Economic and Financial Markets Research
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February inflation – Downward surprise on a strong decline in agricultural goods due to seasonality

- **Headline inflation (February): 0.09% m/m; Banorte: 0.18%; consensus: 0.12% (range: 0.05% to 0.20%); previous: 0.89%**
- **Core inflation (February): 0.49% m/m; Banorte: 0.50%; consensus: 0.48% (range: 0.46% to 0.51%); previous: 0.40%**
- **The core was relatively subdued, with goods (0.4%) modest despite an adverse seasonality in 'others' (0.4%). Services (0.6%) were slightly higher, highlighting persistent pressures in key categories within 'others' (0.7%). The non-core (-1.10%) was quite positive despite differences within, with energy up 2.8% –mainly driven by LP gas (10.2%) and low-grade gasoline (2.1%)–, albeit with a strong decline in agricultural items (-4.6%) –dragged by fruits and vegetables at -8.4%, highlighting a favorable seasonal pattern for tomatoes in the month**
- **With this, inflation in February moderated to 4.40% from 4.88% in the previous month. The core extended its downward trend, standing at 4.64% (previous: 4.76%)**
- **We believe the recent performance will help Banxico to start cutting the reference rate in the March 21st meeting by -25bps. Nevertheless, we still anticipate a pause in May on the back of lingering risks on the horizon**

Inflation at 0.09% m/m in February. The result was considerably lower than long-term averages for the period. In the core (0.49%), goods (0.4%) saw modest changes, with processed foods up 0.4%, and with 'other goods' increasing by the same magnitude –highlighting the end of seasonal discounts on clothing and footwear in the latter. In services (0.6%), housing remained somewhat high (0.4%), coming on top of the usual adjustments in education (0.6%) given revisions in university tuitions. However, we highlight the 0.7% increase in 'other services', with pressures persisting in 'dining away from home' (0.9%). Meanwhile, at the non-core (-1.10%) we saw an extension of the favorable performance in the 1st fortnight, despite mixed results within. Energy (2.8%) rebounded, driven by both LP gas (10.2%) and low-grade gasoline (2.1%) despite the 0.1% drop in electricity. In agricultural items (-4.6%), the result was dictated by the 8.4% decline in fruits and vegetables, highlighting tomatoes–with a favorable seasonality at this time of the year–, although with additional reductions in husk tomatoes and nopales. Meat and egg also fell (0.7%), helped by chicken. Finally, government tariffs remained contained at 0.6%.

February 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
LP gas	15.4	10.2
Low-grade gasoline	10.0	2.1
Dining away from home	4.5	0.9
Onions	4.0	8.6
Housing	3.8	0.4
Goods and services with the largest negative contribution		
Tomatoes	-48.8	-41.8
Husk tomatoes	-4.4	-21.1
Chicken	-2.3	-1.4
Nopales	-1.7	-12.1
Eggs	-1.7	-1.8

Source: INEGI


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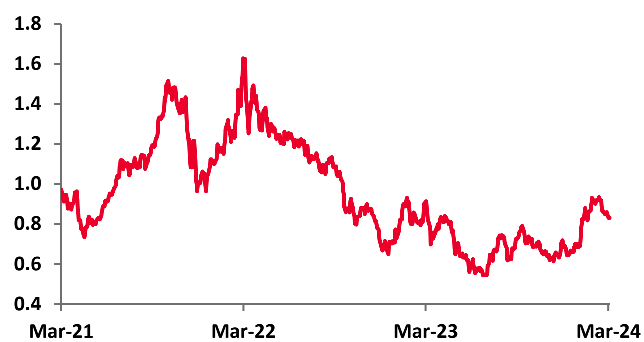
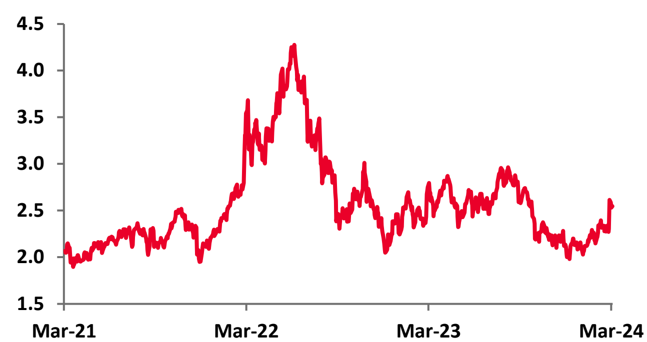
Moderation in annual inflation, although we believe that risks remain tilted to the upside. With this result, inflation fell to 4.40% from 4.88% y/y in the previous month. Inside, both the core (at 4.64% from 4.76%) and the non-core (at 3.67% from 5.24%) declined, although with some upside risks persisting in specific categories. In the former, our concerns remain centered on services –which came in at 5.3%, above 5% for a 19th month in a row. This is relevant since most of Banxico's Board members commented in the latest minutes that "*...services inflation still does not show a clear downward trend...*", enough from some of them to remain with a cautious stance. Turning to the non-core, we do not rule out a rebound in tomatoes, which usually materializes between March and May. Moreover, high drought levels will probably continue weighing on other crops. In addition, we will keep monitoring livestock imports, which in our view have been key in keeping prices relatively contained. On the other hand, energy could be more volatile. Current LP gas prices in the US point to a possible moderation in our country at the beginning of March (chart below, left). However, gasoline has shown an additional increase (chart below, right), which could be reflected in prices despite higher subsidies to excise taxes. In this sense, we will watch closely the dynamics of these items in coming months. Nevertheless, we believe the balance of risks remains skewed to the upside, so we maintain our year-end estimate at 4.6%.

LP gas (Mont Belvieu)
US$/gallon



Source: Banorte with figures from Bloomberg

Gasoline
US$/gallon



Source: Banorte with figures from Bloomberg

Recent dynamics will help Banxico with the first cut, although challenges on the horizon will push for gradual actions later. Considering the central bank's latest communications, along with the last two inflation reports, it is our take that most Board members will support a 25bps reduction to the reference rate in their upcoming decision (March 21st). However, as several have shown a preference for staying data-dependent and that risks are still tilted to the upside, we reiterate our call that they will opt for a pause in May. Following this, we could see consecutive 25bps cuts per meeting starting in June, which would bring the rate to 9.75% by the end of the year.

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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, 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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