

# 1H-Feb inflation – Annual inflation back to Banxico’s target range

February 22, 2019

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- **INEGI just published its inflation report for the first half of February**
- **Headline inflation (1H-Feb): -0.10% 2w/2w; Banorte: -0.09%; consensus: 0.04% (range of estimates: -0.10% - 0.25%); previous: 0.01%**
- **Core inflation (1H-Feb): 0.26% 2w/2w; Banorte: 0.13%; consensus: 0.25% (range of estimates: 0.13% - 0.31%); previous: 0.16%**
- **Inflation in the period was explained by further declines in the prices of fruits and vegetables, partially compensated by an increase in merchandise prices**
- **We highlight that non-core prices have surprised to the downside in three consecutive bi-weekly prints, with annual inflation in this component going from 8.4% at the end of 2018 to 5.73% currently**
- **With these figures, annual headline inflation stands at 3.89 % from 4.37% in the previous month and inside Banxico’s target range for the first time since December 2016. Core-inflation edged-down to 3.51% from 3.60%**
- **Limited rally in local rates despite benign news coming from inflation in Mexico and sovereign bonds worldwide**

## Fixed income and FX Strategy

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**Consumer prices declined 0.10% 2w/2w in the first half of February.** This number was considerably below consensus expectations at 0.04%, but practically in line with our -0.09% forecast. Core inflation rose 0.26% lower than our 0.13% estimate. The main deviation from our forecast came from: (1) A lower than expected contribution from fruits and vegetables (-33bps vs. our -18bps); (2) a higher impact from other foods (+7bps vs. our 1bp); and (3) a higher contribution from processed foods (6bps vs. our 2bps), as shown in the table below:

**1H-February inflation by components**  
% bi-weekly incidence

	INEGI	Banorte	Difference
Total	-0.10	-0.09	-0.01
Core	0.19	0.10	0.09
Goods	0.13	0.03	0.10
Processed foods	0.06	0.02	0.04
Other goods	0.07	0.01	0.06
Services	0.06	0.07	-0.01
Housing	0.02	0.02	0.00
Education	0.01	0.01	0.01
Other services	0.03	0.04	-0.01
Non-core	-0.29	-0.19	-0.11
Agriculture	-0.30	-0.18	-0.12
Fruits & vegetables	-0.33	-0.18	-0.15
Meat & eggs	0.02	0.00	0.02
Energy & government tariffs	0.01	-0.01	0.01
Energy	0.00	-0.01	0.01
Government tariffs	0.01	0.00	0.01

Source: INEGI, Banorte.

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

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**Inflation in the period was explained by an extension of the decline in the prices of fruits and vegetables, partially compensated by an increase in merchandise prices.** Specifically, the former plunged 6.2% 2w/2w, subtracting 33bps to the headline index. In this respect, seven out of ten of the products with the highest declines belong to this sector, highlighting the declines in the prices of tomatoes (-24.6%), *Serrano* chilies (-24.5%) and *Husk* tomatoes (-18.5%), among others. Nevertheless, this was partially compensated by higher prices of onions (+7.2%). Meanwhile, energy prices were basically unchanged, subtracting only 1bp to the headline index mostly due to a slight decrease in electricity tariffs (-0.6%) partially offset by an increase in low-grade gasoline prices, up 0.2%.

By contrast, core inflation increased 0.26% 2w/2w, adding 19bps to total CPI variation. In particular, we highlight a 0.3% increase in processed foods, explained to some extent by higher sugar prices (4.3%) and sodas (0.4%). Additionally, other goods prices increased 0.4%, the lower print observed for this same period in the last two years. Moreover, in the services sub-index, we highlight the increase in education costs (+0.4%), consistent with typical seasonal patterns.

Despite the upward surprise in the core index, it is our take that prices are not yet reflecting a sizable negative effect from fuel distribution delays and railway blockades that took place during the period in question. In this respect, the increases observed in merchandise prices do not defer much from their performance in 2018. Moreover, we also think that the positive effect from tax reductions at the Northern Border has practically diluted, with only Cd. Acuña (in the state of Coahuila) among the top 10 cities with declines in CPI.

**Annual inflation stands at 3.89 % from 4.37% in the previous month. Core-inflation edged-down to 3.51% from 3.60%.** In this context, we highlight that this is the first time that headline inflation returns to Banxico's target range since December 2016, just before the liberalization of gasoline prices at the start of 2017. Nevertheless, core inflation still remains at relatively high levels, actually surprising consensus slightly to the upside. We believe this is relevant in a context in which Banxico has stressed the resistance to the downside of this component as a cause of concern, such as in yesterday's minutes. For details, see: "*Banxico minutes – High for long*", <[pdf](#)>.

Additionally, based on our price monitoring, gasoline prices have started to exhibit higher pressures during the second half of the month, which could limit an extension of the recent decline in the non-core component. However, recall that there is an implied price cap in gasoline prices as a result of the new pricing policy of the federal administration. Thus, we reiterate our year-end inflation forecast of 3.5% yoy, still above consensus at 3.8%, according to the latest *Citibanamex* survey. In this context, we maintain our view that the central bank will remain on hold at 8.25% for the rest of the year. Further ahead, we see a higher probability of a rate cut in 2020.

*From our fixed income and FX strategy team*

**Limited rally in local rates despite benign news coming from inflation in Mexico and sovereign bonds worldwide.** The benign inflation backdrop is supporting the idea of a more dovish Banxico going forward. Local rates are trading 2bps lower against yesterday's close reacting to the lower-than-expected headline CPI print in tandem with the rally in several sovereign bonds worldwide. Taking into account the assessment about CPI dynamics (including the core and non-core breakdown) inside yesterday's minutes from Banxico, together with today's fortnightly report, we think that the yield curve is accurately pricing in the skewed risk of a rate cut in a 12-month horizon. Nevertheless, the current valuation in terms of term and risk premiums is reaching fair values, explaining the limited reaction today. Overall, this supports our idea of waiting for better entry levels for new directional long positions, especially in the belly of the Mbonos curve. On the other hand, the combination of the lower UDI-related carry and valuation of inflation *breakevens* remains a headwind for CPI-linked Udibonos. For more details please refer to our research notes "*Banxico minutes – High for long*" [<pdf>](#), February 21<sup>st</sup>, 2019; and "*Fixed-Income and FX Weekly*" [<pdf>](#), February 18<sup>th</sup>, 2019.

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