

1H-May inflation – Slightly above consensus as food prices remain pressured

- **Headline inflation (1H-May): -0.06% 2w/2w; Banorte: -0.01%; consensus: -0.08 % (range: -0.13% to 0.05%); previous: 0.18%**
- **Core inflation (1H-May): 0.31% 2w/2w; Banorte: 0.44%; consensus: 0.28% (range: 0.20% to 0.44%); previous: 0.27%**
- **Inflation was relatively high despite a benign seasonality. The decline in electricity tariffs (-20.4%) on summer discounts was more modest than our estimate. Gasoline and LP gas were more stable, so energy dipped 3.5%. In agricultural goods (0.5%), we highlight meat and egg (+0.6%). At the core, goods (0.4%) were pushed by processed foods (0.6%), with others (0.1%) surprising us to the downside. Meanwhile, services grew 0.3%, with non-tourism categories still somewhat pressured**
- **Annual inflation fell to 7.58% from 7.68% on average in April, signaling that the peak may be behind us. Nevertheless, the core kept climbing at the margin, at 7.24% from 7.22% in the same period**
- **We expect Banxico to hike by 50bps in its June 23rd decision. Risks of a higher pace remain, with focus on inflation and the Fed**
- **Upside risks remain for faster hikes by Banxico**

Inflation at -0.06% 2w/2w in 1H-May. This was slightly above consensus and relatively high considering its typical seasonality. The latter is due to energy (-3.5%) within the non-core (-1.2%). Specifically, the second tranche of summer discounts to electricity tariffs (-20.4%), which were above our call. On the other hand, low grade gasoline (0.2%) and LP gas (0.1%) were more stable as government policies limited moves, with international prices still volatile. Agricultural goods were up 0.5%, mainly on meat & egg (0.6%), with fruits and vegetables (0.2%) more mixed. The core increased 0.3%, with goods (0.4%) still leading as pressures on processed foods (0.6%) have not abated. Milk was among the top ten products with the highest increases. ‘Others’ (0.1%) were our main downward surprise, with several household appliances lower (which may be related to discounts). Services (0.3%) were mixed, mainly affected by airfares (9.8%), dining away from home (0.6%) and restaurants (0.4%).

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

	INEGI	Banorte	Difference
Total	-0.06	-0.01	-0.05
Core	0.23	0.33	-0.10
Goods	0.14	0.22	-0.07
Processed foods	0.12	0.13	-0.01
Other goods	0.02	0.09	-0.07
Services	0.09	0.11	-0.02
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.07	0.10	-0.03
Non-core	-0.29	-0.34	0.04
Agriculture	0.05	0.05	0.00
Fruits & vegetables	0.01	0.01	0.00
Meat & egg	0.04	0.04	0.00
Energy & government tariffs	-0.35	-0.39	0.04
Energy	-0.35	-0.39	0.04
Government tariffs	0.00	0.00	0.00

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

May 24, 2022

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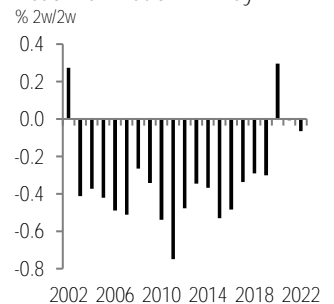
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Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*



Headline inflation 1H-May



Source: INEGI

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1H-May 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
Avocados	5.1	13.4
Tomatoes	4.2	7.9
Dining away from home	2.8	0.6
Airfares	2.2	9.8
Eggs	1.8	1.9
Goods and services with the largest negative contribution		
Electricity tariffs	-36.6	-20.4
Lemon	-4.7	-24.6
Onions	-3.3	-11.4
Serrano chillies	-2.4	-16.4
Refrigerators	-0.9	-3.9

Source: INEGI

Annual inflation has like peaked, but the core remains a headache. Headline inflation fell from 7.68% y/y on average in April to 7.58%. This gives us more confidence that the peak (at 7.72% in 1H-Apr) is behind us, in line with our view. Nevertheless, the core stood at 7.24% from 7.22% and is poised to add 18 consecutive months on the upside. Although a lower headline print is welcome, it may well reverse again (although not our base case). In the short-term, main risks include: (1) More severe droughts and surging bird flu cases in Mexico and the US, potentially affecting both fruits and vegetables and meat & egg; (2) export bans in some countries (*e.g.* wheat and sugar in India, palm oil in Indonesia) that could affect several goods; and (3) still high oil and gasoline prices, with low global inventories. On the contrary, we will look for some relief because of: (4) Discounts during the *Hot Sale* campaign, from May 23rd to 31st; and (5) zero tariffs in some basic goods since mid-May, based on the [Plan Against Inflation](#).

Banxico to keep hiking, focused on inflation and the Fed. We reiterate our call of a 50bps hike in the decision to be held on June 23. Nevertheless, we keep seeing risks of an even higher pace in the short term, especially as they warned of the possibility of “more forceful measures”. In this sense, we will analyze the minutes this week, especially members’ comments about the conditions that may be needed for the latter to materialize. For details, please see [Ahead of the Curve](#).

From our fixed income and FX strategy team

Upside risks remain for faster hikes by Banxico. High global inflation keeps pressuring central banks to follow a restrictive policy. In Mexico, risks of more aggressive hikes have increased after the more hawkish tone in Banxico's last decision. As a result, the market decoupled Banxico's path from the Fed, assigning the former a 90% chance of a 75bps hike at the June meeting. Cumulatively, the curve is pricing-in implicit hikes of +211bps to end the tightening cycle. This is lower than our call of a terminal rate of 9.50% (+250bps). In this respect, we believe Banxico's minutes will be key to either consolidate or recalibrate market expectations. Since the last meeting, the TIEE-28 IRS curve has flattened, with pressures of 14bps at the short-end and gains of 25bps in the long-end.

Mbonos have also followed this dynamic, gaining 10bps in long-term securities. In our view, the latter segment remains the most attractive, particularly tenors Nov'42 and Nov'47, with further room for appreciation after the strong sell-off in April. However, volatility limits the attractiveness for directional positions. Short-term Udibonos have traded more defensively, highlighting a significant compression in breakevens, although they have not yet reached attractive levels.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, David Alejandro Arenas Sánchez, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enriquez, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivos Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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