

ECONOMIC ANALYSIS

Disinflation pressures are taking hold

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Inflation fell sharply in the first three months of the year as we expected

Headline inflation in Mar was 0.32% MoM, below expectations and somewhat closer to our below-consensus forecast (BBVA Research: 0.38%, consensus: 0.40%). In annual terms, it dropped 0.3pp from 5.34% YoY in Feb to 5.04% YoY, a 13-month low. Core inflation was 0.33% MoM, broadly in line with our below-consensus forecast and somewhat lower than the consensus one (BBVA Research: 0.34%, consensus: 0.36%). In annual terms, core inflation fell to 4.02% YoY from 4.27% in Feb, a 14-month low. After peaking at 6.8% YoY, headline inflation fell sharply in the first three months of the year ie, (-) 1.74 pp. Core inflation fell (-)0.85 pp over the same period.

Disinflation pressures are taking hold

Relative to our forecasts, we nailed every core price category (see table). The falling trend in core inflation is broad-based. Core goods price categories declined markedly during March, while the services price categories remained broadly unchanged. Pressures on the core component are clearly unwinding and disinflation pressures are taking hold. In annual terms, both core goods components eased substantially from December's levels: food core goods from 6.8% to 5.3% and non-food core goods from 5.6% to 4.0%. Service prices remain stable and well behaved, confirming our view of no second-round effects arising from the temporary uptick in headline inflation during 4Q17. Non-core inflation was lower than anticipated in March, favored by a large decline in LP gas prices and a better-than-expected performance of the meats & eggs component in the second fortnight of the month.

Table 1. Inflation in Mar 18: actual vs BBVA Research forecast

	MoM % change			YoY % change		
	Mar	Mar*	Feb	Mar	Mar*	Feb
Headline	0.32	0.38	0.38	5.04	5.10	5.34
Core	0.33	0.34	0.49	4.02	4.03	4.27
Goods	0.25	0.27	0.54	4.64	4.66	5.18
Food	0.18	0.18	0.50	5.35	5.35	5.97
Non-food	0.32	0.34	0.57	4.04	4.07	4.53
Services	0.40	0.39	0.45	3.49	3.49	3.49
Housing	0.23	0.22	0.26	2.54	2.53	2.55
Education	0.02	0.02	0.45	4.84	4.84	4.83
Other	0.68	0.67	0.64	4.07	4.06	4.06
Non-core	0.30	0.52	0.08	8.03	8.26	8.49
Perishable	0.38	0.40	-1.90	7.74	7.77	9.69
Fruits & Veget.	-0.31	-0.47	-7.04	8.82	8.64	15.50
Meat & Eggs	0.79	1.04	1.46	7.12	7.38	6.49
Energy & Regula	0.26	0.59	1.26	8.19	8.55	7.81
Energy	0.29	0.83	1.58	8.85	9.43	8.16
Regulated	0.19	0.18	0.60	6.85	6.84	7.08

Source: BBVA Research with INEGI data

Inflation set to fall further; Banxico will most likely keep rates unchanged on Thursday

We expect inflation to continue easing. As we have been anticipating, headline and core inflation will fall below 5% and 4% respectively in April. The next base effect will take place over the next two months. Headline inflation is likely to fall around (-) 0.5pp over this period. The strength of the MXN (in spite of AMLO's improving odds) along with a likely decline in short-term inflation expectations in coming weeks have lowered inflation risks. Banxico's recent communication is signaling that they are becoming increasingly comfortable with the inflation path. Banxico will most likely leave interest rates unchanged (at 7.5%) on Thursday, and we think that the wording will have substantial changes that will signal a pause in the near-term. We also think that the door for a rate cut will likely open in 4Q18, once inflation falls back into Banxico's target range.

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