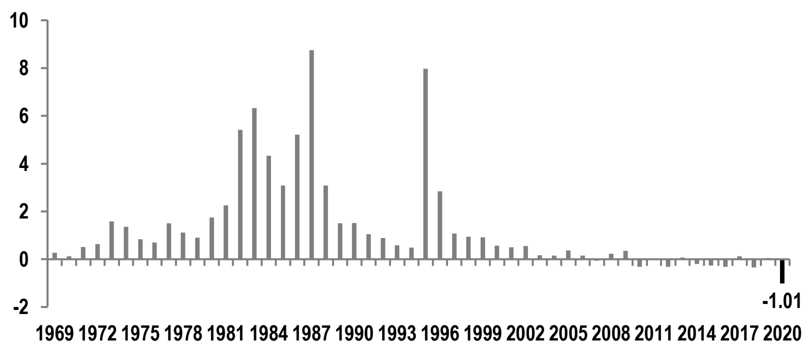
April inflation – Annual rate at 2.1%, with the lowest monthly change in history

- **Headline inflation (April): -1.01% m/m; Banorte: -1.03%; consensus: -1.01% (range of estimates: -1.24% to -0.88%); previous: -0.05%**
- **Core inflation (April): 0.36% m/m; Banorte: 0.34%; consensus: 0.33% (range of estimates: 0.26% to 0.40%); previous: 0.29%**
- **Similar to March, the decline was led by non-core prices, plunging 5.2% m/m and subtracting 128bps to the headline. Low- and high-grade gasoline fell again at the margin, while some agricultural goods were pressured in the second fortnight. At the core, the increase was mostly due to goods (0.6% m/m), with services quite muted (0.1%)**
- **Annual inflation fell to 2.15% from 3.25% in March. Core inflation also inched lower, at 3.50% from 3.60%. Inflation will likely remain below the 3% target in coming months, maintaining the favorable backdrop in this front for the central bank to keep cutting the reference rate**
- **Inflation conditions suggest breakevens will remain low for the following months**

Consumer prices fell 1.01% m/m, negative for second consecutive month. It should be noted this is the lowest print for any April in the history of the series (see chart below), while it is also a minimum in the monthly change. In contrast, the core index stood at 0.36% m/m from 0.29% in March, contributing 27bps to the headline. Although non-core prices are typically negative or very low in this period on the back of seasonal discounts to electricity tariffs, this component plunged 5.2% m/m driven also by the fall in gasoline prices, which subtracted 95bps in terms of contribution. On the contrary, we highlight some pressures in fresh fruits and vegetables in the second half of the month, in line with our monitoring. At the core, pressures were observed in goods (0.6%), especially processed foods (1.1%). Other goods (0.1%) were low as companies face a demand shock due to the pandemic. Services were muted (0.1%), with airfares (-5.4%), tourism-related services (-2.3%) and hotels (-3.8%) declining strongly, failing to show their typical seasonal pattern due to the Easter holiday.

Monthly inflation in April
% m/m



Source: INEGI

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April inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	-1.01	-1.03	0.02
Core	0.27	0.25	0.02
Goods	0.25	0.24	0.00
Processed foods	0.22	0.23	-0.01
Other goods	0.02	0.02	0.01
Services	0.02	0.01	0.01
Housing	0.04	0.04	-0.01
Education	0.00	0.00	0.00
Other services	-0.02	-0.03	0.02
Non-core	-1.28	-1.28	0.00
Agriculture	-0.09	-0.04	-0.05
Fruits & vegetables	-0.21	-0.15	-0.06
Meat & eggs	0.13	0.11	0.02
Energy & government tariffs	-1.20	-1.24	0.05
Energy	-1.20	-1.25	0.05
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.

April inflation: Goods and services with the largest contributions
% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	m/m
Eggs	11.8	12.4
Serrano chilies	3.7	34.2
Beer	3.5	2.7
Sugar	3.3	9.0
Beans	3.1	6.3
Goods and services with the largest negative contribution		
Low-grade gasoline	-84.4	-17.4
Tomatoes	-27.9	-31.3
Electricity tariffs	-25.2	-12.2
High-grade gasoline	-10.4	-15.9
Husk tomatoes	-7.9	-33.3

Source: INEGI

Annual inflation will likely stay low in coming months. After today's print, annual headline inflation stood at 2.15% y/y from 3.25% in March, its second lowest in history just behind December 2015. The core component also declined, albeit more modestly, to 3.50% from 3.60%. The latter is also favorable considering that the annual rate has exhibited stickiness to the downside, not able to breach the psychological 3.50% level in a little more than three years. Although these dynamics can be explained mostly by direct and/or indirect effects of the pandemic on some goods and services, we believe inflation will remain limited in the short term. In this respect and in our view, Banxico's latest minutes also showed that, despite high uncertainty about the mid- and long-term outlook, most members are also tilted towards expecting low levels of inflation in coming months. In particular, we currently anticipate a return closer to the central bank's target of 3% until 4Q20, with the output gap widening further into negative territory which should help dampen potential pressures even if the exchange rate stays close to current levels and risks that scarcity on some goods affects market prices to the upside.

Overall, and given the central bank's dovish tone about growth, we believe the backdrop still argues for additional rate cuts. Specifically, we reiterate our view of another 50bps cut in next week's scheduled meeting, followed by a 75bps decrease on the June 25th decision. Considering highly changing conditions, we do not rule out another intra-meeting action, bringing forward the 75bps cut. In either scenario, this would take the reference rate to 4.75%, level where we expect it to close this year. In addition, we could see an expansion of current liquidity and credit facilities if market dynamics deteriorate again, as we believe the central bank remains fully committed to ensuring the proper functioning and health of the financial system and the economy.

From our fixed income and FX strategy team

Inflation conditions suggest breakevens will remain low for the following months. Today's CPI print continues to argue in favor of our view on a low inflation backdrop for the remainder of this quarter, a context that has resulted in the relevant cheapening of market inflation breakevens. In this sense, as the short-end of the Udibonos curve has outperformed Mbonos in recent sessions, inflation breakevens have slightly picked-up in short-term readings, while longer maturities have extended their compression. We expect current conditions to hold breakevens contained throughout the quarter. Moreover, these CPI dynamics joining the deteriorated growth scene will keep supporting the expectation of further cuts from Banxico, resulting in an anchored short-end for the local yield curve. In this context, we see an attractive relative valuation in Mbono May'29 considering a duration-adjusted regression against the curve, and a risk premium analysis which depicts greater space of further contraction when crossing mid-term tenors.

Certification of Analysts.

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, 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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	Reference
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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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