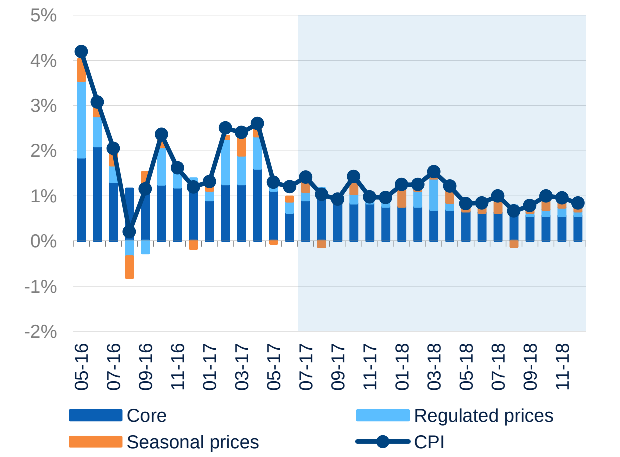
4. Inflation begins to ease after a quarter of negative data

We maintain our inflation forecasts slightly above the BCRA targets for 2017 and 2018

The inflation rate fell to 1.3% in May and 1.4% monthly in June, after having averaged 2.5% MoM during the previous 3 months. The fall in inflation reflects not only the end of the schedule of increases in regulated prices, but also a fall in the core inflation rate (which fell from 2% per month to 1.55% MoM on average in the first two months) and a slowdown in food price increases (Figure 4.1). We believe that this decreasing trend in core inflation will be maintained in the coming months to achieve an average of 1.1% per month in 3Q17 on the basis of a monetary policy that will remain tight. Considering that energy rate increases are resumed in 4Q17, inflation measured by INDEC's Greater Buenos Aires (GBA) CPI will reach 19.5% by the end of 2017 as reported in our previous Economic Outlook. We also maintain unchanged the forecast of 12.9% for 2018 that foresees a stabilisation of inflation at around 0.9% per month and an impact on headline inflation of increase in energy rates of 1.9 pp.

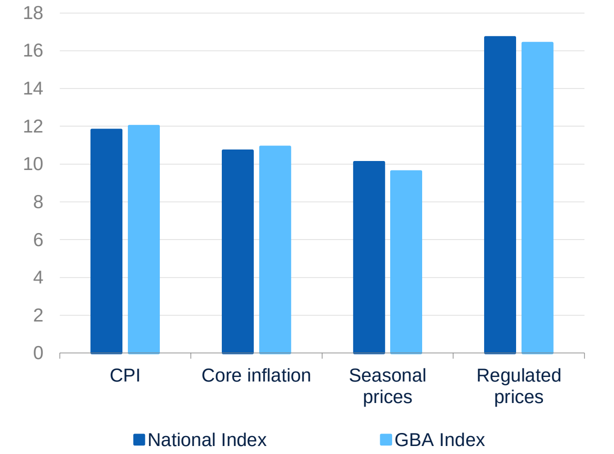
Despite the tightening of monetary policy since April, consensus inflation expectations of analysts surveyed by the Central Bank (BCRA) remain at around 21.6% YoY for December 2017 (and have remained above 21% since March) although they are expected to drop to 17.1% is expected over the next 12 months. However, public expectations (according the Di Tella University survey) have been corrected downward in the last quarter from 25% in March to 20% in June. Wage agreements are progressing slowly, averaging increases between 21-23% YoY that do not add to inflation pressures. Until mid-May, exchange-rate stability contributed to sustaining downward inflation expectations and it is to be expected that recent episodes of volatility will not be greatly passed through to prices, since a higher rate of depreciation was expected in the second half of the year. The exception could be the increase in fuel prices set for July due to the adjustment formula that takes into account both the increase in the international price of oil and the exchange rate and which will have an incidence of close to 0.2 pp in inflation for that month.

Figure 4.1 Inflation INDEC GBA per month, incidence of regulated prices, core and seasonal prices



Source: BBVA Research based on INDEC data

Figure 4.2 Cumulative inflation in 1H17 by components - GBA CPI and National CPI



Source: BBVA Research based on INDEC data

The new national inflation index (National CPI/IPC Nacional) that will be used to assess the attainment of inflation targets, which the INDEC published on 11 July, will not generate significant changes in the feasibility of fulfilling BCRA targets as it will continue to have a strong weighting in the Greater Buenos Aires area. The first measurement for June registered an inflation rate of 1.2% per month, slightly below the 1.4% registered by GBA CPI (which was the previous benchmark as the index with the widest coverage computed by INDEC) and also a slightly lower core inflation of 1.3% MoM. However, in the accumulated inflation for the first half of the year, the national CPI showed an inflation rate of 11.8% just under the 12% measured by the GBA CPI, and very similar increases both in regulated prices and core inflation (Figure 4.2).

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