May 23, 2024

Inflation 1H-May – Pressures remain in services within the core

- **Headline inflation (1H-May): -0.21% 2w/2w; Banorte: -0.25%; consensus: -0.24% (range: -0.30% to -0.07%); previous: 0.25%**
- **Core inflation (1H-May): 0.15% 2w/2w; Banorte: 0.13%; consensus: 0.15% (range: 0.12% to 0.20%); previous: 0.07%**
- **Once again, most of the result was driven by the start of the second tranche of summer discounts to electricity tariffs, with a 21.5% drop (contribution: -38bps). Remaining energy items were mixed. Agricultural items were more modest at the margin, up 0.4% and with increases in both categories. Within the core, goods posted a favorable result at 0.1%. Services were higher at 0.2%, with pressures continuing in 'others' (0.2%)**
- **In bi-weekly terms, annual inflation increased to 4.78% from 4.67% in 2H-April, adding three fortnights to the upside. Meanwhile, the core kept moderating by coming in at 4.31% (previous: 4.34%)**
- **Attention on Banxico's minutes later today, expecting suggestions that rate cuts could resume in June. Nevertheless, the price outlook remains full of risks, which should merit caution and prudence in communications**

Inflation at -0.21% 2w/2w during the first half of May. The result was impacted by the seasonal effect stemming from the start of the second tranche of summer discounts on electricity tariffs. Thus, this component fell 21.5% (-38bps of contribution to the total). Remaining energy items were more mixed, with LP gas falling (-1.2%), but with low-grade gasoline up 0.3% despite a stronger MXN and lower reference prices in the US. Regarding agricultural items (0.4%), both items increased, with upticks in fruits and vegetables (0.5%) and in meat and egg (0.4%). Within the former, price increases in tomatoes and serrano chilies stood out, although with relevant drops in onions and husk tomatoes. In the latter, eggs kept climbing. Closing with the non-core, government tariffs were quite low at 0.1%. Turning to the core (0.15%), goods remained fairly subdued at 0.1%, with processed foods (0.2%) slightly higher than 'other goods' (0.0%). In services (0.2%), pressures continued in 'others' (0.2%), with relevant gains in items such as airfares (9.8%). Meanwhile, housing accelerated again with an increase of 0.2%, contrasting with a more moderate behavior in the previous three fortnights.

1H-May 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
Tomatoes	7.3	10.4
Serrano chilies	2.5	14.0
Housing	2.3	0.2
Air fares	2.2	9.8
Eggs	1.9	2.0
Goods and services with the largest negative contribution		
Electricity	-37.6	-21.5
Onions	-3.7	-13.2
LP gas	-2.0	-1.2
Husk tomatoes	-1.6	-8.2
Melons	-1.1	-13.7

Source: INEGI


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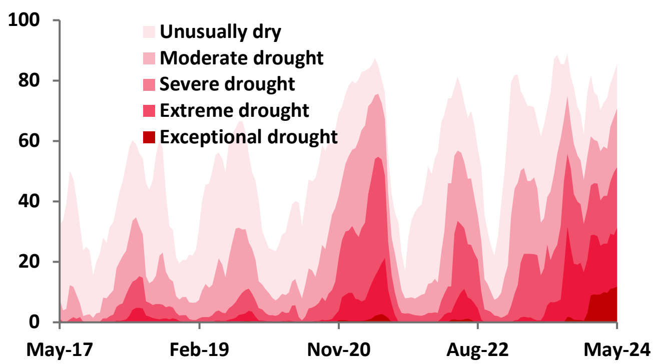
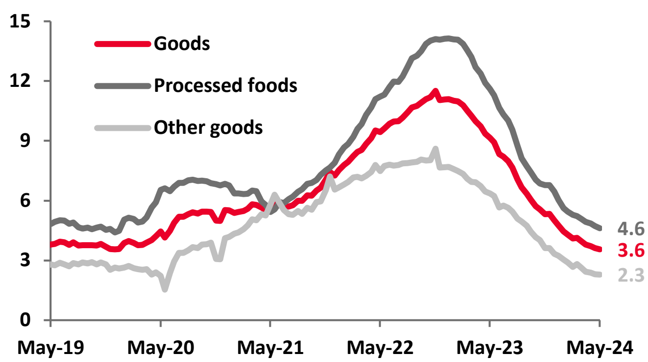
Headline inflation advanced in the annual comparison, but with the core still moderating. With today's report, headline inflation came in at 4.78% y/y from 4.67% in the second half of April, adding three consecutive fortnightly increases. As mentioned in previous reports, part of this is explained by a more challenging base effect at the non-core, reaching 6.27% (previous: 5.69%), its highest since the beginning of 2023. On the other hand, the core continued to moderate, standing at 4.31% (previous: 4.34%), although with more limited improvements. Regarding the first category, agricultural products continued to accelerate (8.8%), highlighting that 'fruits and vegetables' stood near the 20% barrier for the first time since the beginning of the year –when strong increases were seen in tomatoes. Looking at which products have been the target of some of the most recent pressures –such as chilies–, it is increasingly clear that higher import substitutions will not be enough to alleviate the effects of the drought for all goods. On the latter, the latest CONAGUA report shows that 86% of the country is 'abnormally dry' or worse (see chart below, left), with 'exceptional drought' levels at highs not seen since 2011. In energy, reference prices have stabilized and even diminished for some goods, highlighting the recent update of the *International Energy Agency's* crude oil demand forecasts to the downside in its May report. At the core, it is relevant to mention that the declines are practically entirely explained by goods, reaching 3.6%, with five fortnights already below 4% (see chart below, right). However, services remain elevated at 5.2%, with many of the problems we have discussed in previous notes continuing.

Drought monitor in Mexico
% of disrupted national territory



Source: Banorte with figures from CONAGUA

Core inflation: Goods
% y/y, bi-weekly frequency



Source: Banorte with figures from INEGI

We believe that Banxico's Board will signal that the cuts may continue in June. Later today, the central bank will publish the minutes of its last meeting, in which it decided to leave the reference rate unchanged at 11.00%. We believe the document will maintain a cautious tone, very similar to the statement. Nevertheless, and as part of the communication strategy that has prevailed in recent decisions, we think it is very likely that in the section about members' opinions there will be hints that another cut could materialize in the next meeting, supporting the adjustments observed in the forward guidance. This would be consistent with Governor Victoria Rodriguez's comments in an interview with *El Financiero*, where she mentioned that "*...we are already in a situation in which we can subsequently evaluate whether to continue with downward adjustments in the reference rate...*".

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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, Marcos Saúl García Hernandez, Juan Carlos Mercado Garduño, Ana Gabriela Martínez Mosqueda, 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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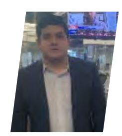

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