

## 1H-February inflation – Downward surprise on lesser pressures in food items

- **Headline inflation (1H-Feb): 0.30% 2w/2w; Banorte: 0.39%; consensus: 0.35% (range: 0.27% to 0.49%); previous: 0.35%**
- **Core inflation (1H-Feb): 0.35% 2w/2w; Banorte: 0.37%; consensus: 0.39% (range: 0.31% to 0.47%); previous: 0.36%**
- **Some pressures lingered around, including goods (0.4%) within the core. We had positive news in processed foods (0.4%) as they moderated their pace at the margin, while ‘Others’ (0.5%) have a negative seasonality. Services (0.3%) rose due to an additional adjustment in education (0.6%). At the non-core (0.15%) we note the move in energy (0.5%), but improving in agricultural (-0.2%) driven by fruits and vegetables (2.6%)**
- **In bi-weekly terms, annual inflation fell to 7.76% from 7.88%, which may be signaling the resumption of its downward trend. The core stood at 8.38% from 8.45%**
- **We still see 25bps rate hikes from Banxico in both March and May, with risks skewed to the upside**
- **Markets are betting on a terminal rate of 12.00% in August**

**Inflation at 0.30% 2w/2w.** At the core (0.35%), goods are still pressured at 0.4%. Nevertheless, processed foods (0.3%) were positive as their pace was the most modest since 2H-November, possibly benefiting from a stronger MXN. ‘Others’ (0.5%) had a negative bias due to the end of clothing discounts. Services (0.3%) were lower, with housing normalizing (0.2%) and education up again (0.6%), in line with its seasonality. In ‘other services’ (0.4%), dining away from home (0.4%) and restaurants (0.2%) still look fragile given input prices. At the non-core (0.15%) energy was mixed, with electricity surprising to the downside (-0.5%) considering announcements of price increases by CFE. LP gas (3.1%) extended its move higher, while low grade gasoline (0.1%) was more stable. Agricultural items were mixed (-0.2%), with fruits and vegetables (-2.6%) helped by tomatoes and chilies; however, meat and egg (1.7%) picked up consistent with reports of a relative shortage of eggs and chicken in some regions. Finally, government tariffs (0.4%) were affected by adjustments in toll roads, among others.

1H-February 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
Eggs	6.1	6.2
LP gas	5.3	3.1
Chicken	4.3	2.5
Dining away from home	2.2	0.4
Universities	1.8	1.3
Goods and services with the largest negative contribution		
Tomatoes	-11.3	-15.8
Serrano chilies	-2.5	-14.1
Zucchini	-1.1	-10.3
Electricity	-0.9	-0.5
Lettuces and cabbage	-0.4	-2.5

Source: INEGI

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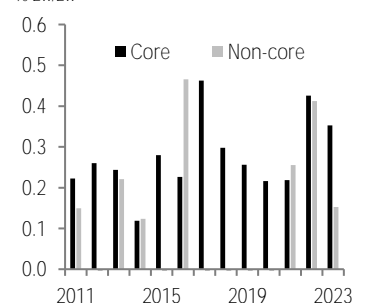
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Core and non-core inflation in 1H-February % 2w/2w



Source: INEGI

Document for distribution among the general public

**Annual inflation tries to reestablish its trend lower.** In bi-weekly terms, headline inflation reached 7.76% from 7.88% in 2H-January. This is favorable given its move higher at the turn of the year. The core reached 8.38%, 8bps lower vs the previous period. Nevertheless, this metric has been more resistant to the downside, hovering close to its current level since October 2022. It is worth noting that base effects will be increasingly beneficial from March onwards. This is because the anniversary of Russia's invasion of Ukraine will be on February 24<sup>th</sup>, which wreaked havoc on global food and energy prices last year. Apart from this statistical issue, the relative normalization in these prices since then, along with MXN strength (gaining 10.6% in the last twelve months) could also help the consolidation of the downward trend in prices. Nevertheless, some concerns remain, especially for the core. Among them, we highlight: (1) Higher labor costs due to recent increases to the minimum wage and other changes to the Labor Law; (2) potentially higher passthrough from the increase in energy prices, closely looking if electricity tariffs will keep moving upwards, in line with plans set for the year by CFE; (3) persistently high food prices on structural headwinds to production, related to climate change; (4) another significant boost to global demand as activity in major economies (including China) has been more robust than expected.

**Banxico should remain vigilant as inflation uncertainty has not faded away.** After surprising us and the market with a [50bps rate hike in February](#), we expect the central bank to remain highly vigilant and cautious. We will watch closely today's release of the corresponding meeting minutes, which we expect with a hawkish tone. Our focus will center on the discussion about price dynamics (both present and future), the relative monetary stance –and the merits behind widening the spread vs. the US–, and the overall evaluation of the reference rate, especially in terms of how restrictive it already is and how much further it could go. All in all, we expect the central bank to continue hiking in the following meetings, with two more 25bps hikes in March and May. Nevertheless, we believe risks to our forecast are tilted to the upside.

*From our fixed income and FX strategy team*

**Markets are betting on a terminal rate of 12.00% in August.** A risk-off mood has characterized markets in recent weeks due to the renewed uncertainty about how high interest rates need to be to curb inflation. Investors expect Banxico to extent its restrictive cycle until the 2H23, reaching a terminal rate of 12.00% in August. Fixed income securities have assimilated this, with Mbonos' yields up more than 100bps so far this month. In a similar fashion, Cetes trade at all-time highs, particularly the 6- and 12-month maturities at 12.02% and 12.10%, respectively. Moreover, CPI-linked bonds (Udibonos) showed a 35bps sell-off, on average. As a result, breakevens picked up, with the 3-year reading at a level not seen since 2008 of 5.74% from 5.01% at the beginning of February. In terms of strategy, we reaffirm our preference for nominal vs real rates, especially if inflation surprises positively going forward.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Daniel Sebastián Sosa Aguilar and Andrea Muñoz Sánchez, 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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