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

- **Headline inflation (March): 0.99% m/m; Banorte: 0.98%; consensus: 0.92% (range: 0.80% to 0.98%); previous: 0.83%**
- **Core inflation (March): 0.72% m/m; Banorte: 0.69%; consensus: 0.67% (range: 0.58% to 0.76%); previous: 0.76%**
- **Pressures were seen in both components. At the non-core, the rebound in energy continued (3.0% m/m), especially LP gas (7.5%) given the impact to global prices from Ukraine's war. Agricultural goods were also up (1.2%), more pressured at the margin. At the core, goods (0.9%) maintain complicated dynamics, while 'other services' (0.8%) accelerated due to an adverse seasonality because of the holidays**
- **Annual inflation stood at 7.45% from 7.28% on average in February. In monthly frequency, this is a new high since January 2001. The core reached 6.78% from 6.59% previously, up for 16th month in a row**
- **The inflation outlook remains very complex. We reiterate our view of a 50bps hike on May 12th and a continuation of the cycle during the rest of the year, with the rate at 8.25% by December**
- **Inflation protection remains expensive**

Inflation at 0.99% m/m in March, above consensus. Nevertheless, it was closer to our 0.98%. We saw pressures in several categories during the second half. At the non-core, energy prices (3.0% m/m) extended their move higher amid a difficult global backdrop. We highlight LP gas (7.5%) given adjustments higher to price ceilings, as well as low-grade gasoline (2.0%) despite stimuli to smooth out upward pressures. Agricultural goods also climbed (1.2%), mainly on meat and egg (1.3%), noting additional increases in eggs. However, fruits and vegetables were also higher (1.1%) on goods such as avocadoes and tomatoes (because of an adverse seasonality). At the core, processed foods (1.2%) are still showing very difficult dynamics, highlighting corn tortillas (2.0%). 'Other goods' (0.6%) were more modest, but still reflecting higher costs. In services (0.5%), airfares (41.7%) and tourism (12.8%) reacted to the start of Spring Break and ahead of the Holy Week holiday, among the main highlights.

March inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.99	0.98	0.01
Core	0.53	0.52	0.02
Goods	0.37	0.36	0.02
Processed foods	0.25	0.24	0.02
Other goods	0.12	0.12	0.00
Services	0.16	0.16	0.00
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.13	0.13	0.00
Non-core	0.46	0.46	0.00
Agriculture	0.14	0.16	-0.02
Fruits & vegetables	0.06	0.08	-0.02
Meat & egg	0.08	0.08	0.01
Energy & government tariffs	0.32	0.31	0.01
Energy	0.31	0.29	0.02
Government tariffs	0.01	0.02	0.00

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

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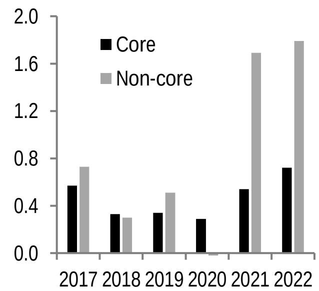
Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Core and non-core inflation in March
% m/m



Source: INEGI

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	16.2	7.5
Low-grade gasoline	10.0	2.0
Airfares	6.9	41.7
Eggs	5.2	6.1
Corn tortillas	4.1	2.0
Goods and services with the largest negative contribution		
Internet, TV and land phones	-7.0	-8.0
Potatoes	-2.6	-7.4
Lemons	-1.4	-4.4
Beans	-0.9	-1.9
Squash	-0.9	-13.1

Source: INEGI

Annual inflation has not likely reached its high. Headline inflation reached 7.45% y/y from 7.28% on average in February, while the core stood at 6.78% from 6.59%. The former surpassed its latest high of 7.38%, seen in November 2021, while the latter has picked up for 16 consecutive months. With this, the 1Q22 average was 7.3% and 6.5%, respectively, with the former above Banxico's latest forecast. Moreover, we believe the annual rate will keep climbing for much of 2Q22, decreasing gradually only after May. Volatility in commodities remains high and some of them have retraced from their recent highs. Nevertheless, they are still above levels seen before the conflict in Ukraine. Moreover, it will be important if there are renewed pressures from: (1) New COVID-19 lockdowns in China, as well as higher cases in Europe and Asia; and (2) the start of drought conditions in the northern part of the country in a backdrop of high fertilizer prices that could impact agricultural production.

Banxico to hike 50bps again in May. Considering the factors above, we are still seeing a very challenging inflation backdrop in the short term. Hence, it is very likely that Banxico will have to increase its inflation estimates again in the decision to be held on May 12th. Moreover, higher market instability and a less accommodative stance by the Fed –including a likely announcement of balance sheet reduction in May– are additional reasons for the central bank to raise its reference rate by 50bps (to 7.00%) in its next decision, as well as extending the hiking cycle at least for the rest of this year, reaching 8.25% by December.

From our fixed income and FX strategy team

Inflation protection remains expensive. The risk of an energy deficit continues skewed to the upside driven mainly by the impact of the economic sanctions against Russia. This, despite the IEA's announcement yesterday to release 120 Mbbl from strategic reserves, of which 50% would come from the US. In this sense, Brent is trading at 103 $/bbl and WTI at 98 $/bbl. In this backdrop, many central banks have reiterated their concern about inflation, including Banxico. The short-end of the yield curve is pricing-in cumulative hikes of +230bps for the remainder year, assigning a high probability of +50bps hikes in upcoming meetings. On the other hand, CPI-linked bonds (Udibonos) remain expensive. For example, the 3-year breakevens stands at 5.38% after hitting all-time highs of 5.44% at the end of March. Given these valuations, we do not recommend new trade ideas despite acknowledging that these securities could remain bid given ongoing appetite for inflation hedges.

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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	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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