

Lower than expected inflation in February

March 8, 2018

- **INEGI just published its inflation report for February**
- **Headline inflation (Feb): 0.38% m/m; Banorte: 0.41% m/m; consensus: 0.41% m/m; (range of estimates: 0.35% to 0.46%); previous: 0.53% m/m**
- **Core inflation (Feb): 0.49% m/m; Banorte: 0.47% m/m; consensus: 0.49% m/m (range of estimates 0.47% to 0.52%); previous: 0.28% m/m**
- **Inflation in February was explained by pressures on goods and energy prices, which were offset by lower agricultural prices**
- **With these results annual inflation stands at 5.34%, below the 5.55% seen in January**
- **Gains in local fixed-income after the positive surprise in February inflation**

Consumer prices increased 0.38% m/m in February, standing below both our forecast and the consensus (0.41% m/m). Core inflation was up 0.49% m/m, marginally above our 0.47% m/m estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution from fresh fruits and vegetables (-27bps vs. our -23bps); (2) a smaller impact from energy (17bps vs. our 19bps); (3) a greater contribution from meat and egg (9bps vs. our 7bps); and (4) a smaller impact from other goods (11bps vs. our 10bps), as shown in the table below.

February inflation by major subcomponent

Monthly incidence, %

	Observed	Banorte forecast	Difference
Headline	0.38	0.41	-0.03
Core	0.36	0.35	0.01
Goods	0.19	0.17	0.01
Processed foods	0.08	0.08	0.00
Other goods	0.11	0.10	0.01
Services	0.18	0.18	0.00
Housing	0.04	0.05	0.00
Education	0.02	0.02	0.00
Other services	0.11	0.11	0.00
Non-core	0.02	0.06	-0.04
Agricultural	-0.18	-0.17	-0.02
Fresh fruits and vegetables	-0.27	-0.23	-0.04
Meat and egg	0.09	0.07	0.02
Energy and government regulated	0.21	0.23	-0.02
Energy	0.17	0.19	-0.02
Government regulated	0.03	0.04	0.00

Source: INEGI, Banorte

Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

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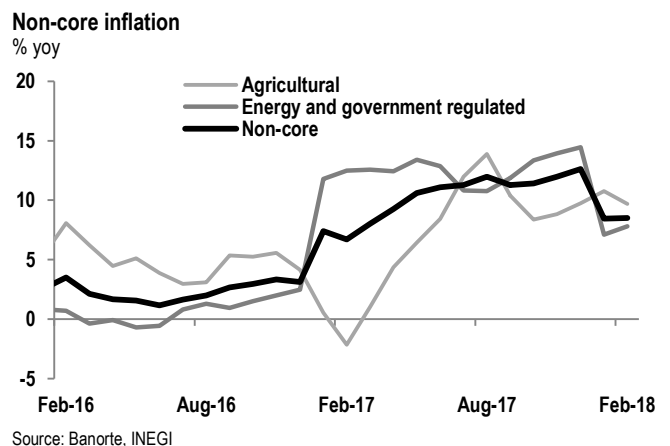
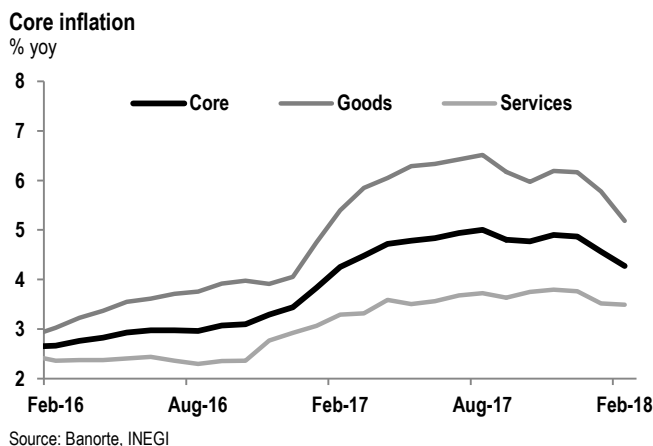
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Inflation in February was explained by pressures on goods and energy prices, offset by lower agricultural prices. Energy prices increased 1.58% m/m on the back of and higher prices low-grade (4.34% m/m) and high grade gasoline (3.25% m/m), while LP gas costs decreased 4% m/m. Moreover, prices of fruits and vegetables came down 7.04% m/m, driven by lower prices of tomatoes (-39.18% m/m), onions (-24.25% m/m) and zucchinis (-25.36% m/m), among others. By contrast, the price of bananas increased 10.66% m/m while the price of lemons edged up 14.61% m/m. In addition, prices of poultry increased 1.46% m/m.

In the core index, we highlight the 0.57% m/m increase in the costs of other goods. Moreover, processed foods edged up 0.50% m/m given higher soda beverages prices (1.63% m/m). In addition other services expanded 0.64% m/m given the growth in dining away from home items (0.54% m/m) and restaurants (0.52% m/m). Finally, housing prices increased 0.26% m/m given the expansion of 0.21% in home ownership costs.

With these figures, annual inflation continued edging down to 5.34% vs. 5.55% in January. Additionally, core inflation came down to 4.27% from 4.56% in the previous month. We continue expecting inflation to show a downward trend to finish 2018 at 4.3%. In the coming months, we will focus on the evolution of energy prices, considering the possible increase in the international reference price –given the start of the US driving season–, as well as the behavior of agricultural prices, and the impact they might have in Mexico’s CPI.



From our fixed income and FX strategy team

Gains in local fixed-income after the positive surprise in February inflation.

Today's figure came in at 0.38% m/m, below our forecast and market expectations of 0.41%, leading to a decrease in year-over-year inflation for a second consecutive month from 5.55% to 5.34%, lowest since February 2017 and in the aftermath of last year's increase in gasoline prices. It is worth noting that a significant driver of this benign print was the plunge in tomato prices (-39.2% m/m). As a result of this positive surprise, Mbonos are gaining 3bps along the curve, concentrated in the mid- and long-end, while Udibonos are broadly unchanged. Moreover, it is our take that most recent dynamics will help cement market expectations of a less hawkish stance by Banxico, particularly as the central bank signaled a sharpened focus on the inflation path in its latest *Quarterly Report* released last week and some early signs of a recent deceleration in economic activity. In this respect, futures markets are pricing-in around 23bps of rate hikes by the middle of the year, plunging from almost 50bps at the end of January. We hold our trade idea of long positions on the *belly* of the yield curve, especially Mbonos with 5- and 10-year maturities, on the back of the expected inflationary backdrop in 2018 and Banxico's less hawkish tilt. On the other hand, upside risks for inflation and the Mexican peso coming from the effects associated with a more hawkish Fed, NAFTA negotiations, and the electoral process in coming months continues to be supportive for our trade idea regarding 5-year floating-rate Bonds D, opened at the beginning of 4Q17. Although the carry and defensive qualities embedded in this strategy remain appealing, we acknowledge that there is limited room for an additional rally after the most recent communication from Banco de México.

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