BANORTE

Economic Research
Mexico

Ahead of the Curve

Banxico to hike the reference rate by 50bps

February 4, 2022

www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Executive Director of Economic Research and Financial Markets Strategy
juan.alderete.macal@banorte.com

Francisco Flores
Director of Economic Research, Mexico
francisco.flores.serrano@banorte.com

Yazmín Pérez
Senior Economist, Mexico
yazmin.perez.enriquez@banorte.com

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

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

- **Banxico's monetary policy decision (February 10th).** On Thursday, Banco de México will carry out its first meeting of the year, in which we expect a 50bps hike, taking the reference rate to 6.00%. This will be a particularly interesting decision, as it will be the first one for the new Governor, Victoria Rodríguez. Our call for another hike of this magnitude is based on several factors, including: (1) An additional move higher in annual core inflation, despite a moderation in the headline; (2) a more hawkish tone from the Fed in its latest policy decision; and (3) the need to maintain a prudent stance. As such, a hawkish bias will likely prevail, even with the near certainty of a split decision happening once again.

- **Inflation (January).** We anticipate headline inflation at 0.56% m/m, recalling that the period is characterized by several seasonal factors related with start-of-the-year price adjustments and updated taxes, among others. This would have affected mainly goods at the core, On the other hand, we see more mixed dynamics at the non-core. With this, annual inflation would moderate for second month in a row, helped by a base effect and reaching 7.04% y/y (previous: 7.36%). Nevertheless, the core would accelerate to 6.18% from 5.94%, which remains concerning.

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 7-Feb		Markets closed due to the Constitution Day holiday					
Wed 9-Feb	7:00am	CPI inflation	January	% m/m	0.56	0.54	0.36
				% y/y	7.04	7.01	7.36
		Core		% m/m	0.59	0.58	0.80
				% y/y	6.18	--	5.94
Wed 9-Feb	10:00am	International reserves	Feb-4	US$ bn	--	--	201.6
Thu 10-Feb		Wage negotiations	January	%	--	--	5.5
Thu 10-Feb	2:00pm	Monetary policy decision (Banxico)	Feb-10	%	6.00	6.00	5.50
Fri 11-Feb	7:00am	Industrial production	December	% y/y	1.6	2.3	1.6
		sa		% m/m	0.5	1.0	-0.1
		Mining		% y/y	1.1	--	1.8
		Utilities		% y/y	-2.5	--	-1.7
		Construction		% y/y	2.3	--	-0.6
		Manufacturing		% y/y	1.8	1.8	2.8

Source: Banorte; Bloomberg

Proceeding in chronological order...

Core inflation likely stayed high in January. We anticipate headline inflation at 0.56% m/m (previous: 0.36%), recalling that the period is characterized by several seasonal factors related with start-of-the-year price adjustments and updated taxes, among others, as already seen in the first fortnight. In this backdrop, some trends could extend to the second half, mainly pressures at the core (centered on goods), with a more mixed dynamic at the non-core. We anticipate them at 0.59% (contribution: +44bps) and 0.48% (+12bps), respectively. With this, annual inflation would moderate for second month in a row, helped by a base effect and reaching 7.04% y/y (previous: 7.36%). The non-core would show similar dynamics, at 9.64% (previous: 11.74%). Nevertheless, the core would accelerate further, to 6.18% from 5.94%, which remains concerning.

In the latter, goods would increase more, at 0.9% (+38bps), reflecting the price increases at the start of the year mentioned above. Processed foods would contribute the most (+1.3%; +26bps), skewed by excise tax adjustments in some of them, as well as cost pressures in several categories. Other goods would be more modest (0.6%, +11bps), in part helped by the elimination of value-added taxes in female hygiene products. Services are expected to be more mixed, at 0.2% (+6bps). Although touristic categories fell because of the end of the holiday season (despite a slight uptick in the second half), 'others' would compensate and take this subdivision to 0.0% (+1bp). We estimate education up 0.6% (+2bps) on higher tuitions in high school and college. Lastly, housing would increase 0.2% (+4bps), relatively in line with its historical trend.

At the non-core, we highlight a renewed increase in LP gas during the second fortnight after a strong accumulated fall since November. Nevertheless, for the full month, it would be at -1.2%. Low-grade gasoline would have risen to 1.7%, with both goods affected by higher international prices and a modest depreciation of the MXN in the period. As a result, energy prices would stand at 0.9%. On the contrary, we see a more favorable performance in agricultural goods, especially in fruits and vegetables (-2.3%). Despite strong pressures during the first half in goods such as lemon and potatoes, our monitoring suggests a stabilization. In addition, we observed a further move down in tomatoes and relevant declines in husk tomatoes and lettuce. In contrast, meat and egg (+1.8%) should rise more due to chicken and beef.

Weekly international reserves report. Last week, net international reserves decreased by US$412 million, closing at US$201.6 billion (please refer to the following table). According to Banxico's report, this was mainly explained by a negative valuation effect in institutional assets. Year-to-date, the central bank's international reserves have fallen by US$816 million.

Banxico's foreign reserve accumulation details
US$, million

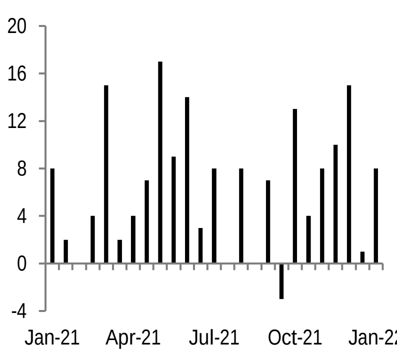
	2021	Jan 28, 2022	Jan 28, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	201,583	-412	-816
(B) Gross international reserve	207,745	209,557	-682	1,813
Pemex	--	--	0	0
Federal government	--	--	-133	3,895
Market operations	--	--	0	0
Other	--	--	-549	-2,082
(C) Short-term government's liabilities	5,346	7,974	-270	2,628

Source: Banco de México

Banxico to hike 50bps to 6.00% as the outlook for inflation remains quite challenging. On Thursday, Banco de México will carry out its first meeting of the year, in which we expect a 50bps hike, taking the reference rate to 6.00%. This is now the consensus view, with 12 out of 13 economists surveyed by *Bloomberg* (including us) believing so. This will also be a particularly interesting decision, as it will be the first one for the new Governor, Victoria Rodríguez. Our call for another hike of this magnitude is based on several factors, including: (1) An additional move higher in annual core inflation, despite a moderation in the headline (see section above); (2) a more hawkish tone from the Fed in its latest policy decision; and (3) the need to maintain a prudent stance. As such, a hawkish bias will likely prevail, even with the near certainty of a split decision happening once again.

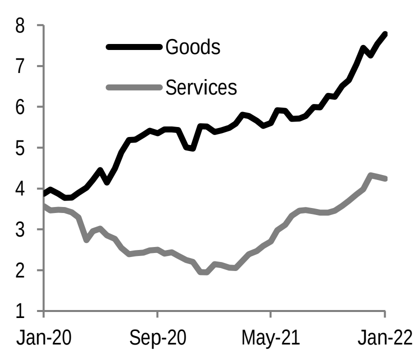
On inflation, the 1H-January was quite telling to us about prevailing dynamics, especially the upward surprise at the core. Since early 2021, only one print has been lower relative to expectations (see chart below on the left). Although mainly driven by goods –likely on cost pressures, among other factors–, services have been trending up recently (chart below, middle). In our view, this remains as the main challenge for the Board. In theory, policy actions should have more influence at the core component. Hence, these trends likely signal that more tightening is necessary, especially on potentially more supply issues because of 'Omicron'. Meanwhile, the non-core has been more benign in recent months, mostly fresh fruits and energy –LP gas– (chart below, right). On top of a more favorable base effect, this has contributed to the moderation in annual headline inflation since late November. However, we think the outlook for energy prices has turned more adverse, partly fueled by rising geopolitical tensions.

Core inflation surprises*
Basis points, bi-weekly frequency



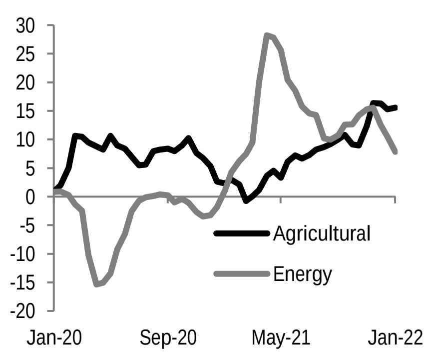
*Calculated as the difference between observed inflation and Bloomberg's median
Source: Banorte with data from INEGI, Bloomberg

Core CPI: Goods and services
% y/y, bi-weekly frequency



Source: Banorte with data from INEGI

Non-core CPI: Agricultural goods and energy
% y/y, bi-weekly frequency



Source: Banorte with data from INEGI

On inflation forecasts, the average for the headline in 4Q21 was 7.0%, lower than the 7.1% expected by the central bank. The core was in line at 5.6%. Considering this, revisions might be more modest than in previous decisions. Nevertheless, these could still be higher as we believe overall risks remain skewed to the upside. All in all, these updates, as well as the view on the balance of risks, will be important to assess the possible magnitude of rate hikes going forward.

Banxico: Inflation forecasts
% y/y, quarterly average

	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Headline	7.0*	6.7	5.1	4.3	3.5	3.3	3.2	3.1	3.0
Core	5.6	6.2	5.8	4.9	4.1	3.3	2.9	2.8	2.7

Source: Banco de México. * Observed data

The second key point in our view is the relative monetary stance. In its latest decision, the Fed showed a more hawkish stance, with the possibility of more hikes throughout the year. This was a key factor behind our forecast adjustment, now expecting five 25bps hikes. It also comes on top of speculation about the balance sheet run-off, which implies additional tightening. In addition, the hiking wave has continued in EMs. So far this year, we highlight Brazil (+150bps), Chile (+150bps), Colombia (+100bps), Peru (+50bps), Poland (+50bps), South Korea (+25bps), South Africa (+25bps) and Ukraine (+100bps), to name a few. In AEs, the BoE lifted by +25bps this week, as well as Norway and New Zealand late last year. In this backdrop, the MXN has been relatively stable since the last decision and even appreciated slightly until mid-January, albeit depreciating since and reaching an intra-day high of 20.91 on January 28th. In fixed income, we saw broad pressures in nominal- and real-rates with a flattening bias, albeit with a slight decline in the spreads to Treasuries. As such, we believe these factors still support the need to maintain a predictable hiking path.

Signals on economic activity have been negative, a situation that may bolster the doves' arguments. This is especially true after the second sequential contraction in GDP as of 4Q21. Risks have also risen at the turn of the year due to the 'Omicron' variant, among other factors. However, we believe concerns on inflation and monetary policy from abroad will have more weight on most members.

Given all of the above, we highlight comments made by some Board members. Since she assumed her role as Governor, we have not had any public comments from Victoria Rodríguez. Hence, any assessment about her policy bias is highly uncertain. Moreover, we also have not found any comments since last meeting from either Galia Borja or Irene Espinosa. In contrast, we have had some key opinions from the remaining members. Gerardo Esquivel has mainly talked about inflation in his Twitter account, stating that a high for annual inflation in this cycle was already reached in November, expecting a downward trend ahead. This is consistent with his view in the previous minutes, maintaining a more dovish bias. Meanwhile, Jonathan Heath was a distinguished guest in our podcast *Norte Económico* (available only in Spanish). For inflation in 2021, he mentioned that "*…we went from a process of rearrangement in relative prices to a generalized and sustained increase in prices, which is precisely the definition of inflation…*".

This illustrates our view that he has been increasingly uncomfortable with price dynamics, becoming one of the most hawkish members. We believe he shares our concerns about the core, stating that "*... we clearly see an upward trend in all of its components...*". He added that they (the central bank) expects it to reach a peak in late February or early March, taking a downward trend at a slow pace afterwards. On monetary policy, he stated that "*...in the short-term, we have to send a resounding message, a message that we are going through a very difficult inflationary process [...] because we have to ensure that inflation expectations, especially in the medium- and long-term, are not affected...*". In our view, he will remain as one of the main proponents of a 50bps hike in this meeting, despite also recognizing that the debate is likely to be whether to increase the rate by this magnitude or only by 25bps.

Following this decision, we expect the tightening cycle to continue. Given the latest developments, we have recalibrated our forecast, now expecting five more hikes of 25bps each in March, May, June, September, and December. This would follow adjustments in the same magnitude by the Fed. As such, the reference rate would close 2022 at 7.25%, an accumulated increase of 175bps relative to YE21.

Industry to rebound with some strength in December. We expect a 1.6% y/y increase, in line with November's print. This would happen despite a more challenging base, suggesting additional dynamism. However, it would still be below the 2.7% implied in preliminary GDP figures. There was one additional working day in the annual comparison, resulting in a 1.2% y/y expansion with seasonally adjusted figures. As a result, our forecast is more favorable than the 0.4% suggested by INEGI's *Timely Indicator of Economic Activity*. Last, but certainly not least, this translates into 0.5% m/m, quite vigorous after a modest result in the previous month.

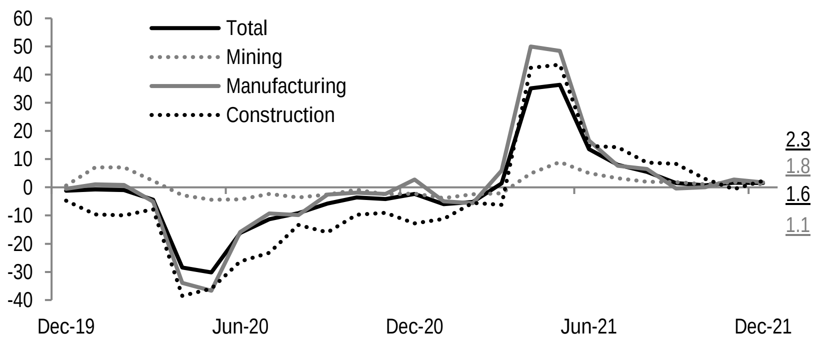
We expect a relevant acceleration in manufacturing, up 0.8% m/m (1.8% y/y). Most signals are positive, including IMEF's PMIs (despite a moderation in 'production' and 'new orders'). The trade balance showed marked strength in 'other' manufacturing exports and additional dynamism in non-oil intermediate goods imports. Nevertheless, we remain wary because of possible distortions due to higher prices. While there was a decline in auto exports, it seems to respond to a base effect, with AMIA's figures pointing to a sequential 10% m/m rise in vehicles produced (using an in-house seasonal adjustment model). On the external front, data from the US is somewhat negative at -0.3% m/m, although following a 0.6% increase in November. Lastly, according to INEGI's employment report, jobs in the sector declined by 22.2 thousand, albeit likely driven by a seasonal effect, thus not as negative as it seems.

Construction would rebound 0.6% m/m (2.3% y/y) after weakness in the past three months, with an accumulated decline of 3.6%. Both business confidence and the aggregate trend indicator improved in the past couple of months –even with an increase in the latter up to January–, so we believe that activity might catch-up to a certain degree. However, dynamism could remain limited by prevailing price pressures, with some reports pointing to a stoppage or cancelation of some works.

Meanwhile, data from federal government spending decelerated substantially to -8.3% y/y in real terms, although remembering that year-end figures tend to be skewed due to different accounting practices. In addition, employment in the sector improved substantially, rising by 268.1 thousand positions according to INEGI.

Mining would backtrack by 0.4% m/m (1.1% y/y) after recent gains. The drag would mainly come from the oil sector, as suggested by output figures. According to CNH, crude oil production inched lower to 1,650kbpd (previous: 1,653kbpd), while natural gas was even lower. On the contrary, the non-oil sector might be stronger, as suggested by higher prices and a mild rebound of exports, albeit not enough to compensate for overall weakness.

Industrial production
% y/y nsa



Source: INEGI, Banorte

Analyst Certification

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 Luis García Casales, Yazmín Selene Pérez Enríquez, José Itzamna Espitia Hernández, Carlos Hernández García, Paola Soto Leal, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Daniela Olea Suárez, 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

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			
Alejandro Padilla Santana	Chief Economist and Head of Research	alejandro.padilla@banorte.com	(55) 1103 - 4043
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research			
Juan Carlos Alderete Macal, CFA	Executive Director of Economic Research and Financial Markets Strategy	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Director of Economic Research, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Director of Economic Research, Global	katia.goya@banorte.com	(55) 1670 - 1821
Yazmín Selene Pérez Enríquez	Senior Economist, Mexico	yazmin.perez.enriquez@banorte.com	(55) 5268 - 1694
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			
Leslie Thalía Orozco Vélez	Senior 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
Carlos Hernández García	Senior Strategist, Equity	carlos.hernandez.garcia@banorte.com	(55) 1670 – 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Paola Soto Leal	Analyst	paola.soto.leal@banorte.com	(55) 1103 - 4000 x 2755
Corporate Debt			
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
Quantitative Analysis			
Alejandro Cervantes Llamas	Executive Director of Quantitative Analysis	alejandro.cervantes@banorte.com	(55) 1670 - 2972
José Luis García Casales	Director of Quantitative Analysis	jose.garcia.casales@banorte.com	(55) 8510 - 4608
Daniela Olea Suárez	Senior Analyst, Quantitative Analysis	daniela.olea.suarez@banorte.com	55) 1103 - 4000
Miguel Alejandro Calvo Domínguez	Senior Analyst, Quantitative Analysis	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5004 - 1282
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 5140
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8173 - 9127
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) 5249 - 6423
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Osvaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5004 - 1051
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) 1670 - 1899