

1H-Mar inflation – Annual inflation remains below 4% despite energy price pressures

- **INEGI** just published its inflation report for the first half of March
- **Headline inflation (1H-Mar): 0.26% 2w/2w; Banorte: 0.31%; consensus: 0.29% (range of estimates: 0.19%-0.35%); previous: 0.14%**
- **Core inflation (1H-Mar): 0.18% 2w/2w; Banorte: 0.20%; consensus: 0.22% (range of estimates: 0.15%-0.25%); previous: 0.19%**
- **Inflation in the period was explained by pressures in energy prices at the non-core component, along with some agricultural goods**
- **With these figures, annual headline inflation stands at 3.95%, marginally higher than the 3.94% at the end of February. Core-inflation edged-down to 3.51% from 3.54% previously**
- **Inflation supporting the expectation of Banxico cutting its repo rate**

Consumer prices increased 0.26% 2w/2w in the first half of March. This number was below consensus at 0.29% and our 0.31% forecast. Core inflation rose 0.18% slightly lower than our 0.20% estimate. The main deviation from our forecast came from: (1) A lower than expected contribution from agricultural goods (1bp vs. our 9bps), as although some goods were indeed pressured, it was compensated by other items; (2) a higher impact from energy (+11bps vs. our 7bps); (3) a higher contribution from other goods (4bps vs. our 1bps); and (4) less pressure in other services (4bps vs. our 7bps), as shown in the table below:

1H-March inflation by components

% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.26	0.31	-0.05
Core	0.13	0.15	-0.01
Goods	0.07	0.06	0.02
Processed foods	0.04	0.05	-0.01
Other goods	0.04	0.01	0.03
Services	0.06	0.09	-0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.04	0.07	-0.03
Non-core	0.12	0.16	-0.04
Agriculture	0.01	0.09	-0.08
Fruits & vegetables	0.03	0.08	-0.05
Meat & eggs	-0.02	0.02	-0.03
Energy & government tariffs	0.12	0.07	0.04
Energy	0.11	0.07	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.

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Inflation in the period was explained by pressures in energy prices at the non-core component, along with some agricultural goods. The former increased 1.1% 2w/2w, driven by both low- and high-grade gasoline (+1.6%), along LP gas (+1.1%). These three items added 12bps to the headline index. In contrast, electricity tariffs fell 0.3%. Agricultural goods increased 0.1%, less than expected according to our price monitoring. Although lemon (+50.7%) and tomatoes (7.6%) were relatively high pressured, these were compensated by the decline in *serrano* chilies (-17.2%), potatoes (-4.3%) and eggs (-1.6%), among others. In total, 8 out of 10 goods with the highest negative contribution are from this category.

Core inflation increased 0.18% 2w/2w, adding 13.4bps to total CPI. We highlight the 0.2% increase in other services, supported by the 7.2% advance in airfares as prices reflected the local holiday on March 18th and as this effect tends to be seen around one to two weeks in advance. On the other hand, core goods increased 0.2%, not that different from what was observed in the previous year.

In our view, these results suggest that prices were not affected by temporary shocks to supply chains. Moreover, the impact of tax reductions at the Northern Border most likely have diluted completely, even with three out of ten of the cities with the highest increase in prices during the period actually beneficiaries of this program, while only Matamoros was among those with the lowest pressures.

Annual inflation stands at 3.95%, marginally above the 3.94% at the end of February. Core-inflation stands at 3.51% from 3.54%. We highlight that, in bi-weekly terms and since December 2016, this is the third consecutive print with headline inflation within Banxico's target range. Moreover, this is the sixth time in a row with headline surprising to the downside consensus expectations according to *Bloomberg*.

Today's pressure was mostly concentrated in energy. In this respect, we will remain attentive to this category as it has been relatively pressured in last two bi-weekly prints. Nevertheless, we stress that the government recently announced fiscal stimulus to gasoline (both low- and high-grade) and made some changes to operational rules in a bid to counter price increases. The new administration reintroduced this mechanism since March 9th as they strive to achieve the goal of maintaining gasoline prices constant in real terms. Considering this, it is likely that gasoline prices fall in the second half of the month, a situation that could help for the continuation of the strong decline in the non-core component since last December. In contrast, we will also be monitoring agricultural goods, given that today's print was mixed and that they have accumulated a 9.2% decline year-to-date. Last but not least, core inflation remains the focus of Banxico, which should be welcomed by the central bank.

From our fixed income and FX strategy team

Inflation supporting the expectation of Banxico cutting its repo rate.

March's 1H inflation extended the recent downward performance, locating below market consensus for the sixth consecutive print. Moreover, core inflation moderated in respect to previous levels, which is a highlight on the back of its relevance for Banxico and after depicting a clear downward resistance in the latest reports.

The local fixed income market has seen a favorable performance in the last weeks, with nominal rates rallying ~30bps during March. Specifically, this week the rally has intensified in the aftermath of the Fed's strong dovish bias in its last monetary policy decision and the impulse this situation has provided to global bonds. As an example, the 10-year UST currently trades at 2.43%, which is its lowest level since January 2018, having started this month close to 2.72%. In this context, the positive CPI surprise today has coupled to a widespread rally in global rates, with risk assets under a steep sell-off. Particularly, Mbonos rally 2-4bps, whereas TIEE-28 swaps strengthen 4bps on average. As a consequence, the yield curve is currently pricing in 12bps of implied cuts for Banxico's repo in 2Q19, -22bps in 3Q19, -49bps in 4Q19, and an accumulated -105bps up to 2020. Regarding real-rate Udibonos, today's performance shows few variations, with some terms pressured marginally. The valuation of these securities has improved recently, with *breakevens* trading below their 12-month mean in tenors up to 10 years. However, it is worth considering an UDIS' carry that will remain low in the following months. Broadly speaking, we see a valuation for local assets that has become more expensive, a reason why we wait for better entry levels for long positions in Mbonos, with greater preference in the belly of the curve.

In the FX market, the Mexican peso is registering a negative performance today, following the sharp adjustment in risk assets and with the USD bouncing back since yesterday after the pressures experienced following the Fed's decision. The currency trades at 19.12 per dollar, equivalent to a 1.4% sell-off in respect to yesterday's close, having traded at 18.75 on Wednesday. This movement takes place with a relevant sell-off in the EM FX spectrum, with losses that surpass 2% in cases such as TRY, ARS, and BRL. In this context, we hold our trade recommendation on USD longs opened last Wednesday. For further details consult: "*Mexico trade idea: Short-term tactical recommendation of long positions in USD*", <[pdf](#)>, published on March 20th, 2019.

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