

Economic Analysis

1H May inflation forecast: annual headline inflation volatility kicks in with the sooner-than-expected rebound in energy prices

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May 20, 2020

We expect headline inflation to post a 0.00% HoH change in the first half of May, thereby increasing to 2.5% YoY from 2.2% in the second half of April. We anticipate a 0.09% HoH core inflation increase (3.60% YoY, unchanged from 3.61% in the previous fortnight). Within non-core inflation, our trackers point to upward pressures on fruits and vegetables prices practically cancelling out by downward pressures on meat and eggs prices, with eggs and chicken prices sharply off their recent highs. We expect energy prices to show only a seasonally modest HoH decline as a c. 20% HoH decline in electricity tariffs will be partially offset by other energy prices, mainly gasoline prices that likely increased 3.3% HoH in the first half of the month. As to core inflation, we expect 1H data to continue to show downside pressures on services and non-food core goods prices offsetting higher food core goods (see table 1).

Our preliminary estimates for May are 0.23% MoM (2.68% YoY) for headline inflation, and 0.18% MoM (3.52% YoY) for core inflation. Currently, we expect low octane gasoline prices to increase between 6 and 7.0% MoM. This implies that gasoline prices will contribute close to 0.40pp to monthly inflation. Therefore, most likely monthly inflation will be unusually high for May. A much sooner and rapid rebound of energy prices as opposed to our expectations a month ago implies more volatility to our projected-inflation path (see graph 2). Before, we were expecting higher energy prices to start to kick in until the summer. Yet, sharp increases are already taking place. We now expect headline inflation to hover close to 3.0% in Aug-Sep before easing somewhat in 4Q until it reaches our unchanged 2.8% year-end forecast. As to core inflation, we expect it to trend downwards until it reached our also unchanged 3.0% year-end forecast.

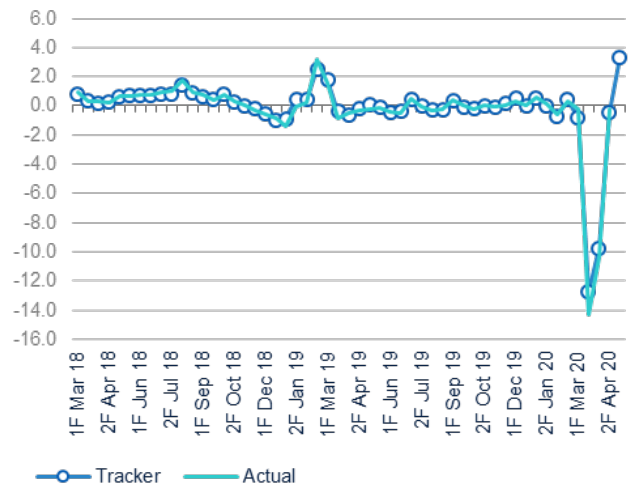
Energy and food prices supply shocks have added volatility to annual headline inflation, but once energy prices stabilize and bottlenecks in food distribution wane out, structurally weak demand will dominate. The main focus on inflation specially now should be on core inflation. In April, it already broke to the downside the 3.6-3.9% in which it fluctuated over the previous two years and in our view it is likely to continue to ease in the coming months. In this context, despite its hawkish rhetoric, we continue to expect Banxico to cut rates in coming meetings at the recent (-)50 bp pace. In our view, Banxico should cut rates much more than currently expected, until real rates are close to 0%.

Table 1. **Inflation Breakdown**

	1H May		2H Apr
	HoH%	YoY %	YoY %
Headline	0.00	2.52	2.21
Core	0.09	3.60	3.61
Core goods	0.13	4.21	4.21
Core food	0.30	6.02	5.91
Nonfood core	-0.05	2.30	2.40
Core services	0.04	2.94	2.95
Core Housing	0.10	2.78	2.82
Core Education (tuitions)	0.00	4.52	4.56
Core Other Services	0.00	2.75	2.72
Non-Core	-0.29	-0.81	-2.00
Non-core Food	0.01	8.00	8.22
Fruits and Vegetables	3.10	14.39	10.22
Meat and Eggs	-2.50	2.95	6.57
Energy-related and Regulated	-0.51	-7.20	-9.24
Energy-related	-0.75	-12.29	-15.04
Regulated	0.07	4.68	4.75

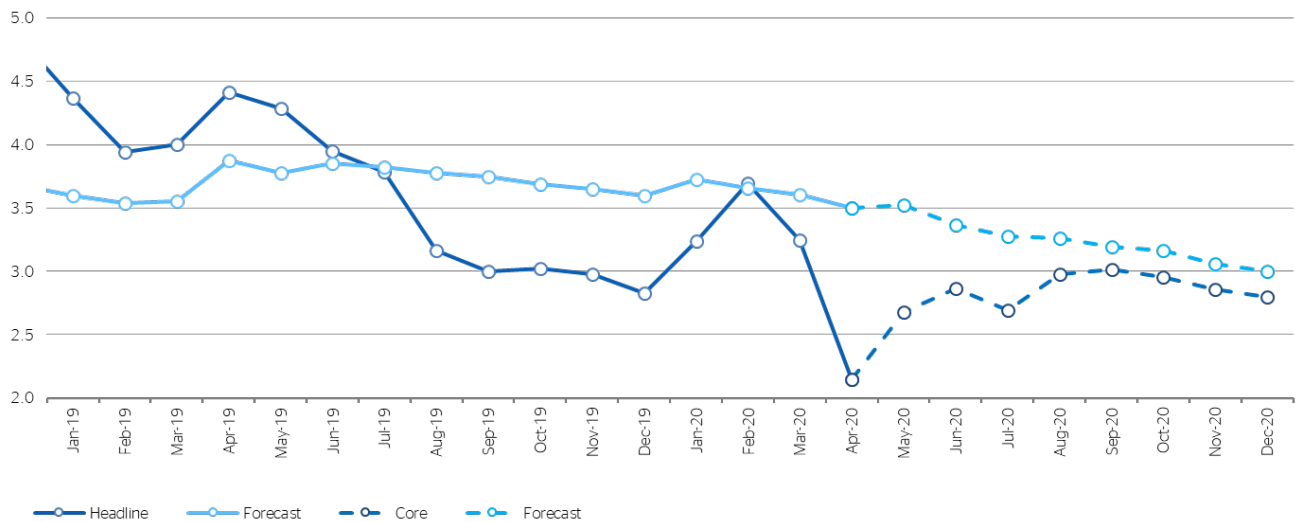
Source: BBVA Research / INEGI

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



Source: BBVA Research / Petrintelligence

Graph 2. **Inflation Outlook (%)**



Source: BBVA Research / INEGI

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