1H-March inflation – Downward surprise despite higher energy on the war in Ukraine

- **Headline inflation (1H-Mar): 0.48% 2w/2w; Banorte: 0.59%; consensus: 0.54% (range: 0.37% to 0.70%); previous: 0.42%**
- **Core inflation (1H-Mar): 0.35% 2w/2w; Banorte: 0.41%; consensus: 0.40% (range: 0.22% to 0.48%); previous: 0.32%**
- **We highlight both LP gas (3.7%) and low-grade gasoline (1.3%) within the non-core (0.9%), reflecting higher prices globally due to the war in Ukraine despite some local measures to contain it. Agricultural goods were mixed (0.2%), albeit with meat and egg (0.4%) still affected. At the core, goods picked up 0.5%, with processed foods (0.6%) still leading relative to 'others' (0.4%). Services (0.2%), were impacted by tourism, but highly benefitted by an unusual drop in home telecom (-7.8%)**
- **Annual inflation increased to 7.29% from 7.28% on average in February. The core stood at 6.68% from 6.59% in the same period**
- **Given higher inflation risks, we reiterate our call of a more aggressive hiking cycle by Banxico in 2022, with the year-end rate at 8.25%**
- **Inflation hedges have become more expensive**

Inflation at 0.48% 2w/2w in 1H-March, a downside surprise despite the war in Ukraine. This was below consensus (0.54%) and our estimate. Inside, we highlight energy (1.8%), likely reflecting higher prices globally due to the war in Ukraine and a weaker and more volatile MXN. This was especially important in LP gas (3.7%) and low-grade gasoline (1.3%), up despite measures by the federal government to try and contain it. In this sense, we also note processed foods (0.6%) at the core, especially corn tortilla (1.0%), with staples such as wheat and grains (as well as several other commodities) also disrupted by the conflict. 'Other goods' (0.4%) stayed pressured, still affected by supply chain issues and higher costs, among others. Services (0.2%) were affected by tourism categories likely on a local holiday and the start of Spring Break. Nevertheless, there was a very sharp and unusual drop in home telecom (-7.8%), steepest in the historical series.

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

	INEGI	Banorte	Difference
Total	0.48	0.59	-0.11
Core	0.26	0.31	-0.04
Goods	0.19	0.17	0.02
Processed foods	0.13	0.10	0.03
Other goods	0.07	0.08	-0.01
Services	0.07	0.14	-0.07
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.05	0.12	-0.06
Non-core	0.22	0.28	-0.07
Agriculture	0.03	0.07	-0.04
Fruits & vegetables	0.00	0.01	-0.01
Meat & egg	0.03	0.06	-0.03
Energy & government tariffs	0.19	0.22	-0.03
Energy	0.19	0.21	-0.02
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.

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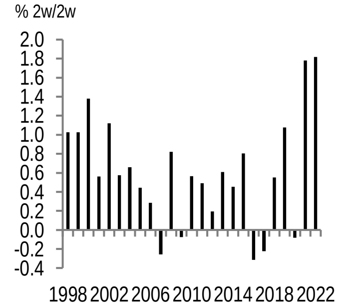
STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Energy prices in 1H-March
% 2w/2w



Source: INEGI

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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
Gas LP	8.1	3.7
Low grade gasoline	6.3	1.3
Airfares	4.2	24.9
Electricity tariffs	3.5	1.7
Onions	3.0	8.4
Goods and services with the largest negative contribution		
Home telecom	-6.9	-7.8
Potatoes	-1.7	-4.9
Lemon	-1.1	-3.4
Squash	-0.9	-12.5
Chicken	-0.7	-0.4

Source: INEGI|

Annual inflation could keep moving higher. Annual headline inflation picked up from 7.28% on average in February to 7.29%. Meanwhile, the core stood at 6.68% from 6.59% in the same period, new high since mid-2001. Given today's results that showed some of the initial effects from higher commodity prices worldwide because of the war in Ukraine, we recently increased our year-end forecasts to 6.7% and 6.4%, respectively. Commodity prices will be key, with very high volatility since the war erupted (including in the MXN). Nevertheless, several goods in energy (*e.g.* crude oil, gasoline, natural gas), food (wheat, corn, soybeans) and metals (aluminum, copper, nickel) remain above levels seen before the invasion. Despite efforts to smooth out some of these adjustments –such as a price ceiling in LP gas and outright stimulus to excise taxes for gasolines–, it is our take that the inflation outlook has deteriorated. In the short-term, we expect direct and second-round effects to other goods and services to keep pressuring prices. Specifically, we now see new highs for annual headline and core inflation in late April and June, in the same order.

Banxico will keep the hiking pace in the short term. Given the above, a more hawkish Fed and a riskier backdrop for financial stability, we expect the central bank to hike by 50bps both today and on their next decision, to be held on May 12th. Afterwards, we estimate 25bps steps in each of the remaining meetings of 2022, taking the rate to 8.25% by year-end. For 2023, we see four consecutive 25bps hikes to reach a terminal rate of 9.25% by the end of 1H23.

From our fixed income and FX strategy team

Inflation hedges have become more expensive. Geopolitical uncertainty keeps pressuring commodity prices. Specifically, crude-oil futures have picked up again —with Brent above 120 $/bbl— given the possibility of new sanctions on Russian energy. As a result, markets anticipate a more hawkish stance from Banxico, pricing-in cumulative hikes of +304bps for the rest of the year vs +200bps before the start of the war in Ukraine. This includes a strong bet for +50bps today, in line with our call. In this context, CPI-linked bonds (Udibonos) have become much more expensive on greater demand for inflation-protected assets. Specifically, the 3-year tenor has rallied 71bps so far in March, trading at 2.95%. Moreover, the breakeven for the same maturity reached all-time highs of 5.44% yesterday. In a similar fashion, 5-, and 10-year breakevens stand near 1-year highs, while the 20- and 30-year readings are above their 12-month averages.

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 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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