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Economic Analysis

Mar inflation forecast: downward pressures on inflation will outweigh upward pressures

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We expect headline inflation to post a mild 0.07% MoM increase in March (3.37% YoY, down from 3.70% in February), with core increasing 0.27% MoM (3.58% YoY, down from 3.66%). Within core prices, we expect a somewhat greater pace of core food prices increases to be offset by a somewhat declining pace of increase of non-food and services prices. The main driver of our low expected headline inflation print is energy prices, particularly gasoline prices that declined more than 12% in the second half of the month, and more than 7% during March, according to our tracker (see graph 1). Energy prices declines will more than outweigh the sizable increase in fresh food prices (see table 1).

Our preliminary estimates for April are -0.75% MoM (2.54% YoY) for headline inflation, and 0.27% MoM (3.39% YoY) for core inflation. Although uncertainty has increased sharply, particularly following the economic lockdown which will make more difficult for INEGI to measure some prices, lower energy prices (eg, gasoline prices are on pace to decrease around 15% in April) will imply a much larger-than-usual drop in non-core prices in April. Core inflation is likely to post a more modest increase than usual in Easter due to the economic lockdown. A typical rise of tourism-related prices is unlikely in a context of economic lockdown, with most people staying at home, beaches closed and hotel occupancy rates below 10%. Although it is uncertain, at this point, it is more likely than not that seasonal price increases in the summer will also be milder in a context of extremely weak demand. As to core goods prices, the pass-through to some products might be offset in the short-term by online sales as a response to plummeting demand. In coming months, markups and pass-through to goods prices will face a context of weak demand / widening output gap, limiting price increases. **We are revising down our year-end forecasts to 2.8% for headline inflation and 3.0% for core inflation.**

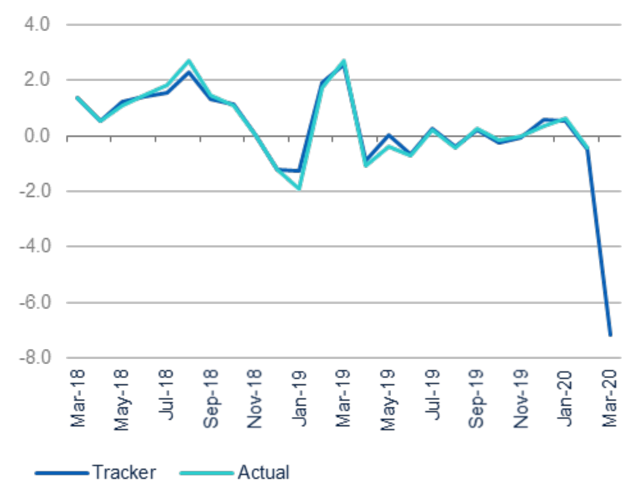
In this context, despite its hawkish rhetoric, we continue to expect Banxico to ease its inexplicable currently restrictive monetary policy stance. In our view, Banxico should cut rates rapidly, considering the lagged effects of monetary policy and its forward-looking nature. With the economy entering a deep recession, even if we account for uncertainty, downward pressures on core prices will eventually more than outweigh upward pressures. Low inflation prints in March and April are likely to feed into lower inflation expectations, and ease Banxico's probable concerns. We think that Banxico should not wait until its next scheduled meeting (May 14) to cut its policy rate. We expect Banxico to lower the policy rate 75bp in April in an out-of-schedule meeting. **Although we think that Banxico should take the policy rate below 5.0% this year, the most hawkish Banxico's Board ever, and its continued hawkish rhetoric even in the current context, makes us think that they will probably stop at 5.0%.**

Table 1. **Inflation Breakdown**

	Mar		Feb
	MoM%	YoY %	YoY %
Headline	0.07	3.37	3.70
Core	0.27	3.58	3.66
Core goods	0.30	3.78	3.82
Core food	0.40	5.01	4.99
Non-food core	0.20	2.48	2.58
Core services	0.24	3.37	3.48
Core Housing	0.29	2.94	2.94
Core Education (tuitions)	0.05	4.58	4.55
Core Other Services	0.24	3.49	3.72
Non-Core	-0.56	2.72	3.81
Non-core Food	2.82	11.61	7.82
Fruits and Vegetables	4.70	17.90	11.23
Meat and Eggs	1.30	6.49	4.91
Energy-related and Regulated	-2.98	-3.29	1.01
Energy-related	-4.37	-6.54	-0.54
Regulated	0.25	4.89	4.86

Source: BBVA Research / INEGI

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



Source: BBVA Research / Petrointelligence

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