

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

- **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.

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**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.

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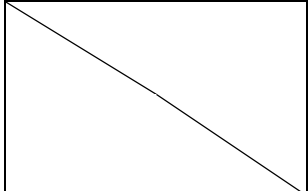
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