

**ECONOMIC ANALYSIS**

# Further fall in inflation in the first half of March

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## The drop in inflation was broad-based and broadly in line with expectations

**Headline inflation in 1H Mar was 0.29% HoH**, slightly above expectations (BBVA Research and consensus: 0.25%) and also above our slight downward bias. In annual terms, it dropped from 5.23% YoY in 2H Feb to **5.17% YoY**. **Core inflation was 0.26% HoH**, broadly in line with our expectation and in line with the consensus forecast (BBVA Research: 0.26%, consensus: 0.24%). In annual terms, core inflation fell to **4.15% YoY** from 4.23% in 2H Feb.

## Disinflation pressures seem to be taking hold

Relative to our forecasts, we nailed every price category (see table), with two exceptions: food core goods (in green) which came in below our forecast, and fruit and vegetable prices (in red) which surprised us on the upside. The former is a very welcome surprise and more importantly suggests that recent pressures on that component arising from last year's significant spike in fruit and vegetable prices are likely now unwinding. Regarding the latter, the negative surprise is not worrisome at all (simply our tracker did not send a good signal this fortnight). **Not only last year's food price shock seems to be finally unwinding, non-food core goods inflation continues to reflect the unwinding of last year's pass-through and the absence of a new round of pass-through following 4Q17 peso's weakness**, as we have been arguing and expecting. In annual terms, both components of core goods have eased 1.3pp: food core goods from 6.8% to 5.5% and non-food core goods from 5.5% to 4.2%. Service prices remain stable and well behaved, supporting our view of no second-round effects arising from the temporary uptick in headline inflation during 4Q17.

**Table 1.** Inflation in 1H mar 18: actual vs forecast

	HoH % change			YoY % change		
	1H Mar	1H Mar <sup>e</sup>	2H Feb	1H Mar	1H Mar <sup>e</sup>	2H Feb
<b>Headline</b>	0.29	0.25	0.04	5.17	5.13	5.23
<b>Core</b>	0.24	0.26	0.14	4.15	4.18	4.23
Goods	0.15	0.22	0.17	4.77	4.84	5.07
Food	<b>0.10</b>	<b>0.20</b>	0.10	5.49	5.59	5.76
Non-food	0.19	0.23	0.23	4.17	4.22	4.49
Services	0.31	0.30	0.10	3.60	3.59	3.49
Housing	0.12	0.12	0.10	2.52	2.52	2.53
Education	0.00	0.01	0.04	4.84	4.84	4.85
Other	0.61	0.58	0.13	4.35	4.32	4.07
<b>Non-core</b>	0.46	0.20	-0.22	8.21	7.93	8.21
Perishable	0.56	-0.07	-0.94	8.03	7.35	8.93
Fruits & Vegetable:	0.68	-0.96	-3.55	9.40	7.63	13.06
Meat & Eggs	0.49	0.57	0.66	7.24	7.32	6.66
Energy & Regulated	0.41	0.37	0.20	8.32	8.28	7.80
Energy	0.55	0.52	0.25	9.03	8.99	8.19
Regulated	0.11	0.13	0.09	6.86	6.88	7.02

Source: BBVA Research with INEGI data

## Inflation set to fall further; Banxico will likely keep rates on hold next month (12 Apr)

Today's data practically guarantee that our expectation since the beginning of the year that headline and core inflation will fall below 5% and 4% respectively in April will materialize. As we have been anticipating, the next significant base effect will likely come in April and May when inflation is likely to continue falling fast (headline to 4.5% and core to 3.8% in May). Moreover, recent hopes of a higher likelihood of NAFTA 2.0 in the near term have supported the peso, further lowering inflation risks. With inflation's positive performance in 1Q18 and the continued anchoring of expectations, peso's relative strength over the quarter compared with expectations of a significant weakening, and recent changes to Banxico's communication, we are changing our call for the next Banxico's policy meeting and we now expect that the Board will leave the monetary policy rate unchanged (rather than pre-emptively hike it again). We now expect the next interest rate move to be a cut; yet, we do not foresee that move until headline inflation falls back into Banxico's target range ie, in 4Q18.

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