

Economic Analysis

# May inflation forecast: temporary jump in inflation driven by food and energy-related prices

Javier Amador  
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**We expect headline inflation to increase 0.58% MoM in May, thereby accelerating to 3.04% YoY from 2.15% in April. We anticipate a 0.36% MoM core inflation increase (3.71% YoY, up from 3.50% in April).** Within non-core inflation, our trackers point to broad-based energy price pressures continuing in the second half of the month. Our tracker points to a c. 7.0% increase in low octane gasoline prices and anticipates another large monthly increase of around 5.0% at this moment for June (see graph 1). LP gas prices likely increased around 3% in May. Not even the seasonally decline in electricity tariffs will prevent the energy component from increasing in May (see table 1). Besides, the substantial increase in fruits and vegetables prices during the first half of the month (the largest since the second fortnight of Dec 2015) drove up non-core inflation. An expected decline for the second half of May along with easing pressures in meats & eggs prices that likely declined further in the second fortnight will not be enough to offset the jump in fruits and vegetables prices in the first fortnight (see table 1). Fruits and vegetables annual inflation likely jumped to c. 20% in May, the highest level since Jan 2018.

**Within core inflation, there are two different trends, with all components easing or remaining well behaved, but continued pressures on core food prices.** For the second month in a row, these prices likely increased more than 1% MoM, driving up the core food annual trend to levels above 6.5%. This time around, downside pressures on housing and education services and non-food core goods will not be enough to offsetting higher food core goods (see table 1). Therefore, core inflation likely increased to 3.7% in May, from 3.5%. **Looking ahead, the temporary pressures on core food prices will hold the key for core inflation. As soon as pressures ease with a gradual return to some sense of normalcy following the economic lockdown, core inflation will decisively ease. Energy and food prices supply shocks have added volatility to both headline and core inflation, but once energy prices stabilize and bottlenecks in food distribution wane out, weak demand will dominate.**

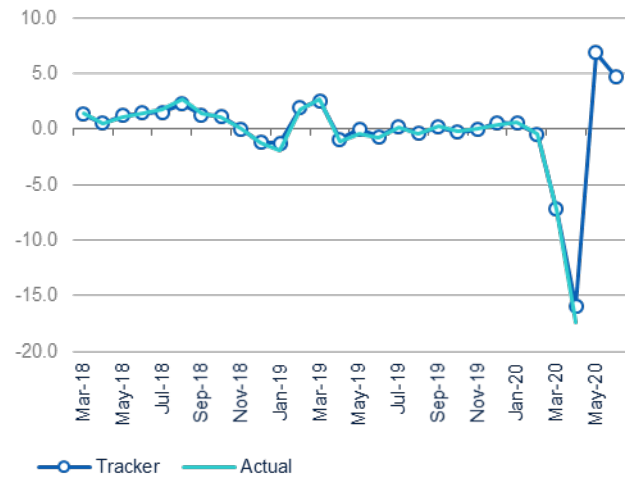
**Inflation is not and will not be a problem for monetary policy with plummeting demand, a rapidly widening negative output gap, increasing labor market slack, and the recent strengthening of the Mexican peso.** We continue to expect headline inflation to end the year slightly below 3.0% with core close to 3.0%, may be slightly above 3.0%. More importantly, volatility and short-term pressures on food and energy prices are supply-driven and thus, should prove temporary. Demand weakness continues to strongly point to lower inflation. With ER-related concerns easing, well-anchored inflation expectations and a high real rate, Banxico should continue to cut rates by 50bp in each of the remaining policy meetings of 2020. **We continue to expect Banxico to cut rates much more than currently expected, until real rates are close to 0%. Although the last policy statement was more hawkish than expected (and warranted), the Minutes reflect a less hawkish bias that in our view was not reflected well in the policy statement. More importantly, Banxico significantly reduced the core inflation forecasts for 2021, showing that lower (not higher) inflation is the most likely scenario in the next 12 to 18 months.**

Table 1. **Inflation Breakdown**

	May		Apr
	MoM%	YoY %	YoY %
<b>Headline</b>	<b>0.58</b>	<b>3.04</b>	2.15
<b>Core</b>	<b>0.36</b>	<b>3.71</b>	3.50
Core goods	<b>0.53</b>	<b>4.36</b>	4.11
Core food	<b>1.18</b>	<b>6.59</b>	5.78
Nonfood core	<b>-0.17</b>	<b>2.02</b>	2.34
Core services	<b>0.19</b>	<b>3.00</b>	2.84
Core Housing	<b>0.07</b>	<b>2.66</b>	2.86
Core Education (tuitions)	<b>0.00</b>	<b>4.51</b>	4.57
Core Other Services	<b>0.33</b>	<b>2.99</b>	2.47
<b>Non-Core</b>	<b>1.25</b>	<b>0.94</b>	-1.96
Non-core Food	<b>1.36</b>	<b>9.81</b>	8.52
Fruits and Vegetables	<b>7.48</b>	<b>19.61</b>	9.35
Meat and Eggs	<b>-3.60</b>	<b>2.16</b>	7.83
Energy-related and Regulated	<b>1.17</b>	<b>-5.50</b>	-9.35
Energy-related	<b>1.47</b>	<b>-10.13</b>	-15.20
Regulated	<b>0.47</b>	<b>5.08</b>	4.81

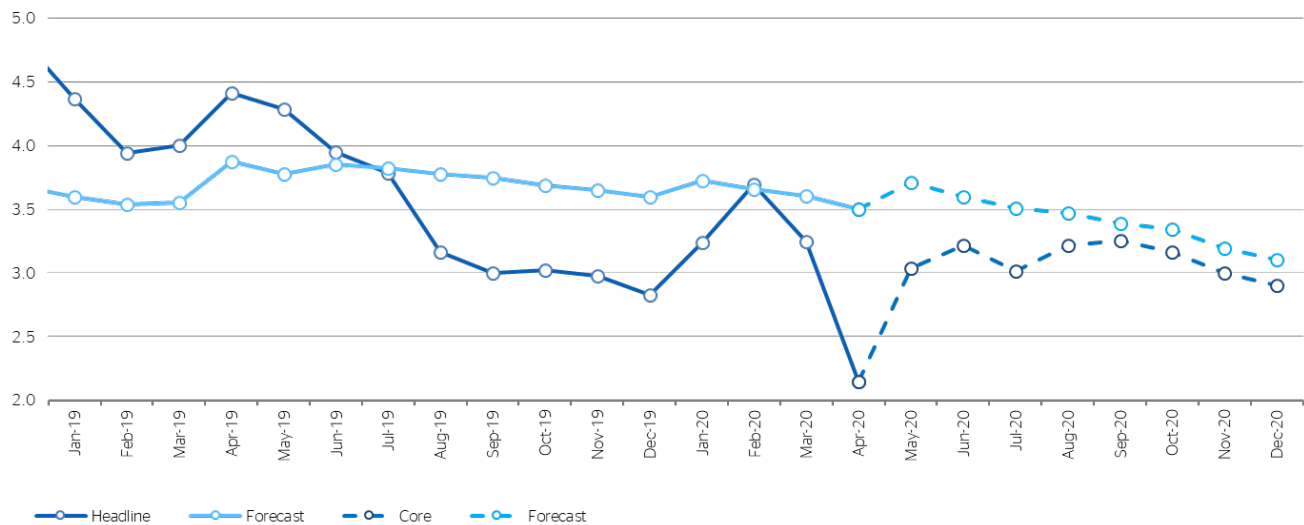
Source: BBVA Research / INEGI

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



Source: BBVA Research / Petroleintelligence

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



Source: BBVA Research / INEGI

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