February 22, 2024

Inflation 1H-February – Strong downward surprise on the back of agricultural goods

- **Headline inflation (1H-Feb): -0.10% 2w/2w; Banorte: 0.27%; consensus: 0.13% (range: 0.04% to 0.50%); previous: 0.32%**
- **Core inflation (1H-Feb): 0.24% 2w/2w; Banorte: 0.26%; consensus: 0.28% (range: 0.23% to 0.33%); previous: 0.32%**
- **The surprise was driven by a strong reversal of recent pressures in agricultural goods, especially fruits and vegetables (-7.2%; contribution: -43bps), albeit also meat & egg (-0.6%). On the contrary, we saw more pressures in energy (2.0%) –highlighting the 7.3% increase in LP gas. As a result, the non-core (-1.10%) improved heftily. At the core (0.24%), there is an unfavorable seasonality in 'other goods' (0.3%), partly on the end of seasonal discounts on clothing. Services (0.3%) benefited from airfares (-5.5%), while in 'others' (0.3%), we note the increase in some items related to food away from home**
- **In bi-weekly terms, annual inflation moderated to 4.45% from 4.87%. Meanwhile, the core extended its downward trend at 4.63% (previous: 4.75%)**
- **The print helps the case that Banxico will begin rate cuts in its upcoming decision (March 21st), particularly due to core dynamics. Nevertheless, we think further challenges for the non-core will linger around in the short-term**

Prices down 0.10% 2w/2w in the 1st half of February. This was below all market forecasts, driven by the strong 7.2% decline in fresh fruits and vegetables. As a result, this category reversed its rise during the last three fortnights. Specifically, due to tomatoes (-35.4%) and husk tomatoes (-13.1%), with both subtracting 45bps to the headline (see table below). In contrast, energy increased 2.0%, with pressures in LP gas (8.1%), reflecting higher reference prices in the US. Low-grade gasoline (0.4%) also showed a relevant uptick. Government tariffs were broadly stable (0.3%) despite toll road price increases in some states. The core exhibited more favorable dynamics. Within goods (0.2%) there is an unfavorable seasonality in 'others' (0.3%) on the end of winter discounts on clothing. However, processed foods were better at 0.2%, resuming a more positive trend after turn-of-the-year adjustments –in our view, helped further by MXN strength. In services (0.3%), on top of the usual adjustment in education (0.3%) due to university tuitions (0.6%), we highlight the 3.0% rise in in 'dining away from home' inside 'others' (0.3%), a situation that may be hinting at some cost pressures. Meanwhile, tourism was quite favorable, noting airfares (-5.5%).

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
LP gas	12.3	8.1
Low-grade gasoline	6.2	1.3
Cebolla	3.0	6.4
Dining away from home	2.5	0.5
Housing	1.9	0.2
Goods and services with the largest negative contribution		
Tomatoes	-42.1	-35.4
Husk tomatoes	-2.6	-13.1
Chicken	-2.2	-1.4
Squash	-1.6	-11.8
Air fares	-1.3	-5.5

Source: INEGI


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Winners of the awards as the best economic forecasters in Mexico by *LSEG* and *Focus Economics* in 2023

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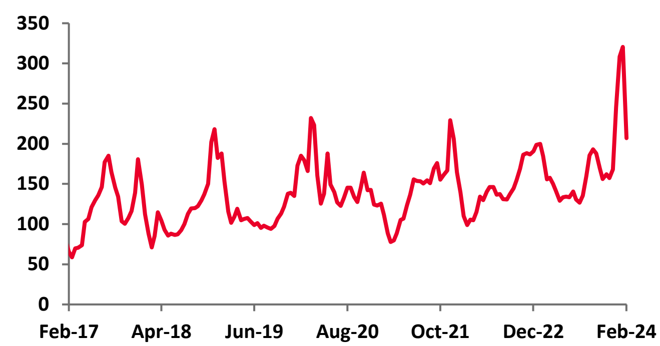
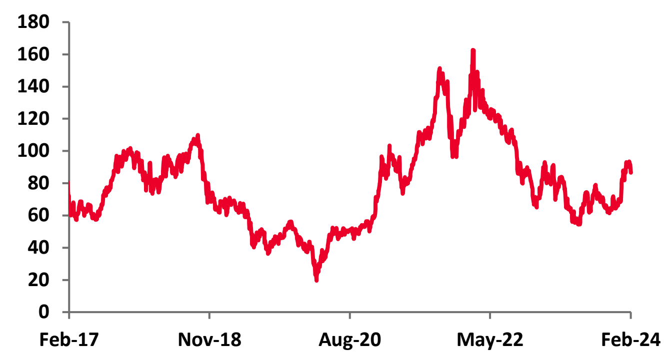
Annual inflation falls further, but some risks should be kept in mind. With these results, headline inflation came in at 4.45% from 4.87% y/y in the 2nd half of January. Specifically, the decline is partly explained by the core, falling to 4.63% (previous: 4.75%), in turn helped primarily by goods. Despite of the latter, we note that services were more stable (falling just by 3bps at the margin) at 5.3%, with those excluding housing and education at 6.3%, which is still high. The non-core was the big surprise lower, to 3.93% (previous: 5.25%). Although we were seeing some reversal of its recent increases, the decline in fruits and vegetables was significantly stronger than our call. This category is especially volatile, so we advise not to read too much into it. Moreover, we believe underlying pressures could resume. We remain skeptical about a sizable extension of the decline despite today's report as it was mostly due to a seasonal effect in tomatoes, usually reaching their lowest prices between late February and early March (see chart below, left). Specifically, we believe that more challenging weather conditions –especially regarding drought levels– as well as a modest rebound in fertilizer prices will weigh more heavily, even with a relevant flow of imports from this sector. Less favorable, LP gas picked up. Seasonal factors are currently working against energy, albeit with the outlook appearing more stable. The benchmark price for LP gas in the US showed a significant increase throughout January and so far in February, reaching its highest since the beginning of last year, although still considerably below the highs in 2022 after the start of the war between Russia and Ukraine (see chart below, right). However, considering expectations of a more balanced global supply and demand, this issue could be more transitory, with adjustments in prices of other goods more limited.

CPI: Tomatoes
Index 100 = 2H-July 2018, bi-weekly frequency



Source: Banorte with data from INEGI

LP gas
US$ per gallon



Source: Banorte with data from Bloomberg

Attention on Banxico's minutes today at 10:00am ET. We think the last statement from the central bank was clear that the next move will be a 25bps cut in the March 21st decision. Nevertheless, information contained in the minutes will be key to estimate both the pace and magnitude of subsequent adjustments. It is our take that it will be relevant whether Board members decide to endorse the comments around 'gradual' changes or 'fine-tuning' the reference rate, which would suggest a preference to opt for at least one pause in the easing cycle after the first cut. In addition, we will be watching which factors could trigger an acceleration or moderation in the pace and magnitude of rate cuts, a situation that is likely to be more relevant in 2H24.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Santiago Leal Singer, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Carlos Hernández García, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Daniel Sebastián Sosa Aguilar, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Juan Carlos Mercado Garduño, Jazmin Daniela Cuautencos Mora, Andrea Muñoz Sánchez and Paula Lozoya Valadez, 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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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
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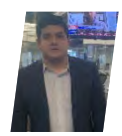

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