4. Negative inflation surprises in Q1 2017

Lingering effect of hikes in regulated prices plus downward “stickiness” in underlying inflation

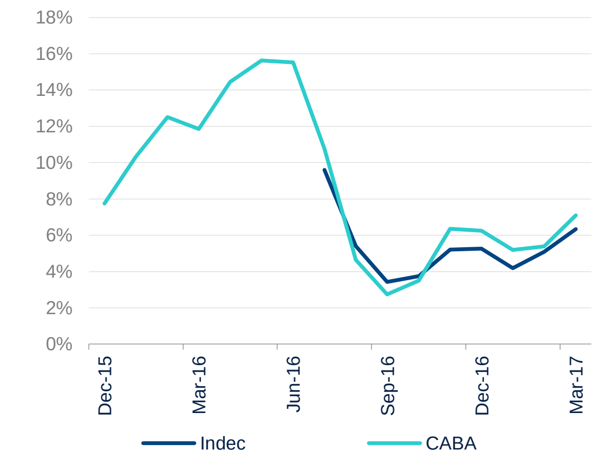
We expect the inflation rate (Buenos Aires City official index- CABA) to reach 22.4% year on year in 2017. This is an increase on our previous forecast of 20.8%. We also increased our forecast for Indec official statistics on inflation to 19.5% (the differences in the figures between the two indices are due to the fact that they have different consumption baskets and cover different geographical areas). Although this is a deceleration compared to the 41% inflation of last year, caused by the initial exchange rate and tariffs shocks, the monthly inflation data for the first quarter are not as encouraging as expected.

In the first quarter of the year average monthly inflation was 2.1% and 2.3% (Indec and Buenos Aires City respectively) while in March alone these rates were 2.4% and 2.9%, respectively, setting an upwards trend. There was a planned hike in electricity prices in February but in the following months inflation did not fall (see Figure 4.1) and increases were also seen in prices for items such as clothing and education. Core inflation is showing a certain downward “stickiness” which should be watched in the next few months. While according to the Indec index, which covers the Greater Buenos Aires and City urban cluster, core inflation has remained at relatively constant on average, the index drawn up by the Buenos Aires City statistics bureau shows underlying inflation on the rise (see Graph 4.2)

The Central Bank continues to be committed to the aim of lowering inflation and has maintained its annual targets (12%/17% in 2017 and 12%/8% in 2018), although these are within ranges which are much lower than those expected by the consensus of analysts. Its strategy continues to aim at reaching single figure inflation in 2019. With this target in mind, the monetary policy rate was raised from 24.75% to 26.25% during the second week of April. This is explained in greater detail in Chapter 5.

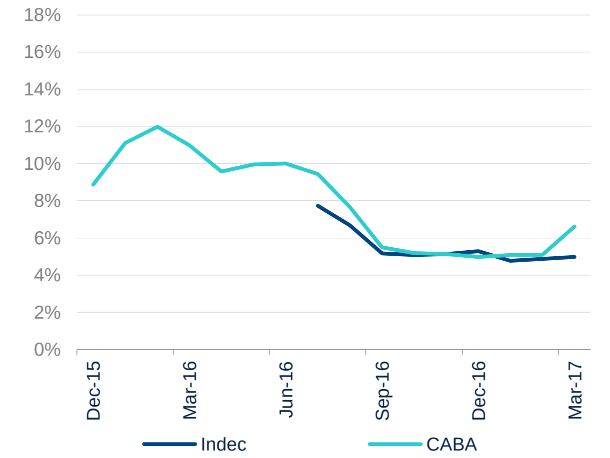
An essential factor in assessing the evolution of inflation going forward is the result of collective wage bargaining agreements, which are usually negotiated during the first four months of the year. Most unions have not yet closed off these negotiations and, in some cases, confrontation with the government has occurred which is still in the process of being resolved, as is the case with teachers’ union. Some agreements have defined similar adjustments to expected inflation but with trigger clauses to compensate for potential deviations from the final inflation outcome. The end result of these negotiations, which may end with larger salary rises than those sought by the government, will influence the the actual inflation rate. The reduction in Central Bank financing to the Treasury, the positive real interest rate policy to pin down expectations and the relative exchange rate stability will be the factors helping inflation converge towards lower levels. Even so, the probability of achieving the inflation target this year is not very likely.

Figure 4.1 Total inflation last quarter
(Y/Y change)



Source: BBVA Research, INDEC and GCBA

Figure 4.2 Underlying inflation last quarter
(Y/Y change)



Source: BBVA Research, INDEC and GCBA

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