1H-March inflation – Some relief will likely help Banxico in its hiking cycle

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- **Headline inflation (1H-Mar): 0.15% 2w/2w; Banorte: 0.18%; consensus: 0.26% (range: 0.16% to 0.40%); previous: 0.16%**
- **Core inflation (1H-Mar): 0.30% 2w/2w; Banorte: 0.25%; consensus: 0.30% (range: 0.21% to 0.36%); previous: 0.16%**
- **The core was mixed, albeit noting some relief in goods (0.3%). Processed foods remained somewhat high (0.3%) on the back of some key products. 'Others' were more modest (0.2%), likely helped by the exchange rate. Services (0.4%) were pushed by an adverse seasonality in tourism. At the non-core (0.31%), energy declined 0.4%, helped by LP gas (-2.4%). In agricultural items (-0.5%) we observed generalized declines**
- **In bi-weekly terms, annual inflation fell to 7.12% from 7.48%, adding four fortnights to the downside. Similarly, the core adjusted to 8.15% from 8.21%**
- **We still expect a 25bps rate hike from Banxico next week, with the tightening cycle continuing in coming months**
- **Inflation breakevens could keep drifting lower**

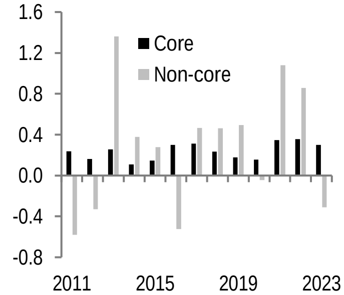
Inflation at 0.15% 2w/2w. At the core (0.30%), goods showed slightly lower pressures at 0.3%. Nevertheless, processed foods (0.3%) remained somewhat high on key goods such as tortillas and milk. 'Others' were more modest at 0.2%, in our view likely aided by MXN strength. Services picked up 0.4%, driven mainly by 'others' (0.6%). Inside of the latter, tourism categories increased meaningfully due to the start of the Spring Break, while remaining sectors, mainly 'dining away from home', kept climbing amid accumulated cost pressures. At the non-core (-0.31%), energy dropped 0.4% on the back of LP gas (-2.4%) and electricity tariffs (-0.3%). Meanwhile, gasolines were more stable, with the low-grade fuel at 0.2%. Agricultural items also fell (-0.5%), with meat & egg leading the move at -0.6%, highlighting chicken, egg, and beef. Fruits and vegetables also declined, at -0.2%. Finally, government tariffs stayed high (0.4%) on adjustments in toll roads, among others.

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
Air fares	3.2	18.0
Lemon	2.5	15.3
Restaurants	1.7	0.6
Tourism services	1.5	4.9
Corn tortillas	1.5	0.7
Goods and services with the largest negative contribution		
LP gas	-4.3	-2.4
Tomatoes	-2.9	-4.8
Chicken	-2.0	-1.1
Prickly pears	-1.4	-14.4
Eggs	-1.2	-1.2

Source: INEGI

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



Source: INEGI

Annual inflation lower for a fourth consecutive fortnight. In bi-weekly terms, headline inflation reached 7.12% from 7.48% in February-2H. Similarly, both the core (8.15% from 8.21%) and non-core (4.15% from 5.37%) moderated. Although part of this corresponds to a more favorable base effect –as energy prices shot up after the start of the war in Ukraine last year–, we believe that some positive developments are indeed materializing, particularly for goods. The most important is recent MXN strength, although we should remain cautious given its recent slide amid higher global financial market volatility. Increased risk aversion has impacted EM assets, but also commodities as fears of a recession have picked up. In this context, we believe that risks remain somewhat balanced, albeit with tail risks picking up on both sides. Moreover, we note the moderation in meat & egg as a new spread of bird flu was averted, at least for the time being. In contrast, we remain somewhat concerned about: (1) Higher labor costs, which still seem to be passed through consumers via gradual price adjustments, particularly in services; and (2) reports that the upcoming draught season could be quite severe, which in turn would affect supply. On the former, the annual print stands at 5.68%, a new high for this cycle.

Banxico to keep hiking rates. We believe this result will likely cement the central bank's signal that they could reduce the pace of rate hikes in their upcoming meeting. Nevertheless, they have yet to declare victory in the fight against inflation, with a long way to go before it returns to its target range. In this respect, we anticipate + 25bps by the central bank in its decision next week, taking the reference rate to 11.25%. We do not rule out additional hikes after that, although we recognize increasing doubts about further tightening by global central banks –particularly the Fed– due to financial stability risks. Hence, we be especially vigilant to the statement's language, particularly the forward guidance to gain additional certainty about potential actions ahead.

From our fixed income and FX strategy team

Inflation breakevens could keep drifting lower. Investors recalibrated their expectations towards lower terminal rates in both the US and Mexico on the back of banking sector concerns in some countries. This triggered an average rally of 70bps in short-term sovereign bonds. In addition, the 2s/30s spread in Mbonos has fallen to -100bps from -184bps in the same period. On the contrary, CPI-linked bonds (Udibonos) flattened, up by 27bps at the short-end and with few changes on longer term tenors. As a result, breakevens decreased, especially those of shorter duration. For example, the 3-year tenor stands at 4.82% from 5.55% in February. However, it remains well above Banxico's inflation target. In terms of strategy, we remain cautions and without directional positions considering very high volatility. We believe that trading will remain erratic in coming sessions, albeit without ruling out renewed pressures on shortest term securities to correct the aggressive cuts that the market is pricing-in for 2H23.

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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, 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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