

Economic Analysis

January inflation forecast: base-effect driven temporary rebound will continue in February

Javier Amador
February 6, 2020

We expect headline inflation to increase 0.45% MoM in January (3.20% YoY), with core coming in at 0.33% MoM (3.73% YoY). If our forecasts prove accurate, headline inflation would have increased 0.4pp and core 0.1pp in annual terms from 2.83% and 3.59%, respectively in December. We expect non-core inflation pressures to have eased in the second half of the month on the back of a likely decline in fresh food prices signaled by our tracker. Meanwhile, energy prices likely behaved positively on the back of a drop in gas prices and easing gasoline prices. This positive performance is likely to continue in February. Nonetheless, there will be an additional base-effect driven temporary rebound. We are expecting annual headline inflation to further increase to 3.6% in February. We are not expecting March's annual inflation to increase further.

The 1Q increase will most likely prove temporary as inflation during April-May of last year (-0.12% MoM) was much higher than usual. Thus, we expect annual headline inflation to drop back to 3.3-3.4% on average during 2Q. For year-end inflation, we are sticking with our forecasts of 3.5% for headline with core at 3.3%. For the whole year, we expect headline inflation to average 3.5% (slightly below last year's 3.6% average) and core 3.5% (vs. 3.7% in 2019). Looking ahead, low international energy prices (eg, US natural gas prices had not been this seasonally cheap in 20 years) will continue to have a positive effect on inflation. More importantly, after rebounding due to base-effects in Jan-Feb, core inflation is likely to resume its downward trend in a context of a weak economy and a widening output gap.

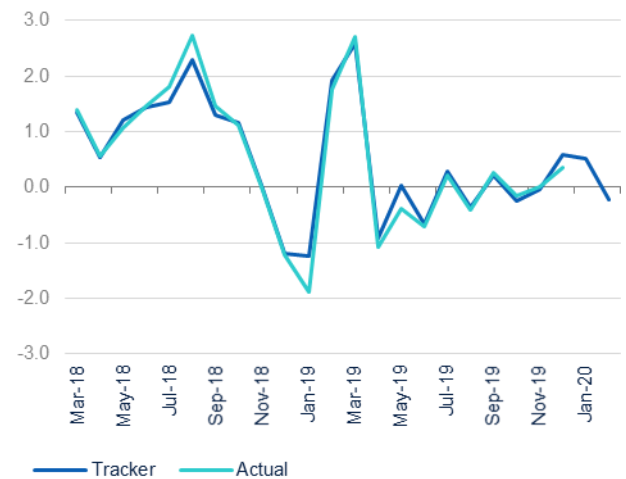
Under such a backdrop, the easing cycle, which actually just started in November since the first two cuts of 2019 were offset by the decline in inflation expectations, has plenty of room to go. Banxico has shown that it prefers to ease policy at a very gradual pace. We expect 25bp rate cuts in each of the first five meetings, taking the policy rate to 6.0% in August. The risk continues to be that Banxico becomes even more cautious with the Fed on the sidelines and with the temporary increase in inflation. A 6.0% rate would only take the monetary policy to a neutral stance. Yet, Banxico has remained overly hawkish and the risk is that they decrease the policy rate less than what is warranted.

Chart 1. **Inflation Breakdown**

| | Jan | | Dec |
|------------------------------|--------------|--------------|-------|
| | MoM% | YoY % | YoY % |
| Headline | 0.45 | 3.20 | 2.83 |
| Core | 0.33 | 3.73 | 3.59 |
| Core goods | 0.61 | 3.87 | 3.56 |
| Core food | 1.06 | 5.05 | 4.45 |
| Non-food core | 0.13 | 2.63 | 2.62 |
| Core services | 0.02 | 3.57 | 3.64 |
| Core Housing | 0.25 | 2.93 | 2.91 |
| Core Education (tuitions) | 0.40 | 4.69 | 4.73 |
| Core Other Services | -0.27 | 3.91 | 4.05 |
| Non-Core | 0.82 | 1.66 | 0.59 |
| Non-core Food | 1.51 | 1.12 | -0.03 |
| Fruits and Vegetables | 3.99 | -2.36 | -5.40 |
| Meat and Eggs | -0.50 | 4.48 | 4.98 |
| Energy-related and Regulated | 0.32 | 2.06 | 1.04 |
| Energy-related | -0.19 | 0.76 | -0.54 |
| Regulated | 1.51 | 5.24 | 5.05 |

Source: BBVA Research / INEGI

Graph 1. **Low octane gasoline prices: actual vs tracker (MoM% change)**



Source: BBVA Research / Petroleintelligence

Disclaimer

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research and BBVA Bancomer S. A., Institución de Banca Múltiple, Grupo Financiero BBVA Bancomer on behalf of itself and is provided for information purposes only. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA Bancomer, and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.