

Economic Analysis

Feb inflation forecast: the base-effect driven temporary rebound will not continue in March

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We expect headline inflation to increase 0.22% MoM in February (3.50% YoY), with core increasing 0.37% MoM (3.66% YoY). That is somewhat less than we were expecting for February before the first half of the month as core inflation surprised to the downside over that period. If our forecasts prove accurate, headline inflation would increase 0.26pp but core would edge down 0.07pp in annual terms from 3.24% and 3.73%, respectively in January. As of now, we do not expect an additional increase in annual terms in the monthly print in either headline or core inflation, and as we have been saying, after the temporary rebound in 1Q, both headline and core inflation are set to decline in 2Q.

We expect headline inflation to decelerate to a 3.3% annual pace on average in 2Q, with core easing 0.2pp to a 3.5% average. We expect core inflation to further ease to 3.4% and 3.3% averages in 3Q and 4Q, while headline will likely hover around 3.5% during 2H. For year-end inflation, we are sticking with our forecasts of 3.5% for headline with core at 3.3%. Most of those who were expecting an end to the rate cut cycle were probably influenced by their expectation of continued core inflation stickiness along with Banxico's hawkish rhetoric. **In our view, and consistent with Banxico's forecasts, not its hawkish wording, core inflation is set to finally end its stickiness and begin to ease from Q2 onwards.**

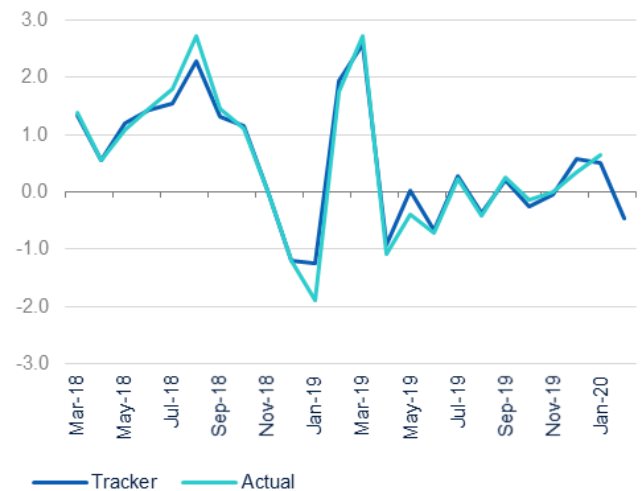
Monetary policy remains very restrictive and the spread with the fed funds rate widened back to 575 bp (the spread that Banxico had maintained from Dec 2017 to Nov 2019) and will likely widened further if expectations of another fed funds rate cut are confirmed. **Recent events**, even if we take into account the recent MXN depreciation, **reinforce our view lower rates going forward.** If anything, the monetary policy stance continues to become less appropriate. We continue to expect Banxico to cut rates in the next four meetings, taking the monetary policy rate to a much more appropriate neutral stance.

Chart 1. **Inflation Breakdown**

	Feb		Jan
	MoM%	YoY %	YoY %
Headline	0.22	3.50	3.24
Core	0.37	3.66	3.73
Core goods	0.41	3.83	3.92
Core food	0.46	5.01	5.10
Non-food core	0.35	2.59	2.68
Core services	0.32	3.47	3.51
Core Housing	0.29	2.95	2.93
Core Education (tuitions)	0.44	4.53	4.69
Core Other Services	0.33	3.72	3.78
Non-Core	-0.22	3.00	1.81
Non-core Food	0.03	6.01	1.44
Fruits and Vegetables	-0.44	7.64	-1.76
Meat and Eggs	0.42	4.58	4.45
Energy-related and Regulated	-0.41	0.90	2.08
Energy-related	-0.73	-0.70	0.86
Regulated	0.34	4.83	5.07

Source: BBVA Research / INEGI

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



Source: BBVA Research / Petroleintelligence

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