1H-March inflation – First effects from COVID-19 start to show

- **Headline inflation (1H-Mar): 0.11% 2w/2w; Banorte: 0.03%; consensus: 0.11% (range of estimates: -0.10%-0.20%); previous: 0.47%**
- **Core inflation (1H-Mar): 0.16% 2w/2w; Banorte: 0.08%; consensus: 0.18% (range of estimates: 0.08%-0.26%); previous: 0.13%**
- **The period's performance was benefited by non-core prices, especially the 0.8% decline in fresh fruits and vegetables (-4.2bps contribution) and the -0.2% 2w/2w in low-grade gasoline, (-1.3bps). Nevertheless, we observed some pressures at the core, including dining away from home and processed foods, which more than compensated for tourism services (-3.2%). We think some of these show the first effects from COVID-19**
- **With today's print, annual inflation remained broadly stable, at 3.71% from 3.70% in February. Core inflation declined to 3.60% from 3.66%, with the non-core component to 4.04% from 3.81%**
- **After Banxico's out-of-calendar decision to cut the reference rate by 50pbs to 6.50% last week, and considering recent events, we believe more easing is coming. We maintain our year-end inflation forecast at 3.6%**
- **Inflation conditions maintain an attractive valuation in 1-year and 2-year TIIE-28 swaps**

Consumer prices increased 0.11% 2w/2w in the first half of March. In our view, the main takeaway is that some categories already started to show some effects from the COVID-19 outbreak impact. At the core level, airfares (-2.0% 2w/2w) and tourism services (-3.2%) were to the downside. On the other hand, goods saw some pressures, particularly processed foods (0.2%), possibly related to the depreciation of the MXN. At the non-core, low-grade gasoline declined 0.2% in our view influenced by plunging global reference prices, while agricultural goods edged-down 0.1% after recent increases. Overall, we believe the effects of the Coronavirus will keep influencing the path for prices in the short-term, a situation for which we will be very attentive in coming months.

1H-March inflation by components
%, bi-weekly incidence

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

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

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1H-March inflation: Goods and services with the largest contributions
% 2w/2w; bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
Chicken	2.9	2.0
Dining away from home	1.8	0.4
Avocadoes	1.8	8.4
Housing (own)	1.7	0.2
Lemons	1.4	13.9
Goods and services with the largest negative contribution		
Tomatoes	-4.1	-3.8
Husk tomatoes	-2.0	-7.7
Onions	-1.9	-7.0
Low-grade gasoline	-1.3	-0.3
Tourism services	-1.1	-3.2

Source: INEGI

Annual inflation stable, although cautiousness still granted about the core. The headline index came in at 3.71% y/y, broadly unchanged relative to February. Core inflation stood at 3.60% from 3.66%. On the other hand, non-core prices were higher at the margin, at 4.04% from 3.81%. We note that agricultural goods are running at a 10.5% annual rate, feeling the brunt of the previous fortnightly increase and a challenging base-effect. In the short-term and based on our monitoring, relevant categories such as gasolines/energy could benefit from lower oil prices, along the possibility of lower tourism-related services prices as the Coronavirus has impacted demand. In our view, these have already been partially observed today. On the contrary, other categories could respond to the upside, including processed foods and other goods within the core, mainly due to the adjustment higher in the FX exchange rate. In this respect, it is our take that today's report suggests the need to be somewhat cautious on this front, as not only the exchange rate impact but also the possibility of supply-chain disruptions could add pressures. We agree with Banxico's last week communiqué that the inflation outlook has become more uncertain, despite maintaining our year-end forecast at 3.6% y/y. We think deflationary forces such as the expectation of a more negative output gap and the decline in oil/commodities, could be broadly compensated with the upward bias on imports inserted by the sizable depreciation of the MXN. For next year, we estimate inflation to be skewed higher due to the lagged impact from market adjustments and possible economic stimulus efforts, with our forecast at 4.2%.

Moreover, given extreme market volatility and last Friday's out-of-calendar decision by Banxico to cut the reference rate by 50bps, to 6.50%, we have recently changed our monetary policy call and adjusted our macroeconomic framework. Specifically, we now expect a 50bps cut in the next central bank's decision, without ruling out it happens again in an unscheduled meeting as the next in the agenda is not until May 14th. In our view, the central bank will likely put more weight to relative monetary conditions and the strong expected impact to growth due to the Coronavirus, despite lingering risks for inflation and financial stability. As such, we expect the reference rate to end 2020 at 5.50%.

From our fixed income and FX strategy team

Inflation conditions maintain an attractive valuation in 1-year and 2-year TIIE-28 swaps. As local inflation dynamics are supportive for our view of a 50bps rate cut from Banxico in its May 14th meeting, or in another intra-meeting decision should it become necessary, we see value in 1-year and 2-year TIIE-28 derivatives for tactical trading. In terms of the implied market inflation, brekevens using Mbonos and Udibonos have compressed in a relevant fashion in the 3- and 5-year tenors during March, moving from 3.21% to 2.74% and from 3.42% to 3.05%, respectively, since the end of last month. Meanwhile, the 10- and 30-year tenors have experienced pressures moving from 3.59% to 3.85% and from 3.72% to 4.48%, in the same order.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Jorge Antonio Izquierdo Lobato and Eridani Ruibal Ortega, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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