March inflation – Relevant moderation in the non-core helps the annual print

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- **Headline inflation (March): 0.27% m/m; Banorte: 0.25%; consensus: 0.29% (range: 0.25% to 0.39%); previous: 0.56%**
- **Core inflation (March): 0.52% m/m; Banorte: 0.51%; consensus: 0.51% (range: 0.47% to 0.55%); previous: 0.61%**
- **Results were mostly positive, with usual seasonal upticks being offset by other favorable developments. In this context, services (0.6%) were pushed by tourism-related categories ahead of the Easter holiday. Goods were lower (0.4%), noting a slight moderation in processed foods (0.5%) in the last couple of prints. At the non-core (-0.50%), both energy (-0.4%) and agricultural goods (-0.7%) had sharp declines, with an uptick in government tariffs (0.7%)**
- **Annual inflation fell to 6.85% from 7.62%, with base effects along more modest pressures driving the decline. The core declined to 8.09% from 8.29% previously**
- **After today's print, we reiterate our call of a 25bps hike by Banxico in May, taking the rate to 11.50% and ending its tightening cycle. However, risks for additional hikes remain**
- **Market expects a terminal rate of 11.50% in May**

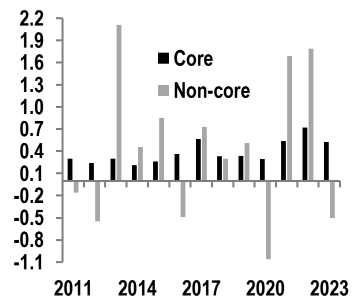
Inflation at 0.27% m/m, moderating further. The core came in at 0.52%, also lower. Trends seen in the 1st half of the month extended, particularly those related to seasonality. Services rose 0.6%, with 'others' being the outperformer (1.0%). These were mostly driven by the increase in tourism-related categories ahead of the Easter holiday, albeit with some pressures persisting in 'dining away from home'. In goods (0.4%), processed foods kept moderating, up 0.5%, with 'other goods' also more modest at 0.3%. In our view, the category is likely being helped by the strength of the MXN, benefiting imported items. There were widespread declines in the non-core (-0.50%), with energy leading the charge down at -0.8%. We note adjustments in LP gas (-4.2%) and natural gas (-6.3%), with gasolines more stable. Agricultural items also contracted (-0.7%). Both fruits and vegetables (-1.0%) and meat and egg (-0.4%) were lower, noting falls in tomatoes, cactus, and chicken, to name a few. Lastly, government tariffs rose 0.7%, impacted by higher highway toll fares.

March 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
Air fares	4.8	26.0
Lemons	4.0	26.7
Housing	3.3	0.3
Tourism services	2.7	8.6
Restaurants	2.7	0.9
Goods and services with the largest negative contribution		
LP gas	-7.4	-4.2
Tomatoes	-4.2	-6.9
Cactus	-2.3	-21.3
Chicken	-1.6	-0.9
Serrano chilies	-1.6	-10.7

Source: INEGI

Core and non-core inflation in March
% m/m



Source: INEGI

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Annual inflation keeps trending down, albeit with some risks picking up. Headline inflation fell to 6.85% y/y from 7.62%, adding two months of declines. Similarly, both the core and non-core were lower, down to 8.09% and 3.27%, respectively. While this is due in part to a more favorable base effect –with the annual print in 2022 accelerating to 7.45% from 7.28% in the aftermath of Russia's invasion of Ukraine–, we believe a moderation in monthly pressures is also helping the figure. This has been more evidenced in the non-core (with a YTD performance of 0.47%), helped both by energy and agricultural items. However, risks for the former have increased as a result of the recent announcement from OPEC+ to cut production, which has driven global reference prices higher over the last few days. While there are shock absorbers to fade some of the effect over several fortnights (*e.g.* subsidies to gasoline excise taxes and a price ceiling to LP gas), the net effect would still likely peter through, impacting final prices. As such, we will remain vigilant over coming prints to evaluate the effect on the price formation process. In the core, we think that the effect from a stronger MXN has become more evident in the latest prints after some upward surprises at the start of the year (up 1.86% YTD). A relevant factor for businesses is also the relatively low volatility it has shown, even amid fears over banking sector in the US and Europe. However, regarding services we still remain somewhat concerned over labor costs as wages keep adjusting higher. All in all, the outlook for our year-end forecast of 4.8% seems relatively balanced, but still with a long way to go in an uncertain environment.

We maintain our call of an additional 25bps hike by Banxico in May, marking the end of the tightening cycle. Today's print implies a quarterly average for the headline at 7.46% y/y, with the core at 8.28%, both in line with the updated forecasts from the central bank in its decision last week –at 7.5% and 8.3%, respectively. In addition, we believe that the statement was less hawkish, leaving the door open for a hike in the next meeting, which we believe will materialize. As such, we estimate a 25bps increase in May, taking the reference rate to 11.50%, level which we think will be terminal for this tightening cycle. Nevertheless, if inflation proves to be stickier or additional risks materialize, Banxico could opt for additional hikes if they consider it necessary.

From our fixed income and FX strategy team

Market foresees a terminal rate of 11.50% in May. In a backdrop of an additional slowdown in prices, the market bets that Banxico will finish with its tightening cycle as early as May, with a 25bps hike, reaching a terminal rate of 11.50%, in line with our call. However, investors maintain a dovish vision for the second half of 2023, pricing-in cuts of 84bps, contrary to our expectation that rules them out for the remainder of the year. In this sense, we believe that the yield curve will be more inverted as the short-term securities will eliminate said scenario. The 2s/30s spread in Mbonos has moved to -152bps from -100bps during the banking crisis in the US after reaching record lows of -192bps a month ago. The expected movements favor paying short-term TIIE-IRS. However, high volatility limits its attractiveness, so we do not recommend directional positions. In relative terms, we continue to prefer nominal vs real rates, especially if inflation continues to moderate.

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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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