February inflation –Pressured but still within Banxico's variability range around the target

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- **Headline inflation (February): 0.63% m/m; Banorte: 0.64%; consensus: 0.62% (range of estimates: 0.54% to 0.64%); previous: 0.86%**
- **Core inflation (February): 0.39% m/m; Banorte: 0.37%; consensus: 0.37% (range of estimates: 0.35% to 0.40%); previous: 0.36%**
- **The non-core component increased further at 1.36% m/m, mainly on pressures in energy prices (3.5%) as harsh weather affected dynamics further. In contrast, agricultural goods fell 0.2%, with a mixed performance within. At the core, goods (0.5%) remain higher than services (0.3%), with the latter still dampened by slack conditions**
- **Annual inflation stands at 3.76% from 3.54% in January. Core inflation was slightly higher, at 3.87% from 3.84%, with the non-core responsible for the move, at 3.43% from 2.63%. Despite of this we expect one last 25bps rate cut in this easing cycle by Banxico on March 25th, taking it to 3.75%**
- **We wait for more attractive levels for tactical longs in long-term Mbonos**

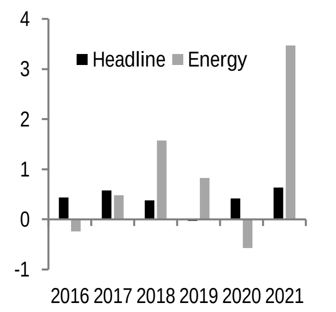
Consumer prices up 0.63% m/m in February. This was an inch higher than consensus at 0.62%, which in turn was slightly below our 0.64%. Pressures in energy continued, up 3.5% m/m, recalling the shock to global gas and gasoline benchmarks on harsh weather at the northern border. Despite more stimulus on excise taxes, low- and high-grade were up 4.6% and 5.1%, in the same order. LP gas (4.3%) was also higher, but natural gas unchanged. In contrast, agricultural goods were mixed, with fresh fruits and vegetables down 2.1% but meat and egg stronger (1.3%). At the core, goods (0.5%) remain above services (0.3%), albeit with the former seeing a seasonal uptick on the end of winter discounts in clothing and shoes. In the latter, we highlight an uptick in 'dining away from home' (0.4%) likely affected by higher costs. On the contrary, there was a very modest advance in education despite its high seasonality due to the return to classes.

February inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.63	0.64	0.00
Core	0.30	0.28	0.02
Goods	0.21	0.20	0.01
Processed foods	0.09	0.09	0.00
Other goods	0.12	0.10	0.01
Services	0.09	0.08	0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.06	0.05	0.01
Non-core	0.34	0.36	-0.02
Agriculture	-0.02	-0.04	0.01
Fruits & vegetables	-0.10	-0.10	0.01
Meat & egg	0.08	0.07	0.01
Energy & government tariffs	0.36	0.39	-0.04
Energy	0.35	0.38	-0.03
Government tariffs	0.01	0.01	0.00

Source: INEGI, Banorte.
Note: Contributions might not add due to the number of decimals allowed in the table.

Headline and energy inflation in February
% m/m



Source: INEGI

February inflation: Goods and services with the largest contributions
% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% m/m
Low-grade gasoline	22.5	4.6
LP Gas	9.8	4.3
Potatoes	6.3	16.0
Chicken	4.1	2.4
High-grade gasoline	3.2	5.1
Goods and services with the largest negative contribution		
Tomatoes	-16.0	-29.9
Onions	-3.2	-15.4
Nopal	-0.7	-7.4
Avocadoes	-0.7	-4.0
Poblano chillies	-0.7	-13.7

Source: INEGI

Annual inflation increases but still inside Banxico's range around the target. Specifically, it picked up to 3.76% from 3.54% on average in January, higher for a second consecutive month. The non-core was again mostly responsible for the move, reaching 3.43% from 2.63% in the same period. More favorably, core inflation was broadly stable, at 3.87% from 3.84%. Differentiation between goods (5.5%) and services (2.1%) in the latter remains wide. We believe this is likely to prevail in the short term, as: (1) Recent exchange rate dynamics, with the MXN weakening, are likely to affect tradable goods more on potential pass-through effects; and (2) COVID-19 restrictions and still ample slack keep limiting services, mainly in tourism-sensitive categories. On the contrary, differences in the annual comparison between these two categories should start to wane starting in March, as base effects kick-in because of distortions induced since the pandemic shock last year. On the other hand, the non-core should maintain an upward bias as investors remain optimistic about the global growth outlook, among other factors, which may limit corrections lower in commodity prices. All in all, we maintain our year-end forecasts of 3.7% and 3.1% y/y for the headline and the core, in the same order, albeit recognizing that risks are tilted slightly to the upside. This, along a better growth outlook, has already been recognized by Banxico in its latest QR. In addition, higher market volatility and some limitations on EM central bank's easy stance (*e.g.* Brazil) suggest less room for further rate cuts. Hence, we now expect only one more 25bps rate cut on March 25th, taking the reference rate to 3.75%, where we see the end of the current easing cycle.

From our fixed income and FX strategy team

We wait for more attractive levels for tactical longs in long-term Mbonos. Pressures in US Treasuries have sharply permeated across the Mexican bonds' performance, with this Tuesday's dynamics probably allowing for a breathier despite local CPI figures. We believe breakeven inflation between Mbonos and Udibonos could still experience further increases after elevating around 20bps from their lowest levels in mid-February (and stronger in short-term figures) when the rates' adjustment started. We wait for more attractive entry levels for tactical longs in long-term Mbonos, while we also expect the curve to find resistance to price in with greater conviction a scenario of greater monetary easing, currently incorporating implied cuts of -8bps for Banxico in the 2Q21.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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