March inflation –We revise up our year-end forecast to 4.7% y/y from 3.7%

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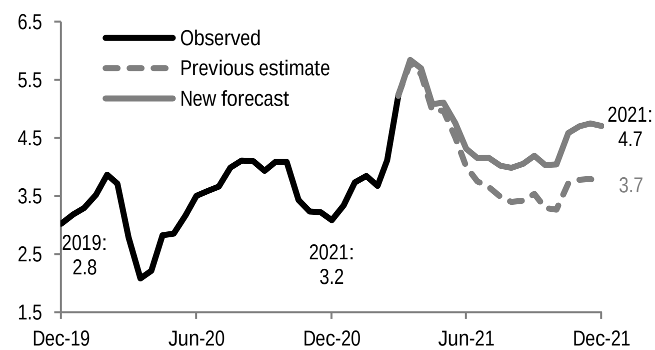
- **Headline inflation (March): 0.83% m/m; Banorte: 0.83%; consensus: 0.83% (range of estimates: 0.71% to 0.88%); previous: 0.63%**
- **Core inflation (March): 0.54% m/m; Banorte: 0.53%; consensus: 0.53% (range of estimates: 0.51% to 0.55%); previous: 0.39%**
- **After today's print, we revise up our year-end forecast higher, to 4.7% y/y from 3.7% previously, and the core to 3.7% from 3.1%**
- **The non-core component keeps pushing the headline higher, up 1.69% m/m, still with pressures in energy (2.8%) and meat and egg (1.9%). The core was high since the first fortnight, with goods (0.6%) affected by items such as tortillas (2.9%), and services (0.5%) reacting to a typical seasonality due to the Easter holiday**
- **Annual inflation surged to 4.67% from 3.76% in the previous month, highest since end-2018. Core inflation was also up, at 4.12% from 3.87%. Given these dynamics, we will carefully watch the debate on the outlook for prices among Board members in today's minutes**
- **The relief rally remains in the local yield curve, although complex conditions prevail on the horizon**

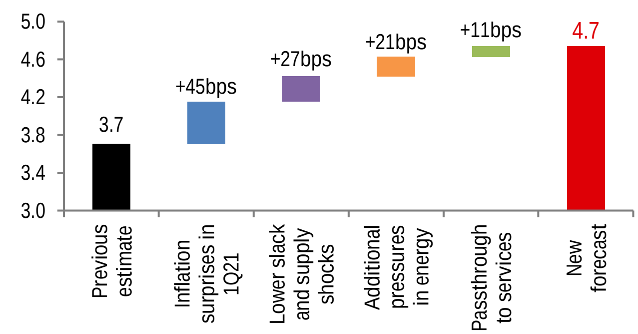
We revise higher our year-end inflation forecast. After recent dynamics and today's figure, we adjust our year-end inflation forecast to 4.7% y/y from 3.7% (see chart below, left). Moreover, we also revise higher our core inflation estimate, to 3.7% from 3.1% previously. This is based on several drivers, highlighting: (1) Upward surprises in inflation prints during 1Q21 relative to our previous estimates, mainly because of higher energy prices, albeit also in meat and egg, and other goods within the core (+45bps, see chart below, right); (2) lower than expected slack in the economy at the margin, along recent supply chain disruptions that are pressuring input costs for firms, contributing an additional 27bps; (3) expectations of additional increases in energy prices, boosted by higher global growth (*e.g.* reflation trade), adding 21bps; and (4) some passthrough effect from the latter to other components, mainly to non-tourism services excluding housing and education (*e.g.* dining away from home and restaurants), with +11bps.

2021 Inflation forecasts
% y/y, bi-weekly frequency



Source: Banorte with data from INEGI

2021 Inflation forecasts
% y/y, contributions in bps



Source: Banorte

Consumer prices accelerated in March, up 0.83% m/m. This was in line with consensus and our estimate. Pressures were seen since the first fortnight and continued in the second half. The core stood at 0.54%, also broadly in line with expectations. Goods picked up 0.6%, highlighting corn tortillas (2.9%) within processed foods, while others were also relatively high, both up 0.6%. Services increased 0.5%, with airfares (33.1%) and tourism-related (9.4%) higher again at the margin on the effect from the Easter holiday. Education and housing remain muted. At the non-core, energy prices strengthened 2.8%, with LP gas (5.2%) and low- (2.1%) and high-grade gasoline (6.0%) with further upward moves in the second fortnight, albeit more modest as the market normalizes and subsidies to excise taxes increased. We also highlight agricultural goods (1.3%), with an extension up in meat and egg (1.9%) and a more modest 0.5% in fresh fruits and vegetables.

March inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.83	0.83	-0.01
Core	0.40	0.40	0.01
Goods	0.24	0.25	-0.01
Processed foods	0.12	0.11	0.01
Other goods	0.12	0.13	-0.01
Services	0.17	0.15	0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.13	0.12	0.01
Non-core	0.42	0.43	-0.01
Agriculture	0.13	0.14	-0.01
Fruits & vegetables	0.02	0.06	-0.04
Meat & egg	0.11	0.08	0.03
Energy & government tariffs	0.29	0.29	0.00
Energy	0.29	0.28	0.00
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.

March 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
LP Gas	12.3	5.2
Low-grade gasoline	10.6	2.1
Eggs	6.8	8.1
Corn tortillas	5.3	2.9
High-grade gasoline	3.9	6.0
Goods and services with the largest negative contribution		
Potatoes	-3.3	-7.2
Beans	-1.7	-2.9
Squash	-1.6	-22.3
Onions	-1.1	-6.1
Nopal	-1.0	-10.8

Source: INEGI

Annual inflation surges on base effects and pressures at the non-core, among other factors. Headline inflation surged to 4.67% y/y from 3.76% in the previous month, highest since end-2018. Core inflation was also up, at 4.12% from 3.87%. This is mainly because we have started to see a much more challenging base effect due to the start of the pandemic last year, mainly in energy –which fell 8.3% 2w/2w in the 2nd half of March 2020– as crude oil and gasolines plunged. This effect, known as the inflation 'hump', will be even more important in April and May, when lockdowns were most severe in 2020.

In this respect, distortions will affect both components. Specifically, the non-core went up to 6.31% from 3.43% in February. Nevertheless, it is also because of the accumulated year-to-date increase in 2021, mainly in energy (11.9%), in turn influenced by: (1) Stronger global growth expectations; (2) supply restrictions in the oil market, although these may moderate in coming months; and (3) temporary exchange rate pressures in March. Price dynamics in recent months are likely to be more concerning for the central bank due to its potential passthrough effect to other components (even with ample slack). In our view, this was the main reason for Banxico's cautious stance in the latest decision, keeping the rate at 4.00% with a unanimous vote. Hence, we will watch carefully the possible debate in this regard in the minutes to be released later today, trying to differentiate opinions about the outlook for prices. This remains key to evaluate the monetary policy stance.

From our fixed income and FX strategy team

The relief rally remains in the local yield curve, although complex conditions prevail on the horizon. The Mexican fixed-income market has experienced a relief rally recently after the strong sell-off observed in the 1Q21, averaging a 23bps appreciation during April for the Mbonos curve. This morning's CPI report came in line with market expectations, which should validate the current dynamics. However, going forward, we consider that the outlook for inflation in Mexico for the remainder of the year, the slightly hawkish bias from Banxico and the possibility of additional pressures on long-term interest rates in the US will continue to trigger volatility. Given this situation, we prefer to wait for better entry levels for long positions on the local curve, with a more interesting relative valuation in those tenors with longer duration. In terms of inflation expectations, breakevens have seen a significant contraction since the end of March, mainly in the 5-10-year zone, with an average reduction of 50bps, after significant adjustments in previous months. Consequently, the yield curve has also moderated the increases that priced in for Banxico from the following quarter, currently incorporating implied hikes of 31bps for the 4Q21 from 37bps a week ago.

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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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