

1H-January inflation – The core remains on the upside

- **Headline inflation (1H-Jan): 0.39% 2w/2w; Banorte: 0.48%; consensus: 0.37% (range: 0.18% to 0.56%); previous: 0.01%**
- **Core inflation (1H-Jan): 0.34% 2w/2w; Banorte: 0.35%; consensus: 0.26% (range: 0.20% to 0.47%); previous: 0.20%**
- **As usual, goods within the core tend to show an important increase at the start of the year (0.6%), with adjustments centered in processed foods, up 0.8% (+17bps). Services were lower (0.0%), aided by seasonality in tourism categories. At the non-core (0.53%), we highlight mixed dynamics inside energy (0.4%), while meat and egg (1.0%) were higher**
- **Annual inflation moderated to 7.13% from 7.36% on average in December. Nevertheless, the core accelerated to 6.11% from 5.94% in the same period**
- **We consider that the extension in inflationary pressures, especially in the core, supports our view of a 50bps rate hike in Banxico’s upcoming monetary policy decision**
- **Inflation supports priced-in expectations of the next rate hike**

Inflation at 0.39% 2w/2w in 1H-January, slightly above consensus. Meanwhile, the core reached 0.34%, higher than anticipated. Goods rose 0.6%, driven by processed foods (0.8%). We should remember that both updates to excise taxes (flavored drinks and cigarettes), as well as usual start-of-the-year adjustments are reflected in this fortnight. On the contrary, services were stable (0.0%), with pressures in housing (0.1%) and education (0.3%) offset by favorable seasonality in airfares (-33.7%) and tourism services (-12.4%). At the non-core (0.53%), energy was mixed (0.4%), with LP gas extending lower (-1.1%), albeit with pressures in low-grade gasoline (1.0%), also skewed by higher excise taxes. Fruits and vegetables surprised us to the downside (0.0%) despite strong adjustments within. Finally, meat and egg accelerated to 1.0%.

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

	INEGI	Banorte	Difference
Total	0.39	0.48	-0.09
Core	0.26	0.26	-0.01
Goods	0.25	0.21	0.04
Processed foods	0.17	0.16	0.01
Other goods	0.08	0.05	0.03
Services	0.01	0.06	-0.05
Housing	0.02	0.02	0.00
Education	0.01	0.01	0.00
Other services	-0.02	0.02	-0.05
Non-core	0.13	0.22	-0.09
Agriculture	0.06	0.14	-0.08
Fruits & vegetables	0.00	0.11	-0.11
Meat & egg	0.06	0.03	0.03
Energy & government tariffs	0.07	0.08	-0.01
Energy	0.04	0.02	0.02
Government tariffs	0.03	0.06	-0.03

Source: INEGI, Banorte.

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

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Fixed income and FX Strategy

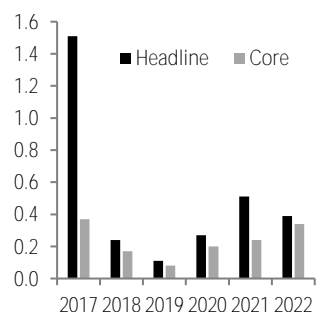
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Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*



Headline and core inflation in 1H-Jan
% 2w/2w



Source: INEGI

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1H-January inflation: Goods and services with the largest contributions

% 2w/2w: bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
Lemons	7.0	36.8
Low-grade gasoline	4.9	1.0
Dining away from home	4.4	0.9
Potatoes	3.7	11.6
Cigarettes	3.4	3.6
Goods and services with the largest negative contribution		
Tomatoes	-10.6	-15.2
Airfares	-8.6	-33.7
Tourism services	-4.3	-12.4
LP gas	-2.4	-1.1
Husk tomatoes	-1.9	-10.9

Source: INEGI

The headline moderates in annual terms, albeit with the core higher. Annual headline inflation declined to 7.13% y/y from 7.36%, partly aided by a base effect. Nevertheless, the core extended its upward trend by going to 6.11% from 5.94%, highest since late 2001 (1H-October). We believe the latter will keep rising during most of the first quarter. This would be partly explained by: (1) Some stability in the base effect; (2) prevailing supply chain disruptions due to the latest wave of contagions; and (3) persistently high raw materials' prices. Although we have seen renewed increases in energy at the non-core, we believe the impact could be more modest at the margin. In agricultural goods uncertainty remains elevated, especially as it is necessary to consider the potential impact from climate events, which have already impacted harvests of lemons and other goods.

Banxico will carry on with a 50bps hike in February. Although the moderation in the headline could influence some members to take a less hawkish stance, we think most will maintain a skew for more restrictions, worried about the trend at the core. In addition, comments about the Fed have turned less accommodative, with an increasing number of analysts anticipating more adjustments in the rate and in line with our view of four 25bps hikes each, which we see in March, June, September and December. As such, we believe Banxico will have to keep the foot on the gas, first with a 50bps adjustment in February, followed by four 25bps following the Fed and taking the reference rate to 7.00% by the end of the year.

From our fixed income and FX strategy team

Inflation supports priced-in expectations of the next rate hike. Today's CPI will support the market's perception about Banxico's restrictive stance, with the yield curve pricing-in a 50bps hike in February with 82% probability. Moreover, the market sees implied hikes of +96bps, +141bps, and +200bps for 1Q22, 2Q22, and by year-end, in the same order. In our view, this is likely to strengthen after the Fed's decision on Wednesday, with investors' attention on details about a fully priced-in 25bps hike as early as March. In this backdrop, breakevens have compressed at a fast pace since the start of the year. 3- and 5-year readings are at 4.17% (-66bps) and 4.43% (-47bps), respectively, while 10- and 30-year tenors are at 4.22% (-11bps) and 4.31% (-19bps). We see greater relative value in mid-term Udibonos and expect high volatility to continue in short- and mid-term nominal rates due to the ongoing adjustment in global monetary normalization expectations. Finally, we see attractiveness in long-term Mbonos considering that this segment has less room for further pressures given wider spreads against UST and high relative value according to our analysis of duration-adjusted yields.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, José Itzamna Espitia Hernández, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez and Gerardo Daniel Valle Trujillo, 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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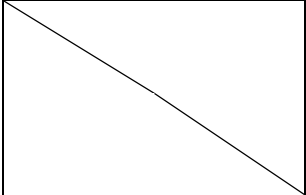
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