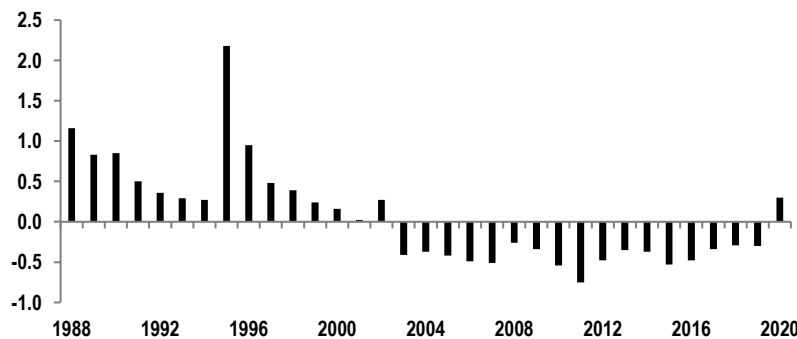


1H-May inflation – Strong upward surprise as non-core prices rebound higher

- **Headline inflation (1H-May): 0.30% 2w/2w; Banorte: -0.07%; consensus: -0.01% (range of estimates: -0.23% to 0.31%); previous: 0.19%**
- **Core inflation (1H-May): 0.24% 2w/2w; Banorte: 0.24%; consensus: 0.12% (range of estimates: 0.03% to 0.24%); previous: 0.17%**
- **Contrary to history, this was the first positive print for this period since 2002 despite the decline in electricity tariffs, contributing -39bps. This was outweighed by: (1) Pressures in fresh fruits and vegetables (7.4% 2w/2w) along low-grade gasoline (4.5%); and (2) an extension higher in goods, particularly processed foods (+0.8%), accelerating since early April. On the other hand, services remain relatively muted at 0.1%**
- **Annual inflation increased to 2.83% from 2.15% in April, still below Banxico’s target albeit in our view likely past its bottom. Core inflation also surprised to the upside, increasing to 3.76% from 3.50%, with non-core prices also higher, at -0.06%**
- **We expect two 50bps rate cuts by Banxico in June and August, with the reference rate reaching 4.50%. Nevertheless, we do not rule out another intra-meeting decision if global and/or domestic conditions call for it**
- **We suggest profit taking in Mbono May’29 and recommend long positions in Udibono Nov’35**

Consumer prices up 0.30% 2w/2w in the first half of May. This was very surprising as it is the first positive print for this period since 2002 (as seen in the chart below). As is typical in this period, electricity tariffs’ discounts led down, contributing -39bps. Nevertheless, this was compensated by other pressures at the non-core. We highlight that after four fortnights with strong declines, low-grade (+4.5%) and high-grade (2.6%) gasolines increased. We also observed high pressures in fresh fruits and vegetables (7.4%) particularly tomatoes (36.1%). Extending recent dynamics, processed foods (0.8%) remain high, with scarcity in some goods such as beer (3.7%). In contrast, services stayed muted (0.1%).

1H-May inflation
% 2w/2w



Source: INEGI

May 22, 2020

www.banorte.com
@analisis_fundam

Alejandro Padilla

Executive Director of Economic Research and Financial Market Strategy
alejandropadilla@banorte.com

Juan Carlos Alderete, CFA

Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores

Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Manuel Jiménez

Director of Market Strategy
manuel.jimenez@banorte.com

Santiago Leal Singer

Senior Strategist, Fixed-Income and FX
santiago.leal@banorte.com

Leslie Orozco

Strategist, Fixed Income and FX
leslie.orozco.velez@banorte.com

Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*



Document for distribution among the general public

1H-May inflation by components

% , bi-weekly incidence	INEGI	Banorte	Difference
Total	0.30	-0.07	0.37
Core	0.18	0.18	0.00
Goods	0.14	0.15	-0.01
Processed foods	0.17	0.12	0.05
Other goods	-0.02	0.03	-0.05
Services	0.04	0.03	0.01
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.04	0.02	0.02
Non-core	0.11	-0.25	0.36
Agriculture	0.26	0.03	0.24
Fruits & vegetables	0.37	0.06	0.31
Meat & eggs	-0.11	-0.03	-0.08
Energy & government tariffs	-0.16	-0.28	0.12
Energy	-0.17	-0.28	0.10
Government tariffs	0.02	0.00	0.02

Source: INEGI, Banorte.

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

1H-May 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
Tomatoes	23.4	36.2
Low-grade gasoline	18.2	4.5
Beer	5.1	3.7
Serrano chilies	3.2	19.4
Squash	2.6	50.3
Goods and services with the largest negative contribution		
Electricity tariffs	-38.8	-21.3
Eggs	-7.3	-6.8
Chicken	-3.7	-2.5
Lemon	-1.6	-10.1
Onions	-1.0	-4.3

Source: INEGI

We expect annual inflation to remain below Banxico's target in coming months. These dynamics would be mostly driven by the accumulated decline in prices of some goods, particularly at the non-core component (*e.g.* gasolines, which despite increasing this fortnight, remain very low in annual terms close to -20%). It is our take that pressures in the short-term will stay relatively modest, especially on services and non-essential goods, as the demand shock from COVID-19 has widened the negative output gap. In this context, we forecast inflation to increase modestly in coming months, approaching Banxico's target until late 3Q20. In our view, the central bank also recognized the possibility of more benign dynamics in coming months in its [latest statement](#), despite still characterizing the balance of risks for prices as very uncertain. Given this scenario, the unanimous decision to cut the reference rate by 50bps last week, and a very weak outlook for growth, among other factors, we recently adjusted our monetary policy expectations. Specifically, we now see two consecutive rate cuts of 50bps in the upcoming two meetings, in June and August. This would take the reference rate to 4.50%. Moreover, we do not rule out another intra-meeting decision if global and/or domestic conditions call for it. This could happen given the current backdrop and added concerns on “...*the unprecedented impact on economic activity as well as [...] the financial shock...*”. Especially, and in our view, it could be in store in case of additional surprises in terms of economic and market events, which could trigger an earlier action than we currently expect.

From our fixed income and FX strategy team

We suggest profit taking in Mbono May'29 and recommend long positions in Udibono Nov'35. As May's inflation for the first half came strongly above expectations, our view on contained CPI dynamics during the quarter begins to show risks, in a context in which in previous weeks low inflation readings supported local rates along with recession expectations and rate cuts from Banxico. Under this framework, we suggest profit taking in our trade recommendation considering long positions in Mbono May'29 opened on May 5th resulting in a 23bps appreciation. We recommend migrating towards longs positions in Udibono Nov'35 amid: (1) A more attractive relative value in this region of the udi-linked yield curve; (2) current inflation breakeven levels; and (2) the possibility of UDIS' carry improving throughout the year.

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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

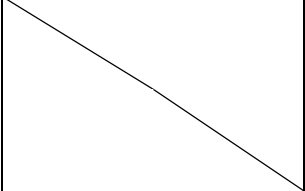
Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
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.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	Chief Economist, Head of Research and IRO	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Market Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Corporate Debt			
Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454