CAPITAL ECONOMICS

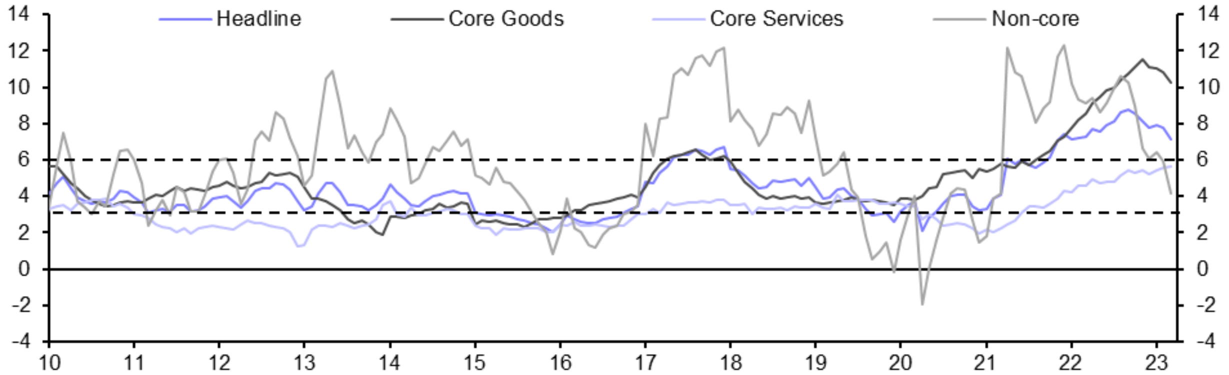
LATIN AMERICA DATA RESPONSE

Mexico Bi-Weekly CPI (Mar.)

Stronger services inflation to keep Banxico tightening

- **Mexico's headline inflation rate dropped back by more than expected, to 7.1% y/y, in the first half of March but the further rise in services inflation will continue to concern policymakers at Banxico. We expect a 25bp hike at next week's Board followed by a similar-sized increase in May, with loosening unlikely to come on the cards until the end of this year.**
- The outturn was softer than the Refinitiv consensus forecast for inflation to dip to 7.3% y/y, but closer to our forecast for inflation to fall to 7.0% y/y. While the reading was down from 7.8% y/y in the first half of February, it was still well above the central bank's target range of 2-4%. (See Chart 1.) In seasonally-adjusted m/m terms, which gives a better gauge of the latest developments, prices rose at an annualised pace of 3%.
- **The breakdown of the data showed that the fall in the headline rate was driven by falls in both core and non-core inflation**. (See Table 1.) Non-core inflation eased from 5.9% y/y in February to 4.2% y/y this month as agricultural and energy price inflation continued to drop back.
- Meanwhile, core inflation declined to a seven-month low of 8.7% y/y. While clearly welcome, it's worth noting that this entirely reflected weaker core goods inflation, with non-food goods prices increasing at their slowest pace in 14 months. **In contrast, services inflation – which has been a key focus of Banxico amid concerns about the persistence of price pressures – reached a fresh 20-year high of 5.7% y/y**.
- We warned recently that a tight labour market and strong wage growth will keep services inflation, and thereby the headline rate, higher than most expect over the next couple of years. Indeed, we don't expect the headline rate to return to Banxico's 2-4% tolerance band until late-2024.
- **The latest inflation data and Deputy Governor Irene Espinosa arguing for the "need for an additional monetary effort", means that a 25bp interest rate hike (to 11.25%) appears to be nailed on**. The dovish tone of yesterday's Fed decision means that it is up in the air whether there will be an additional 25bp increase in rates in May. **Regardless, a turn to loosening is unlikely until the very end of this year and we expect rates to be kept higher than investors and the consensus expect over 2023-24.**

Chart 1: Mexico Mid-Month Consumer Prices (% y/y)



Sources: INEGI, Refinitiv

Table 1: Mexico Mid-Month Consumer Prices* (% y/y)

	Headline	Core	Core Goods	Services	Non-core	Agricultural	Energy & Reg.
Dec.	7.8	8.4	11.1	5.2	6.1	8.8	3.9
Jan.	7.9	8.4	11.0	5.5	6.4	10.0	3.6
Feb.	7.8	8.4	10.8	5.6	5.9	9.7	2.9
Mar.	**7.1**	**8.1**	**10.3**	**5.7**	**4.2**	**8.1**	**1.0**

Sources: Refinitiv, INEGI. *Data to the middle of each month.

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