This confirms that there FX pass-through effects have remained limited, likely because domestic demand remains rather weak. The ample economic slack will continue to limit the rate at which higher import costs, due to a weaker peso, will be passed on to consumers.

The surge in tomato prices led the upside surprise in non-core inflation. Non-core inflation was 0.85% MoM, pushed up by the surge in fruit and vegetable prices in the second fortnight (5.24% FoF; BBVAe: 2.50%), mainly led by the 53.3% MoM increase in tomato prices. On the bright side pork and poultry prices seem to be easing as suggested by the -3.3% and -1.3% MoM decline in March. The meat and eggs component had a slight monthly deflation as we anticipated (-0.05% MoM; BBVAe: -0.10%). Energy-related prices increased in line with our forecast (1.29% MoM; BBVAe: 1.22%), mainly led gasoline price increases at the border.

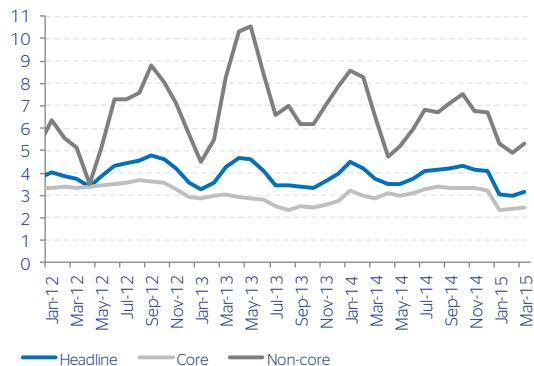
Bottom line: Today's print supports our view that annual inflation is likely to remain close to Banxico's target (3.0%) throughout 2015, before declining to 2.9% by year-end. Although continued peso weakness increases pass-through risks, up to now, the weaker peso has not created a build-up of inflationary pressures. Even though it is likely that some of the increase in import costs will be passed on to consumers in the coming months, the pass-through should remain contained in a context of weak domestic demand.

Table 1
Inflation (MoM and YoY % change)

Inflation					
	MoM % change			YoY % change	
	Mar-15	BBVAe	consensus	Mar-15	Feb-15
Headline	0.41	0.34	0.32	3.14	3.00
Core	0.26	0.25	0.24	2.45	2.40
Non Core	0.85	0.64	0.58	5.29	4.88

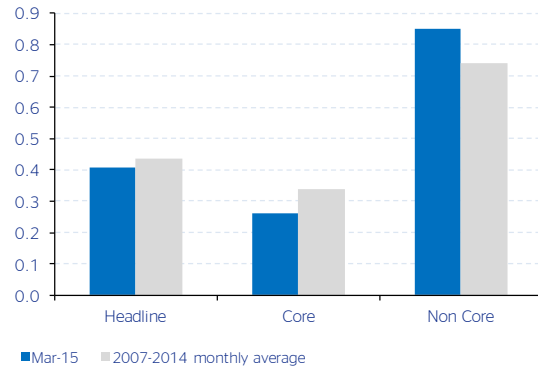
Source: BBVA Research, INEGI

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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