

Economic Research

Mexico

1H-April inflation – Annual rate surpasses 6% on adverse base effects and other factors

- **Headline inflation (1H-Apr): 0.06% 2w/2w; Banorte: -0.02%; consensus: -0.08% (range: -0.35% to -0.01%); previous: 0.28%**
- **Core inflation (1H-Apr): 0.18% 2w/2w; Banorte: 0.16%; consensus: 0.14% (range: 0.09% to 0.21%); previous: 0.20%**
- **As usual, this period is skewed down due to the first round of subsidies to electricity tariffs, which fell 12.0% (contribution: -25bps). Within the non-core, we also highlight pressures in agricultural goods (1.6%), mainly in fruits and vegetables (3.2%). At the core, goods picked up 0.3%, with services more modest at 0.1%. Within the latter, tourism-related categories partially reversed their Easter holiday increase**
- **Annual inflation surged to 6.05% from 4.67% on average in March, highest since late 2017. The core was more stable at 4.13% from 4.12% during the same period, albeit also above Banxico's variability range**
- **Although the hefty increase in annual inflation was mainly because of distortions related to the pandemic, we believe the outlook for prices has become more challenging. As a result, we reiterate our call for Banxico to hike the reference rate by 25bps in their meeting on December 16th**
- **Udibonos' carry benefiting temporally**

Inflation at 0.06% 2w/2w, above consensus. In turn, the print was closer to our -0.02%, estimate. The core stood at 0.18% (Banorte: 0.16%). As usual, this period is skewed down due to the first round of subsidies to electricity tariffs, which fell 12.0% (contribution: -25bps). We also highlight the 3.2% increase in fresh fruits and vegetables, contrary to its usual seasonality and in line with our monitoring. More positively, other energy prices stabilized, with LP gas down 0.4% and low-grade gasoline inching higher, at 0.1%. Going to the core, goods stayed relatively high at 0.3%. Among them, we note that corn tortilla prices rose again (0.9%), while other goods picked up 0.6%, highlighting autos. Services slowed to 0.1%. This is mainly due to tourism-related categories that partially reversed the increase driven by the Easter holiday. Nevertheless, pressures persist in dining away from home.

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

	INEGI	Banorte	Difference
Total	0.06	-0.02	0.08
Core	0.14	0.12	0.01
Goods	0.11	0.11	0.01
Processed foods	0.05	0.06	0.00
Other goods	0.06	0.05	0.01
Services	0.02	0.02	0.01
Housing	0.01	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.01	0.00	0.01
Non-core	-0.07	-0.14	0.07
Agriculture	0.17	0.12	0.05
Fruits & vegetables	0.15	0.10	0.05
Meat & egg	0.02	0.02	0.00
Energy & government tariffs	-0.24	-0.26	0.02
Energy	-0.25	-0.26	0.01
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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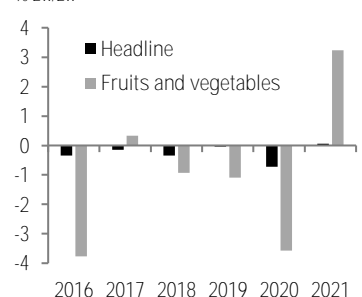
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Headline and fresh fruits and vegetables inflation in 1H-April
% 2w/2w



Source: INEGI

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1H-April 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
Tomatoes	7.4	18.8
Avocados	3.2	15.7
Dining away from home	2.1	0.5
Serrano chilies	1.9	25.1
Corn tortillas	1.7	0.9
Goods and services with the largest negative contribution		
Electricity	-24.6	-12.0
Potatoes	-3.4	-8.9
Tourism services	-2.3	-7.2
LP gas	-0.9	-0.4
Airfares	-0.8	-4.2

Source: INEGI

Highest annual inflation since late 2017. This metric surged to 6.05% from 4.67% on average in March. In bi-weekly terms, this is its highest since the second half of December 2017, in the aftermath of the liberalization of gasoline prices at the beginning of said year. Nevertheless, the actual increase is somewhat different from that occasion. Currently, it has a lot to do with a very difficult base effect, with annual inflation in the same period last year plunging to 2.08% given the impact from the start of the pandemic. The latter was particularly important for the non-core, which fell to -1.93% from 2.19% in March, as energy prices dipped. This base effect will keep distorting annual rates for a while, a situation already anticipated by the central bank. Nonetheless, and more relevant in our view, we also warn about other factors that are pushing inflation higher. Among them, we stress some impact at the core level from: (1) Global supply restrictions, which may be increasing input costs; (2) passthrough effects from accumulated pressures in energy prices so far this year; and (3) potential price adjustments due to minimum wage hikes and exchange rate weakness, albeit with a better performance in the latter after some pressures were seen early in the previous month. Given this backdrop, we recently revised higher our year-end inflation forecast to 4.7%, above consensus expectations which are close to 4.2%. As a result, we believe that a more difficult inflation environment than projected, among other factors, will result in a 25bps reference rate hike by Banxico in their December 16th meeting, ending this year at 4.25%.

From our fixed income and FX strategy team

Udibonos' carry benefiting temporally. The strong upward surprise will support Mexican linkers' carry, adding to the likely stronger appetite for these securities amid recent CPI prints. Moreover, local nominal yield curves will probably extend their recent upward correction, resulting in inflation breakevens widening further after rising 34bps, on average, for 3- and 5-year tenors in the last two weeks. Particularly, these are currently trading at levels of 3.90% and 3.98%, respectively. Amid this situation we prefer to wait for better entry points for tactical long positions in Mbonos. Meanwhile, market's pricing on Banxico for the 4Q21 has elevated to +39bps from +32bps the previous week.

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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 Ill 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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