

March's inflation – Pressures on energy and agricultural goods prices

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- **INEGI just published its inflation report for March**
- **Headline inflation (Mar): 0.41% m/m; Banorte-Ixe: 0.39% m/m; consensus: 0.32% m/m (range of estimates: 0.26% to 0.46%); previous: 0.19%**
- **Core inflation (Mar): 0.26% m/m; Banorte-Ixe: 0.22% m/m; consensus: 0.25% m/m (range of estimates: 0.20% to 0.30%); previous: 0.34%**
- **Inflation during March was explained by pressures on “agricultural goods” prices along with increases in “energy” prices**
- **Moreover we believe that the 0.26% m/m increase on the “other goods” sub-index suggests a certain pass-through effect of the depreciation of the Mexican currency to inflation**
- **With these numbers, annual inflation is at 3.14 vs. 3% in February**

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Consumer prices increased 0.41% m/m in March, slightly above our 0.39% m/m forecast (consensus: 0.32% m/m). Similarly, core inflation stood at 0.26% m/m vs. our 0.22% estimate (consensus: 0.25% m/m). The main deviation from our forecast comes from: (1) A lower than expected contribution of agriculture prices (6.9bps vs. our 7.7bps); (2) a lower than expected contribution of “goods” prices (5bps vs. our 6bps); (3) a larger than expected contribution of services prices (14.5bps vs. our 10.9bps), as shown in the table below

March inflation by components

% monthly incidence

	Observed	Banorte-Ixe forecast	Difference
Headline	0.41	0.39	0.021
Core	0.20	0.17	0.030
Goods	0.05	0.06	-0.007
Processed foods	0.00	0.01	-0.009
Other goods	0.05	0.05	0.002
Services	0.14	0.11	0.036
Housing	0.031	0.028	0.003
Education	0.00	0.00	0.000
Other services	0.11	0.08	0.034
Non-core	0.22	0.22	-0.005
Agricultural	0.07	0.08	-0.008
Fresh fruits and vegetables	0.07	0.09	-0.019
Meat and egg	0.00	-0.01	0.011
Energy and government regulated	0.15	0.15	0.000
Energy	0.14	0.14	0.001
Government regulated	0.01	0.01	-0.001

Source: Banorte-Ixe with data from INEGI and Banco de México.

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 during March was explained by pressures on “agricultural goods” prices along with increases in “energy” prices. We highlight the 2.32% m/m hike in “agricultural goods” prices, which was mainly explained by the 53.1% m/m increase in tomato and the 16.6% expansion in the prices of lemons. Similarly, “energy” prices increased 1.29% m/m derived from the sharp rise in low-grade gasoline prices in the Mexican border. Moreover, “other services” prices grew 0.65% m/m as a result of the 9.6% m/m increase in Air fares, given the anticipation of the Holy Week vacation period. Finally, we believe that the 0.26% m/m increase on the “other goods” sub-index suggests a certain pass-through effect of the depreciation of the Mexican currency to inflation.

With these numbers, annual inflation is at 3.14% vs. 3% in February. Meanwhile, core inflation is at 2.47% from 2.38 in February. In this context, we believe that inflation will remain around 3% in the coming months.

From our fixed income and FX strategy team

The CPI won’t be an important concern in terms of policy assessment despite today’s modest correction. Today’s CPI report depicted a slightly higher-than-expected monthly increase (0.41% vs. Banorte-Ixe 0.39% and market consensus of 0.32%), which is considerably above the 0.19% m/m observed in February and de -0.09% m/m in January. However, annual inflation continues well anchored near to Banxico’s 3% target (3.14% in March from 3.00% in February) with dynamics that suggest the lack of relevant inflationary pressures ahead that could trigger concerns in terms of monetary policy assessment. Key to focus from this report is the evidence of no (or minor) FX pass-through effect on prices, as most of today’s increase was explained by a strong 53% increase in tomato price, seasonal components (tourism and flights associated with Easter holidays) and a modest comeback of gasoline prices in Northern cities. In the aftermath of today’s report, local rates observe a modest profit taking of 2-3pb after 5 consecutive sessions of a strong rally. It is our take that inflation scenario will continue to be supportive for local rates. As a result, we hold a positive view in 20-year Mbonos (May’31 and Nov’34), tenors that continue portraying an appealing valuation in terms of the shape of the curve and the country risk premia embedded in these securities. In terms of Mexican linkers, valuation is extremely attractive in Udibonos, especially the mid and long ends. Inflation breakevens are hovering 3% in every tenor. The most attractive breakevens are the 10-year (2.78%) and 30-year (2.82%). Risk rewards in these strategies could be 60-75bps. However, an important issue to take into consideration is the negative carry of Mexican linkers in the 1H15. In this regard, we consider that in April/May the market is likely to swap long strategies from Mbonos to Udibonos.

The peso weakened ahead of the report, going from 14.88 to 14.92 per dollar currently, moderately recovering after the publication given a higher-than-expected increase in the headline index. Despite of the latter, the core component remains relatively well behaved, in line with yesterday comments by governor Carstens's about the low pass-through effect of peso losses to prices. We still see limited support for the currency coming from Banxico's monetary policy stance and expectations relative to the US. In our view, the Board is not highly likely to signal stronger concerns than the ones already expressed about the peso's accumulated depreciation. As a result, carry advantage is expected to remain low even after the reduction in overall volatility in the last few days, more so considering the hawkish bias of flow competitors such as Brazil (which could possibly keep hiking rates). All in all and after yesterday Fed minutes, we maintain our long position in USD/MXN (entry: 14.98, target: 15.50; stop-loss: 14.60) opened back on March 20 despite recent losses, still defensive on the peso even after acknowledging higher risks of a USD correction and increased data-dependency, seeing few catalysts in the local front amid a still challenging external environment.

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