

Higher inflation makes Banxico's decision tomorrow even more complicated

- **Headline inflation (1H-Mar): 0.53% 2w/2w; Banorte: 0.35%; consensus: 0.31% (range of estimates: 0.20% to 0.41%); previous: 0.31%**
- **Core inflation (1H-Mar): 0.35% 2w/2w; Banorte: 0.21%; consensus: 0.20% (range of estimates: 0.16% to 0.25%); previous: 0.18%**
- **We highlight the strong upward surprise at the core. Goods picked up 0.4%, noting pressures in corn tortilla prices. Services advanced 0.3%, with increases in tourism-related categories due to an adverse seasonality ahead of the Easter holiday. The non-core rose 1.1%, adding 27bps. Energy (1.8%) and agricultural goods (0.8%) were pressured, affected by disruptions from cold weather, among other factors**
- **Annual inflation picked up to 4.12% from 3.76% on average in February, above Banxico's variability range. This remains mostly due to the non-core, reaching 4.19% from 3.43%. Nevertheless, the core increased to 4.09% from 3.87% during the same period**
- **We expect Banxico to cut the rate one last time in this easing cycle on Thursday, down 25bps to 3.75%. Nevertheless, the decision has become even more difficult after this print, which among other adverse factors, could imply changes to the longer-term outlook of the central bank**
- **The report will contribute to further pressures in the local yield curve**

Inflation at 0.53% 2w/2w in the first half of March. This was strongly above consensus at 0.31%, and also higher than our 0.35%. The core stood at 0.35% (Banorte: 0.21%), with its strong upward surprise as the main highlight. Goods picked up 0.4% and services 0.3%. We note corn tortillas (1.8%) in the former, while in the latter we recall that tourism-related categories were higher ahead of the Easter holiday. The non-core rose 1.1%. In our view, disruptions to energy markets because of cold weather in the US south and northern and central Mexico in mid-February impacted several categories. Low- and high-grade gasoline were up 1.0% and 3.7%, respectively. Moreover, LP gas (4.1%) was also affected. Agricultural goods were also higher (0.8%). It is our take the weather also impacted dynamics, especially meat and eggs (1.0%).

1H-March inflation by components
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.53	0.35	0.18
Core	0.26	0.16	0.10
Goods	0.16	0.09	0.07
Processed foods	0.08	0.05	0.03
Other goods	0.08	0.04	0.04
Services	0.10	0.07	0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.08	0.05	0.03
Non-core	0.27	0.20	0.07
Agriculture	0.08	0.11	-0.03
Fruits & vegetables	0.02	0.07	-0.05
Meat & egg	0.06	0.04	0.02
Energy & government tariffs	0.19	0.09	0.10
Energy	0.19	0.08	0.10
Government tariffs	0.01	0.00	0.00

Source: INEGI, Banorte.

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

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1H-March inflation: Goods and services with the largest contributions

% 2w/2w; bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
LP Gas	9.6	4.1
Low-grade gasoline	5.0	1.0
Corn tortillas	3.3	1.8
Eggs	3.3	3.9
High-grade gasoline	2.5	3.7
Goods and services with the largest negative contribution		
Potatoes	-1.3	-2.8
Beans	-1.0	-1.8
Squash	-0.8	-11.8
Hair-styling products	-0.6	-1.8
Onions	-0.5	-2.9

Source: INEGI

Annual inflation higher again. This metric increased to 4.12% from 3.76% on average in February, above Banxico’s upper bound of its variability range for the first time since October. The core was also higher, at 4.09% from 3.87% in the same period. We recall that headline inflation is poised to keep increasing from here on due to distortions from base effects because of the pandemic last year. This has been acknowledged by the central bank repeatedly as the so-called ‘hump’ in inflation. In bi-weekly frequency, our forecast shows annual inflation above 4% for the rest of 1H21. Despite of today’s print and the latter outlook, we still expect Banxico to cut the reference rate by 25bps on Thursday, to 3.75%. Nevertheless, we recognize that [the decision will be very difficult](#). Although a central bank should not react to a fortnightly print but assess how much it could affect their forecasts relative to the target –in the period of influence of monetary policy–, this figure complicates even more tomorrow’s decision. Specifically, it is our take that concerns about inflation dynamics could rise even further, given that: (1) Short-term expectations have been revised higher; (2) adverse dynamics have been observed since the start of the year, particularly at the non-core; (3) market volatility increases risks to the upside, particularly due to exchange rate pass-through, along the persistent upward move in energy prices; and (4) less relative room to maneuver as the latter has resulted in a reaction from other EM central banks, which have become more hawkish at the margin. After this decision, we believe the ‘window of opportunity’ for more cuts will be closed at least for the rest of the year, effectively ending the easing cycle with an accumulated decline of 450bps since it started, on August 2019.

From our fixed income and FX strategy team

The report will contribute to further pressures in the local yield curve. The Mexican fixed-income market has experienced a substantial sell-off since mid-February as a reflection of, among other factors, the adjustment in US Treasuries amid the expectation of stronger growth dynamics and possible inflation pressures, and in most recently, as a result of a hawkish tone from other emerging market central banks. This situation has also translated to the shortest-end of the Mexican yield curve which is no longer pricing in rate cuts from Banxico this year, and furthermore, is currently pricing a +40bps hike at the end of 2021. The upward surprise in today’s CPI is likely to trigger greater adjustments in the nominal yield curve, reason why we prefer to wait for better entry levels for tactical long positions in mid- and long-term Mbonos.

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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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