May inflation – Annual rate stays below 3% as price pressures moderate at the margin

June 9, 2020

www.banorte.com
@analisis_fundam

Alejandro Padilla
Executive Director of Economic Research and Financial Market Strategy
alejandro.padilla@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

- **Headline inflation (May): 0.38% m/m; Banorte: 0.49%; consensus: 0.52% (range of estimates: 0.42% to 0.58%); previous: -1.01%**
- **Core inflation (May): 0.30% m/m; Banorte: 0.41%; consensus: 0.41% (range of estimates: 0.35% to 0.44%); previous: 0.36%**
- **The downward surprise was driven by lower pressures in the second fortnight in some components within both the core and non-core indices. In the first, we highlight goods at +0.5%, driven by processed foods (1.2%), while services stayed muted at 0.1%. In the latter, fresh fruits and vegetables increased 5.9%, reversing in the second half of the month some of the pressures observed in the previous fortnight**
- **Annual inflation went up to 2.84% from 2.15% in April, closer but still below Banxico's target, likely bottoming out last month. Core inflation increased to 3.64% from 3.50%, failing to breach the latter level since late 2016. We maintain our year-end forecast of 3.2%**
- **Despite the downward CPI surprise, we hold our trade idea consisting on long positions in Udibono Nov'35**

Consumer prices up 0.38% m/m, rebounding after last month's low. This was significantly below consensus at 0.52% and our forecast (0.49%). In our view, price dynamics are still distorted by COVID-19, with some pressures despite the period being historically negative due to electricity tariffs' discounts. Within the core, processed foods extended their increase, higher 1.2% m/m and running at a 6.6% y/y pace. Nonetheless, other goods surprised to the downside (-0.3%). In addition, airfares were up (7.5%), but overall services remain muted (+0.1%). At the non-core level, low-grade gasoline was highly pressured in the second fortnight, advancing 8.1% m/m. On the contrary, agricultural goods reversed more strongly pressures observed during the first half, albeit with fresh fruits increasing 5.9% in the full period, while meat and egg declined 2.5%.

May inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.38	0.49	-0.10
Core	0.23	0.31	-0.08
Goods	0.18	0.25	-0.06
Processed foods	0.24	0.27	-0.03
Other goods	-0.06	-0.02	-0.03
Services	0.04	0.06	-0.02
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.05	-0.02
Non-core	0.39	0.49	-0.10
Agriculture	0.23	0.31	-0.08
Fruits & vegetables	0.18	0.25	-0.06
Meat & eggs	0.24	0.27	-0.03
Energy & government tariffs	-0.06	-0.02	-0.03
Energy	0.04	0.06	-0.02
Government tariffs	0.00	0.02	-0.02

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

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

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

May 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
Low-grade gasoline	32.9	8.1
Tomatoes	17.3	27.9
Beer	7.2	5.3
Serrano chilies	4.1	27.7
LP Gas	4.0	2.1
Goods and services with the largest negative contribution		
Electricity tariffs	-38.9	-21.3
Eggs	-11.0	-10.2
Chicken	-4.6	-3.1
Lemon	-2.5	-16.3
Onions	-2.4	-9.8

Source: INEGI

We reiterate our year-end inflation forecast at 3.2%. We reaffirm our forecast for year-end inflation at 3.2% y/y, with consensus increasing to this level in the latest *Citibanamex* survey. In this context, and based on our forecast path, inflation would stay below Banxico's 3% target until late in the third quarter, supporting our view of additional cuts in the reference rate (see section below). In this respect, average annual inflation stands at 2.49% so far in 2Q20, so it is likely the central bank undershoots its 2.7% forecast contained in the 1Q20 Quarterly Report. Although inflation has been more volatile on the back of COVID-19 distortions, we also highlight recent comments by some members signaling this possibility. Among them, Deputy Governor Javier Guzmán –which we identify with a relatively hawkish bias– said last week in a presentation that inflation dynamics will likely allow for additional easing. Nevertheless, we also believe the cautious tone will prevail as uncertainty remains quite high and short-term price volatility has increased. This is also reinforced by recent pressures at the core level (despite today's downward surprise), making it harder for annual inflation to decline further despite the high degree of economic slack. In our view, these dynamics will stay in place in coming months, with our estimate for core inflation at 3.7% by the end of this year.

Banxico will keep cutting the reference rate in the short term. Although inflation picked up at a faster than usual pace in May due to pressures at the non-core level –especially in the first half of the month–, dynamics remain consistent with relatively contained pressures, leaving enough room for Banxico to keep cutting the reference rate. As such, we maintain our view of two additional, consecutive 50bps rate cuts each, in June and August, to a level of 4.50%, where we expect the rate to finish this year. Moreover, we still do not rule out another intra-meeting decision, particularly in case of renewed market stress. Nevertheless, the less dovish tone that we perceived in the *Quarterly Report* and latest minutes has reduced the probability of this latter scenario.

From our fixed income and FX strategy team

Despite the downward CPI surprise, we hold our trade idea consisting on long positions in Udibono Nov'35. In our view, today's print confirms a backdrop of high uncertainty for local inflation, as has been expressed by some members of Banxico's Board as well as in the Quarterly Report released on May 27th. In this sense, despite a possible short-term adjustment that could be experienced in the real-rates' yield curve, we hold our trade idea of long positions in the inflation-linked Udibono Nov'35, considering a Mexican CPI scenario that will play more favorably to these securities' carry in the 2H20 given seasonally high price dynamics and potential additional pressures derived from several fronts. This security closed yesterday at 2.84%, with an entry level of 3.05%, target at 2.70%, and stop-loss at 3.25%. Meanwhile, inflation breakevens have extended their recent pick-up, currently trading at 3.07% and 3.27% for the 3- and 5-year tenors, from 1.98% and 2.38%, respectively, at the beginning of May. Regarding the 10- and 30-year figures, these stand at 3.85% and 3.93%, from 3.22% and 3.82%, in the same order, at the beginning of last month.

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.

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

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	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 Markets 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 Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
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
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Osvaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
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.roldan.ferrer@banorte.com	(55) 5004 - 1454