January inflation –Above expectations on higher energy prices

- **Headline inflation (January): 0.86% m/m; Banorte: 0.81%; consensus: 0.77% (range of estimates: 0.68% to 0.83%); previous: 0.38%**
- **Core inflation (January): 0.36% m/m; Banorte: 0.34%; consensus: 0.35% (range of estimates: 0.31% to 0.39%); previous: 0.55%**
- **The non-core component increased further in the second half and was up 2.40% m/m. Within, energy picked up 5.2%, contributing 51bps to the headline. Agricultural goods also grew, at 0.5%. In turn, the core was more modest. Goods (0.6%) remain more pressured than services (0.1%), with the latter still limited by the pandemic's impact**
- **With these, annual inflation stands at 3.54% from 3.15% at the end of last year. Core inflation was more stable, at 3.84% from 3.80%. We reiterate our call that Banxico will resume the easing cycle with a 25bps cut on Thursday, although with a more difficult decision at the margin**
- **We expect Udibonos to extend their outperformance**

Consumer prices up 0.86% m/m in January. This was above consensus at 0.77%, but closer to our 0.81%. As mentioned after the first half, pressures were mainly at the non-core, which increased 2.40%. Specifically, energy surged 5.2%, contributing 51bps, mainly on low-grade gasoline (6.1%) and LP gas (9.0%). Agricultural goods were also higher (0.5%), in line with the signal from our monitoring. The core was more modest (0.36%), slightly higher than its 5-year average. The bulk of the move remained in goods (0.6%), remembering start-of-year adjustments to prices and taxes. Services stayed muted (0.1%), highlighting an additional decline at the margin in airfares (-21.5%) and tourism-related (-11.6%). Moreover, education fell 0.1% despite universities returning to classes. Lastly, we highlight that 'dining away from home' was higher by 0.7%, likely affected by energy price dynamics and last year's 15% minimum wage hike.

January inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.86	0.81	0.05
Core	0.27	0.26	0.01
Goods	0.22	0.20	0.02
Processed foods	0.14	0.13	0.02
Other goods	0.08	0.07	0.01
Services	0.05	0.06	-0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	-0.01
Other services	0.03	0.03	0.00
Non-core	0.59	0.55	0.04
Agriculture	0.06	0.06	0.00
Fruits & vegetables	0.02	0.02	0.00
Meat & egg	0.03	0.04	0.00
Energy & government tariffs	0.53	0.49	0.04
Energy	0.51	0.46	0.04
Government tariffs	0.03	0.03	0.00

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

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Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

January inflation: Goods and services with the largest contributions
% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% m/m
Low-grade gasoline	28.3	6.1
LP Gas	19.0	9.0
Potatoes	6.3	18.8
Chicken	4.6	2.8
Dining away from home	3.4	0.7
Goods and services with the largest negative contribution		
Onions	-4.8	-18.8
Airfares	-3.9	-21.5
Tourism services	-3.7	-11.6
Eggs	-3.6	-4.2
Tomatoes	-2.3	-4.2

Source: INEGI

Inflation begins the year with upward surprises. With today's print, annual inflation increased to 3.54% from 3.15% at the end of 2020, still within Banxico's variability range around the target. The core was more stable, at 3.84% from 3.80%. In this backdrop, pressures at the non-core so far have been stronger than what we had anticipated a couple of months ago. We attribute this mainly to the effect that the 'Blue Wave' in the US has had on market dynamics. Specifically, it has induced a renewed optimism about the potential approval of more aggressive fiscal stimulus that would boost economic growth. Markets have reacted to this with: (1) Upward adjustments to asset prices sensitive to the stage of the cycle, highlighting commodities, in an environment of higher risk appetite; and (2) less weakness than expected on the USD globally given this rebound in growth, which has been stronger than in other regions. Hence, we will be looking even closer at this component's dynamics, as Mexico is a 'price taker' that limits possible actions in a context of increasing global inflation expectations. Nevertheless, we highlight that: (1) Starting on February 6th, the government resumed subsidies to low-grade gasoline excise taxes, in a bid to moderate the pace of the increase; and (2) global benchmarks for commodities –such as LP gas and copper– seem to be plateauing recently, albeit these are still very early signals given broadly higher inflation premia worldwide. On the other hand, Banxico's first decision of the year will be held on Thursday. We expect a 25bps cut, to 4.00%. Nevertheless, we see a more complicated backdrop mainly due to recent news about inflation, as already explained. Despite of this, it is our take that the window of opportunity to resume the easing cycle has reopened. For now, we continue expecting three consecutive 25bps cuts starting this week, with the rate reaching 3.50%. For further details about the decision, see here.

From our fixed income and FX strategy team

We expect Udibonos to extend their outperformance. The positive dynamics experienced in the last weeks for Mexican linkers will extend, in a backdrop in which inflation breakevens have picked-up across all tenors, although still depict space for further increases in shorter-duration readings. Particularly, the 3- and 5-year marks stand at 3.48% and 3.70%, with 12-month medians at 3.20% and 3.30%, respectively. Meanwhile, the market prices in implied cuts for Banxico's rate of -9bps, -19bps, and -25bps for the 1Q, 2Q, and 3Q21, in the same order, reason why we hold our recommendation on receiving the 6-month TIIE-28 IRS (6x1). Since December 17th, this trade idea accumulates a 6bps gain, still limited by the complexity around Banxico's next monetary policy decisions.

Analyst Certification

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, Eridani Ruibal Ortega and Juan Barbier Arizmendi, 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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