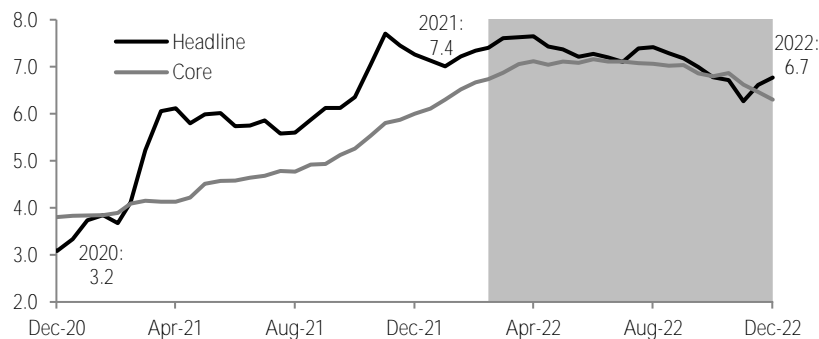


Inflation 2022– Year-end now seen at 6.7% amid more challenging conditions abroad

- We believe the inflation outlook has deteriorated significantly in the past couple of weeks, leading us to revise our year-end forecast for 2022 to 6.7% y/y (previous: 4.4%)
- Both core and non-core inflation would be higher, forecasting them at 6.4% and 7.6%, respectively
- The main drivers behind our revision include:
 - (1) Higher prices of energy and other commodities, along with increased MXN volatility due to the war in Ukraine;
 - (2) Upside surprises at the core from prevailing supply disruptions, further cost increases, and additional changes in consumption patterns; and
 - (3) More difficult weather conditions that would impact crops, as well as other sectors
- Some downside risks may be materializing (*e.g.* an improvement on virus conditions and mobility), albeit it is our take that drivers to the upside will be more persistent and stronger in magnitude, resulting in a more modest reduction in annual inflation for the rest of the year
- Considering this backdrop along and a more hawkish stance by the Fed, we maintain our call for a 50bps hike by Banxico on Thursday. Moreover, we now believe this will be followed by an increase of the same magnitude in May
- Following this, we expect +25bps adjustments in the five remaining decisions of the year, in line with the similar moves by the Federal Reserve, taking the reference rate to 8.25% (previous: 7.50%)

Inflation at 6.7% y/y by the end of 2022. This represents 230bps more than our previous estimate. In our view, the outlook for inflation has deteriorated significantly in the past couple of weeks, mainly (but not exclusively) because of the reverberations of the war in Ukraine across global markets. In particular, we now expect both the core and non-core higher at 6.4% (previous: 4.1%) and 7.6% (previous: 5.1%), in the same order. Most shocks still seem to be mainly originating abroad, albeit likely with a more sizable domestic impact in the price formation process given built-up cost pressures and more lasting effects.

Inflation forecasts
% y/y; bi-weekly frequency



Source: INEGI, Banorte.

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Alejandro Padilla
Chief Economist and Head of Research
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
Executive Director of Economic Research
and Financial Markets Strategy
juan.alderete.macal@banorte.com

Francisco Flores
Director of Economic Research, Mexico
francisco.flores.serrano@banorte.com

Yazmín Pérez
Senior Economist, Mexico
yazmin.perez.enriquez@banorte.com

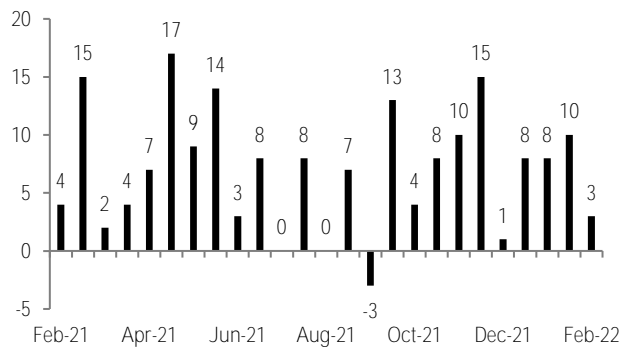
Winners of the award for best economic forecasters for Mexico in 2021, granted by Refinitiv



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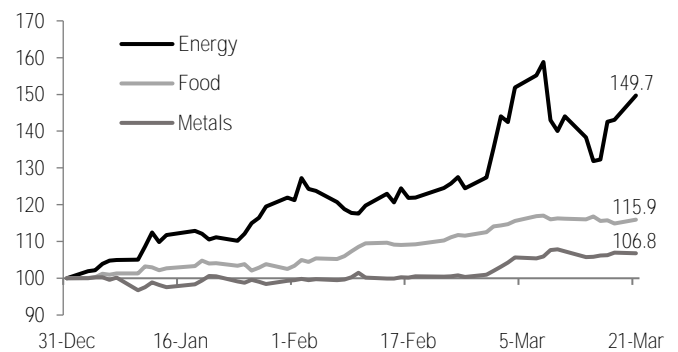
A more challenging backdrop for inflation. Inflation dynamics have become more complex since 2020, especially at the core. This component has shown more persistent pressures and has consistently overshoot estimates (chart below, left) because of several factors, including: (1) Supply disruptions; (2) cost increases; and (3) changes in consumption patterns, among others. However, and contrary to our expectations, these have extended further into 2022, resulting in additional challenges for prices. Lastly, the war in Ukraine has triggered sharp increases across most commodities –especially energy (chart below, right)–, which we see as having both direct and indirect effects on CPI as costs pass-through to consumers. Lastly, we expect adverse weather effects to keep weighing on crops, with additional reports of distortions from an extended process of the *La Niña* phenomenon.

Inflation surprises in the core component*
Basis points



*Difference between the actual print and the median from the survey
Source: Banorte with data from INEGI and Bloomberg

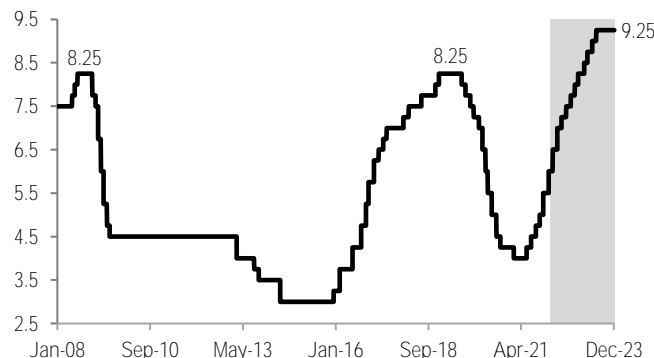
Commodities prices*
Index 100 = Dec-31-2021



*Note Food and metals indices come from CRB and the energy is the Bloomberg Energy Subindex
Source: Bloomberg, Banorte

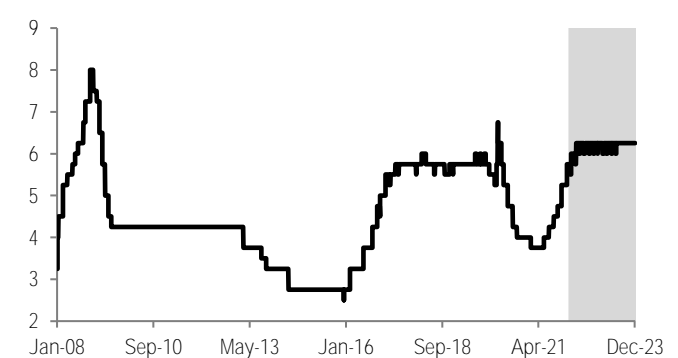
Banxico to take a more aggressive approach in its hiking cycle. We maintain our forecast that the central bank will increase the reference rate by 50bps this Thursday. However, we now forecast +50bps also in May (previous: +25bps), mainly on a more complex short-term inflation outlook –at a high of 7.6% in April– and challenging financial conditions. After this, Banxico would follow a more hawkish Fed –now forecasting 25bps hikes in each of the 6 decisions left this year– with +25bps steps in the five remaining meetings after May (June, August, September, November and December). With this, the rate would reach 8.25% by the end of 2022 (previous: 7.50%). For 2023, we still anticipate an accumulated 100bps increase, although now front-loaded to 1H23, ending the hiking cycle earlier and with a higher terminal rate of 9.25%.

Forecasted path of the reference rate
%



Source: Banxico, Banorte

Spread between the *Fed funds* rate and Banxico's reference rate
%



Source: Banorte with data from Banxico and the Federal Reserve

Analyst Certification

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 Thalia 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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GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Alejandro Padilla Santlana	Chief Economist and Head of Research	alejandro.padilla@banorte.com	(55) 1103 - 4043
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Economic Research

Juan Carlos Alderete Macal, CFA	Executive Director of Economic Research and Financial Markets Strategy	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Director of Economic Research, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katía Celina Goya Ostos	Director of Economic Research, Global	katia.goya@banorte.com	(55) 1670 - 1821
Yazmín Selene Pérez Enríquez	Senior Economist, Mexico	yazmin.perez.enriquez@banorte.com	(55) 5268 - 1694
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707

Market Strategy

Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
-------------------------	-----------------------------	----------------------------	------------------

Fixed income and FX Strategy

Leslie Thalía Orozco Vélez	Senior Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Isaías Rodríguez Sobrino	Analyst, Fixed Income, FX and Commodities	isaiais.rodriguez.sobrino@banorte.com	(55) 1670 - 2144

Equity Strategy

Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Carlos Hernández García	Senior Strategist, Equity	carlos.hernandez.garcia@banorte.com	(55) 1670 - 2250
David Alejandro Arenas Sánchez	Senior Strategist, Equity	david.arenas.sanchez@banorte.com	(55) 1670 - 1746
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Paola Soto Leal	Analyst	paola.soto.leal@banorte.com	(55) 1103 - 4000 x 2755

Corporate Debt

Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Quantitative Analysis

Alejandro Cervantes Llamas	Executive Director of Quantitative Analysis	alejandro.cervantes@banorte.com	(55) 1670 - 2972
José Luis García Casales	Director of Quantitative Analysis	jose.garcia.casales@banorte.com	(55) 8510 - 4608
Daniela Olea Suárez	Senior Analyst, Quantitative Analysis	daniela.olea.suarez@banorte.com	(55) 1103 - 4000
Miguel Alejandro Calvo Domínguez	Senior Analyst, Quantitative Analysis	miguel.calvo@banorte.com	(55) 1670 - 2220

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebaldos@banorte.com	(55) 5004 - 1282
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 5140
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8173 - 9127
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5249 - 6423
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Oswaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5004 - 1051
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 1670 - 1899