

Inflation during the first half of March spurred by higher tomato prices

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- **INEGI** just published its inflation report for the first half of March
- **Headline inflation (1H-Mar): 0.35% 2w/2w; Banorte-Ixe: 0.34% 2w/2w; consensus: 0.33% 2w/2w (range of estimates: 0.12% to 0.37%); previous: 0.25% 2s/2s**
- **Core inflation (1H-Mar): 0.31% 2w/2w; Banorte-Ixe: 0.28% 2w/2w; consensus: 0.30% 2w/2w (range of estimates: 0.20% to 0.35%), previous: 0.23% 2w/2w**
- **Inflation in the first half of March was explained by pressures on fresh fruits and vegetables prices, particularly in tomatoes**
- **With these numbers, annual inflation stands at 5.29% vs. 5.02% in the previous month**
- **We continue to expect year-end inflation at 5.7%**
- **Mexican assets continue depicting a lower risk premium despite peaking inflation**

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Consumer prices increased 0.35% 2w/2w in the first half of March (Banorte-Ixe: 0.34% 2w/2w). In addition, core inflation was 0.31% vs. our 0.29% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (-2.6bp vs our 2.6bp); and (2) an underestimation of other goods prices (9.4bp vs our 6bp), as shown in the table below.

1H-March inflation by major subcomponent

Bi-weekly incidence, %

	INEGI	Banorte-Ixe	Difference
Total	0.35	0.34	0.006
Core	0.23	0.21	0.023
Goods	0.15	0.12	0.032
Processed foods	0.06	0.06	-0.002
Other goods	0.09	0.06	0.034
Services	0.08	0.09	-0.008
Housing	0.02	0.02	-0.001
Education	0.00	0.00	0.001
Other services	0.06	0.07	-0.007
Non-core	0.12	0.14	-0.015
Agriculture	0.13	0.11	0.023
Fruits & vegetables	0.13	0.12	0.012
Meat & eggs	0.00	-0.02	0.012
Energy & government tariffs	-0.01	0.03	-0.042
Energy	-0.03	0.03	-0.052
Government tariffs	0.01	0.01	0.009

Source: INEGI, Banorte-Ixe

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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Inflation in the first half of March was explained by pressures on fresh fruits and vegetables prices. According to *INEGI*, among the items with the highest change in prices were other fruits and vegetables (4.04% 2w/2w), mainly due to increases in the prices of tomatoes (18.51% 2w/2w), lemons (19.22% 2w/2w) and husk tomatoes (24.76% 2w/2w). Moreover, another sub-index with substantial changes was other goods, which grew 0.50% 2w/2w.

On the other hand, the biggest decreases were seen in the energy prices, which declined 0.22% 2w/2w, driven by lower prices of both low and high grade gasoline (-1.06% 2w/2w and -0.57% 2w/2w respectively).

With these numbers, annual inflation stands at 5.29%, 27bp above the previous month's figure. Moreover, core inflation in March marginally increased from 4.32% last month to 4.32%. Looking ahead, we consider that inflation will be impacted by: (1) The increase and liberalization of gasoline prices; and (2) second round effects stemming from the higher pass-through effect of the depreciation of the Mexican peso and higher energy costs to prices. We expect the headline index to close 2017 at 5.7% yoy.

From our fixed income and FX strategy team

Mexican assets continue depicting a lower risk premium despite peaking inflation. Local rates are trading with a positive tone, depicting a 3bps rally *vis-à-vis* yesterday's closing marks, as a result of a significant decline in country risk premia since January 20th (e.g. 5-year CDS moving from 175bps to 139bps), notwithstanding inflation figures that continue to trend higher. Today's CPI report has confirmed the negative scenario for 2017, with annual figure standing at 5.29% (193bps higher from 2016-end annual reading). At the beginning of the year the market priced in a convoluted path for the rest of 2017. However, it has recently lower the inflation premium embedded in the yield curve in tandem with a significant recovery of the Mexican peso (13% since January's peak) and recognizing more benign conditions for coming years (e.g. 2018). At this moment, short-term breakevens are hovering around 3.6% (from a 6-month high of 4.9%), and long-term indicators at 3.8% (max at 4.5%). This suggests that valuation has improved in CPI-adjusted Udibonos, mainly in the mid- and long-end (Jun'22, Dec'25 and Nov'35 securities). On the other hand, we hold a positive view in terms of the Mbonos curve, still acknowledging that the most attractive valuation remains in the 5- and 7-year area (Jun'22, Dec'23 and Dec'24).

In the FX market, the Mexican peso flipped back to positive after the report, gaining 0.2% on the day to 18.98 per dollar. Inflation slightly higher than expected will likely confirm expectations that Banxico will increase rates next week, supporting the relatively high carry in the currency when compared to other EM. In terms of strategy we remain on the sidelines in terms of directional positions for the time being as the risk-on mood keeps benefiting MXN but seems vulnerable to negative surprises based on several technical indicators, seeing levels below USD/MXN 19.00 as attractive for long trading positions in the short-term.

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