Food prices pushed inflation higher in January

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- **Headline inflation (January): 0.48% m/m; Banorte: 0.53%; consensus: 0.52% (range of estimates: 0.40%-0.57%); previous: 0.56%**
- **Core inflation (January): 0.33% m/m; Banorte: 0.33%; consensus: 0.35% (range of estimates: 0.25%-0.39%); previous: 0.41%**
- **Pressures in processed foods extended (1.1% m/m, contribution: 22bps), albeit compensated to some extent by contained prices in other services (-0.4%). At the non-core, we highlight the 4.6% advance in fresh fruits and vegetables (contribution: +22bps)**
- **With today's figure, annual inflation climbed to 3.24% from 2.83% at year-end 2019, slightly lower than expectations. In a similar fashion, core inflation picked up to 3.73% from 3.59%**
- **Despite the more modest increase, we continue expecting annual inflation climb in coming months, although with the report suggesting that economic slack could be dampening price pressures slightly more than we had anticipated**
- **We hold our trade idea of long positions in the CPI-linked Udibono Nov'28 amid the current inflationary outlook**

Consumer prices increased 0.48% m/m in January. This was 4bps lower than consensus, also standing below our forecast. Core inflation edged-up 0.33%, in line with our estimate. The main deviations came from: (1) A lower impact from agricultural goods (+19bps vs. our +22bps), particularly due to the decline in meat and egg; (2) less than expected contribution in other services (-7bps vs our -4bps); and (3) a higher effect in processed foods (+22bps vs. our +20bps), as shown in the table below.

January inflation by components
% monthly incidence

	INEGI	Banorte	Difference
Total	0.48	0.53	-0.05
Core	0.25	0.25	0.00
Goods	0.26	0.23	0.02
Processed foods	0.22	0.20	0.02
Other goods	0.03	0.03	0.00
Services	-0.01	0.01	-0.02
Housing	0.04	0.04	0.00
Education	0.01	0.02	0.00
Other services	-0.07	-0.04	-0.03
Non-core	0.24	0.28	-0.04
Agriculture	0.19	0.22	-0.03
Fruits & vegetables	0.22	0.23	-0.01
Meat & eggs	-0.03	-0.01	-0.02
Energy & government tariffs	0.05	0.06	-0.01
Energy	-0.01	0.00	-0.01
Government tariffs	0.06	0.06	-0.01

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

A mixed bag in terms of core inflation. This component increased 0.33% m/m, contributing with 25bps. In terms of price increases, processed foods extended the advance observed in the first fortnight, heavily influenced by change-of-year price increases and higher excise taxes. We thought these adjustments would have been limited to the first half of the month, which did not materialize, with this component accelerating to 5.1% y/y from 4.4% at the end of 2019. Other goods climbed 0.2% m/m, broadly in line with recent years. On the contrary, other services surprised to the downside at -0.39%, subtracting 6.7bps to the headline. Dynamics were similar relative to the previous bi-weekly print, with tourism and telecom services down, more than compensating for pressures in dining away from home items.

The non-core component was helped by contained energy prices but kept increasing. This component picked up 0.96% m/m, with a 24bps contribution. Government tariffs stood at 1.4% (+6bps), very similar to the adjustment observed in the previous year, highlighting the 1.8bps contribution from water rights and bus fares (+2.4bps), remembering that this most federal and local governments update amounts charged for their services in this period. Moreover, agricultural goods stabilized after pressures in the first half of the month, resulting in an accumulated advance of 1.8% m/m (+19bps), with fruits and vegetables mostly responsible (+4.6%) while meat and egg fell 0.5%. On a more positive note, energy helped compensate somewhat for these, with a strong 2.2% decline in LP gas. Meanwhile, low-grade gasoline moderated its previous uptick, aided by price dynamics in international markets were more than enough to reduce tax subsidies.

Annual inflation up to 3.24% from 2.83%. We continue to believe that annual inflation will climb further in coming months. The core component, which increased to 3.73% from 3.59% at year-end 2019, will likely stay close to its current level in the short-term. On the other hand, non-core inflation dynamics will continue to be affected by challenging base-effects and the possible extension of the recent increase in agricultural goods (especially fresh fruits and vegetables). This component was pushed to 1.81% from 0.59% in December. Our main takeaway of the report is that relatively limited pressures in other services may be signaling that the effect of economic slack in limiting price increases could be more important than we had previously anticipated. This would help compensate for the potential impact from the minimum wage increase, particularly if it also dampens revisions higher in other segments of the wage distribution. We will be very attentive to these drivers, although we believe it is still too early to tell which of them could have a stronger influence. Lastly, the fact that processed foods were significantly higher is relevant given that it is highly unlikely these adjustments will reverse soon as they were driven mostly by tax updates and were observed even with the Mexican peso staying relatively strong against the US dollar.

From our fixed income and FX strategy team

We hold our trade idea of long positions in the CPI-linked Udibono Nov'28 amid the current inflationary outlook. Mexico released today a better than expected inflation figure for the second half of January but market participants are acknowledging that CPI dynamics will deteriorate this quarter given the arguments enlisted previously in this document. As a result, the annual reading increased by 41bps from December to January, granting relevant carry gains for UDI-related assets. It is our take that the combination of an interesting valuation in terms of breakevens, higher inflation prints expected for the rest of 1Q20, and the strong demand for fixed income assets worldwide will be supportive for our trade idea of long positions in the CPI-linked Udibono Nov'28, which we opened on January 31st, with an entry level of 3.25%, target of 3.10% and stop-loss of 3.35%.**.**

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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.

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