February inflation – Rebound in the annual rate, with the core still trending up

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STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

- **Headline inflation (February): 0.83% m/m; Banorte: 0.82%; consensus: 0.80% (range: 0.72% to 0.85%); previous: 0.59%**
- **Core inflation (February): 0.76% m/m; Banorte: 0.76%; consensus: 0.75% (range: 0.66% to 0.77%); previous: 0.62%**
- **Inflation was high at both the headline and core. In the latter, goods (1.0%) stayed pressured, especially processed foods (1.0%), but with 'others' also elevated. Services (0.5%) were mainly affected by non-tourism categories. At the non-core, we highlight energy (1.7%) as prices started to react late in the period to Russia's invasion of Ukraine. Agricultural goods rose 0.5%, affected by meat and egg**
- **Annual headline inflation picked up to 7.28% from 7.07% on average in January. The core increased further, reaching 6.59% from 6.21%, in the same order, a new high since mid-2001**
- **Given financial market deterioration and a worse outlook for short-term inflation, we expect Banxico to hike by 50bps on March 24th. As such, risks of a more aggressive hiking cycle remain in place**
- **We see short-term CPI-linked Udibonos as attractive**

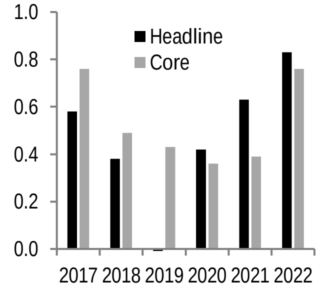
Inflation at 0.83% m/m in February, above its 5-year average. This was higher than consensus (0.80%) but practically in line with our 0.82%. We keep seeing pressures in several fronts, in our view related to supply shocks that have pushed costs up, among others. Core inflation reached 0.76%, with goods still leading (1.0%), especially processed foods (1.0%). One item significantly higher was corn tortillas. Services increased 0.5%, with tourism and non-tourism categories adding to the upside. At the non-core, we highlight energy (1.7%), especially LP gas (5.7%) and low-grade gasoline (1.0%). In the latter, we recall that subsidies to excise taxes were already high, while the impact from surging oil prices because of the conflict in Ukraine was likely modest. Agricultural goods were mixed, with fruits and vegetables (-1.2%) favorable, but meat and egg pressured (1.9%), in line with our monitoring

February inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.83	0.82	0.01
Core	0.57	0.57	0.00
Goods	0.39	0.38	0.01
Processed foods	0.21	0.21	0.01
Other goods	0.17	0.17	0.00
Services	0.18	0.19	-0.01
Housing	0.04	0.05	0.00
Education	0.02	0.02	0.00
Other services	0.12	0.13	-0.01
Non-core	0.26	0.25	0.02
Agriculture	0.06	0.03	0.02
Fruits & vegetables	-0.06	-0.09	0.03
Meat & egg	0.12	0.13	-0.01
Energy & government tariffs	0.21	0.21	-0.01
Energy	0.18	0.18	-0.01
Government tariffs	0.03	0.03	0.00

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

Headline and core inflation in February
% m/m



Source: INEGI

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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
LP Gas	11.8	5.7
Chicken	6.3	3.6
Dinning away from home	5.4	1.1
Low-grade gasoline	5.2	1.0
Limes	4.2	15.2
Goods and services with the largest negative contribution		
Tomatoes	-9.5	-18.2
Poblano chilies	-2.0	-27.6
Husk tomatoes	-1.7	-12.3
Squash	-1.2	-11.2
Potatoes	-1.1	-3.1

Source: INEGI

Annual inflation rises again. Headline inflation reached 7.28% y/y from 7.07% on average in January, while the core stands at 6.59% from 6.21%. The latter reached a new high since June 2001 and remains as Banxico's top concern. So far, average inflation in 1Q22 has been 7.17% and 6.40%, in the same order. For Banxico's forecasts to materialize, they would need to be at least at 6.35% and 6.40% in March, which looks very unlikely. Apart from this, surging commodity prices –more evident since the start of this month– due to Russia's invasion have materially worsened the price outlook. The move has been broad, including energy (*e.g.* oil and natural gas), industrial metals (*e.g.* aluminum, copper) and some agricultural goods (*e.g.* wheat), rising the risk of second-round effects on consumer prices. To the latter we must add a weaker Mexican peso (by 3.2% so far in March) and broader financial market instability.

Banxico to hike 50bps in March. Given the abovementioned factors, we expect the central bank to adjust higher its inflation forecasts –at least for this year– in the next decision, on March 24th. In our view, recent signals point to even higher concerns about price dynamics. As such, we recently recalibrated our call on the reference rate, now seeing a 50bps hike in said meeting. Despite remaining data-dependent, global financial instability has also heightened risks of higher inflation and lower growth. Overall, these mean that the door could be open for more rate increases than what we currently expect.

From our fixed income and FX strategy team

We see short-term CPI-linked Udibonos as attractive. The broad increase in commodity prices has exacerbated fears about global inflation. WTI trades at 2008 highs of 120 $/bbl, influencing prices of crude derivatives. Specifically, gasoline has reached all-time highs in the US. In this backdrop, upside risk to local inflation have deteriorated and markets now see a more hawkish stance by Banxico. The short-end of the yield curve is pricing-in cumulative hikes of +253bps for the rest of the year, above the +200bps before the start of the war in Ukraine. In this sense, market participants have consolidated their bets for a 50bps hike in March and have assigned a higher probability to similar adjustment in May, June, August, and September. On real rates, the latest inflation prints have increased appetite for Udibonos, mainly in the short-end. In yesterday's primary government auction, the 3-year Udibono recorded a demand of 2.09x, higher than in the last two offerings. In addition, the breakeven for this same tenor looks modestly cheaper than other maturities. Therefore, we see short-term Udibonos as attractive when compared to other maturities, with value for trading positions.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, José Luis García Casales, Yazmín Selene Pérez Enríquez, José Itzamna Espitia Hernández, Carlos Hernández García, David Alejandro Arenas Sánchez. Paola Soto Leal, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Daniela Olea Suárez, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Isaías Rodríguez Sobrino, 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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