1H-January inflation – Price pressures at the turn of the year

January 23, 2020

www.banorte.com
@analisis_fundam

Alejandro Padilla
Executive Director of Economic Research and Financial Market Strategy
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores
Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Santiago Leal Singer
Senior Strategist, Fixed-Income and FX
santiago.leal@banorte.com

Leslie Orozco
Strategist, Fixed Income and FX
leslie.orozco.velez@banorte.com

- **Headline inflation (1H-Jan): 0.27% 2w/2w; Banorte: 0.25%; consensus: 0.25% (range of estimates: 0.08%-0.45%); previous: 0.32%**
- **Core inflation (1H-Jan): 0.20% 2w/2w; Banorte: 0.27%; consensus: 0.19% (range of estimates: 0.09%-0.33%); previous: 0.08%**
- **We highlight pressures in processed foods (0.9% 2w/2w, contribution: 17bps), driving up the core component. In our view, this was influenced to some extent by change-of-year price increases and higher excise taxes in some categories (*e.g.* cigarettes and sugary drinks)**
- **At the non-core, we note the 1.2% increase in government tariffs, which we believe reflects some updates at the start of the year, albeit with its highest contribution since October 2017**
- **With today's print, annual inflation climbed to 3.18% from 2.83% at year-end 2019. In a similar fashion, core inflation picked up to 3.73% from 3.59%, respectively**
- **In our view, annual inflation is likely to climb further in coming months, influenced by challenging base effects –particularly at the non-core level– and limited downside potential at the core component**
- **We hold our positive view in terms of CPI-linked Udibonos**

Consumer prices increased 0.27% 2w/2w in the first half of January. This was 2bps above consensus, which coincided with our forecast. It should be mentioned the range of estimates was pretty wide, reflecting uncertainty about several drivers at the turn of the year. Core inflation edged-up 0.20%, below our estimate (0.27%). The main deviations from our forecast came from: (1) Higher pressures in fresh fruits and vegetables (+10bps vs. our 2bps; (2) less effect from other services (-8bps vs our -2bps); and (3) a higher contribution from processed foods (+17bps vs. our +14bps), as shown in the table below.

1H-Jan inflation by components
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.27	0.25	0.02
Core	0.15	0.20	-0.05
Goods	0.20	0.19	0.01
Processed foods	0.17	0.14	0.03
Other goods	0.03	0.05	-0.02
Services	-0.05	0.01	-0.06
Housing	0.02	0.02	0.00
Education	0.01	0.01	0.00
Other services	-0.08	-0.02	-0.06
Non-core	0.11	0.05	0.07
Agriculture	0.07	-0.01	0.08
Fruits & vegetables	0.10	0.02	0.08
Meat & eggs	-0.04	-0.03	-0.01
Energy & government tariffs	0.05	0.06	-0.01
Energy	0.00	0.01	-0.02
Government tariffs	0.05	0.04	0.01

Source: INEGI, Banorte.
Note: Contributions might not add due to the number of decimals allowed in the table.

Inflation saw some pressures at the core level. Core inflation increased 0.2% 2w/2w, contributing with 15bps. We highlight that the increase was heavily concentrated in processed foods, in our view reflecting change-of-year price increases in some products, along higher excise taxes in others such as cigarettes and sugary drinks. In this respect, the former good exhibited the highest contribution of all at 6.8bps. Other goods were more modest and similar to the previous year. In services, those related to tourism grinded lower, as prices kept adjusting in the aftermath of the holiday season. The latter, coupled with relevant declines in internet and TV services, helped compensate for other items such as dining away from home (+0.5%), which is arguably among those that could be more sensitive to recent wage increases.

Non-core keeps rising. This component picked up 0.5% 2w/2w, resulting in a 11bps contribution. In annual terms, this sub-index increased from a very low level of 0.59% in 2019 to 1.60%. Government tariffs stood at 1.2% 2w/2w (5bps), typically high in the first two fortnights of each year as most federal and local governments update amounts charged for their services. Nonetheless, its contribution was the highest since October 2017, when it was distorted to the upside after the earthquake of the previous month. In energy, low-grade gasoline advanced (0.6%), with international prices and volatility up –influenced by US-Iran tensions–, but aided by subsidies and a relatively strong exchange rate. LP gas fell 1.7%. Contrary to our view, agricultural goods were pressured (7bps), with fresh fruits and vegetables at 2.2% while meat and egg declined 0.7%. Goods with the highest impact included tomatoes (7.3%), husk tomatoes (20.9%), and squash (25.6%); among those declining were chicken (-2.3%), nopal cactus (-13.1%), and egg (-1.0%).

Annual inflation has likely bottomed out. We maintain our view that inflation will keep climbing in coming months, influenced by challenging base effects –especially at the non-core– and limited downside at the core. We believe agricultural goods will likely extend its trend higher, more in line with historical norms. As a result, headline inflation increased to 3.18% yoy from 2.83% at year-end 2019, while the core reached 3.73% from 3.59%, respectively.

Nonetheless, we continue expecting Banxico to cut by 75bps in 2019, with three consecutive 25bps cuts in February, March and May. In our view, the central bank's tone remains dovish despite the need of a prudent and cautious approach. We expect this to prevail as economic activity remains muted (with the output gap at around -2% of potential GDP) and Banxico's inflation forecasts already anticipated some pressures. Specifically, their estimates for average headline and core inflation in 1Q20 stand at 3.5% and 3.6%, in the same order, virtually in line with our own. Moreover, Banxico's Governor, Alejandro Díaz de León, stated that the central bank already expected a "little bump" in prices, so today's data should not come as a big surprise. Meanwhile, other communications have hinted of an upward adjustment in their estimated path. All in all, we believe these factors suggest that the easing cycle will continue in the short term, albeit modestly in order to have time to gauge potential risks in terms of price dynamics.

From our fixed income and FX strategy team

We hold our positive view in terms of CPI-linked Udibonos. Today's CPI report is confirming our view that Banxico will have a more gradual approach towards additional stimulus and that current conditions will continue benefiting inflation-linked Udibonos. In this regard, the Mexican yield curve is pricing in 87bps of implied rate cuts for the entire year, slightly more optimistic *vis-à-vis* our 75bps rate reduction expected in 2020, conveying an expensive valuation in the short-end and the possibility of a flattening bias in the Mbonos curve. In terms of the Udibonos curve, yesterday our trade idea of long positions on the Jun'22 security reached the proposed profit taking target. However, we hold a positive view in terms of Udibonos, especially the belly of curve.

Certification of Analysts.

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Jorge Antonio Izquierdo Lobato and Eridani Ruibal Ortega, 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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., *through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.*

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	Chief Economist, Head of Research and IRO	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Market Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Corporate Debt			
Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454