

## Economic Analysis

# Annual headline inflation hits a fresh record low

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**Headline: actual: 0.17% MoM (BBVAe: 0.17%; consensus: 0.19%)****Core: actual: 0.21% MoM (BBVAe: 0.20%; consensus: 0.21%)**

- **Annual headline inflation will likely bottom in Q4 and will most likely remain below target for the rest of the year. We keep unchanged our year-end forecast of 2.65%**
- **Core inflation seems to be reaching an inflection point. We expect it to accelerate somewhat in H2 with better growth**

Headline inflation rose exactly in line with our forecast in June but slightly below market forecasts (BBVAe: 0.17%, consensus: 0.19%), pushing the annual inflation rate to the lowest level on record (2.87%). As we expected, declines in fruit and vegetable prices in the second half of the month contributed to a low monthly headline inflation print. Core prices increased 0.21% from a month earlier, in line with expectations. In annual terms, core inflation remained unchanged at 2.33%. Today's print supports our view that headline inflation will remain below Banxico's target for the rest of the year. We maintain our 2.65% year-end forecast for headline inflation. We expect it to bottom in Q4 as base effects contribute to a lower annual rate in the last months of the year. In contrast, core inflation seems to be beginning to gain some momentum, which suggests better economic conditions. We maintain our 2.50% year-end forecast for core inflation. Our expected path implies that core inflation probably bottomed in June and will accelerate somewhat in H2 with better growth. Both headline and core inflation will accelerate in Q1 16 due to base effects and stronger growth but we expect headline inflation to remain relatively close to target throughout 2016.

**Core inflation increased in line with expectations. Firmer other core goods inflation continues to be offset stable services inflation in a context of ample economic slack.** Core goods inflation increased in line with our forecast (0.21% MoM) while core services inflation was a bit higher (0.21% MoM vs BBVAe: 0.19%). Although FX pass-through remains modest, other core goods annual inflation resumed the upward trend that briefly stopped in May. It now stands at 2.60% compared to 1.66% in January and 2.04% at the end of last year. Meanwhile, annual core services inflation stands at 2.20% compared to 2.21% on average over the previous five months. All in all, the impact of the economic slack on the services sector has offset the FX pass-through to core goods. Thus, with better economic conditions core inflation is likely to accelerate hereinafter considering that services inflation should gradually increase as growth firms up.

**As we expected, declines in fruit and vegetable prices in the second fortnight of the month were behind the low headline inflation print.** Non-core inflation was 0.04% MoM (BBVAe: 0.07%), pushed down by large declines in eggs and poultry prices (-4.75% and -1.22% MoM, respectively) and by a 1.52% QoQ decline in fruits and vegetable prices in the second fortnight of June, similar to the drop that we were expecting.

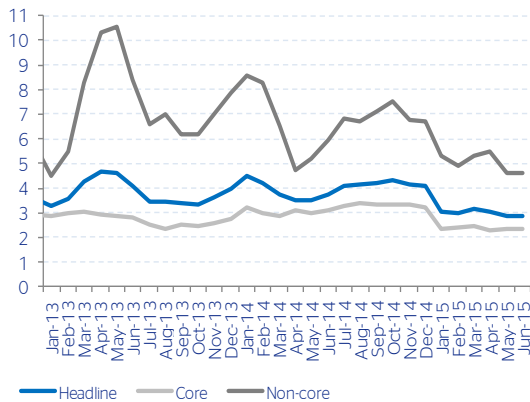
**Bottom line: Today's print supports our expected inflation path. Core inflation will likely remain subdued despite the weak peso in a context of still weak domestic demand but will probably begin to gradually increase as economic conditions improve and the exchange rate remains elevated.**

Table 1  
**Inflation (MoM and YoY % change)**

Inflation					
	MoM % change			YoY % change	
	Jun-15	BBVAe	consensus	Jun-15	May-15
Headline	0.17	0.17	0.19	2.87	2.88
Core	0.21	0.20	0.21	2.33	2.33
Non Core	0.04	0.07	0.12	4.63	4.64

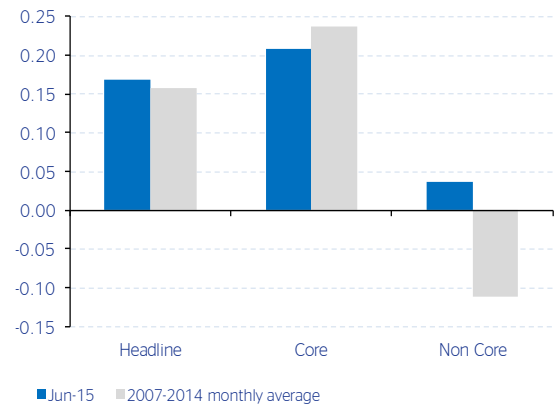
Source: BBVA Research, INEGI, Banamex Survey

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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