1H-January inflation – Pressures at the start of the year boost annual metrics

- **Headline inflation (1H-Jan): 0.46% 2w/2w; Banorte: 0.39%; consensus: 0.39% (range: 0.24% to 0.48%); previous: 0.10%**
- **Core inflation (1H-Jan): 0.44% 2w/2w; Banorte: 0.34%; consensus: 0.32% (range: 0.24% to 0.38%); previous: 0.19%**
- **The period's dynamics are impacted by an adverse seasonality, with typical turn-of-the-year adjustments in several categories and taxes. Within the core, pressures are still centered in processed foods (0.7%) and other goods (0.3%). However, education (0.3%) and housing (0.3%) were also impacted in services. At the non-core (0.51%), energy rose (0.6%), boosted by electricity (0.9%) and low-grade gasoline (0.6%)**
- **In bi-weekly frequency, annual inflation adjusted to 7.94% from 7.86%. The core accelerated at the margin, standing at 8.45% from 8.34%, without a clear trend change yet**
- **Banxico will extend its tightening cycle, albeit likely reducing the pace once again**
- **Markets expect the end of the restrictive cycle in 1Q23**

Inflation at 0.46% 2w/2w, with an adverse seasonality. Many of the pressures come from typical adjustments conducted early in the year in prices and taxes. As such, the expansion within the core (0.44%) centered in processed foods (0.7%) –impacted by higher excise taxes on sugary drinks and cigarettes– and, to a lesser extent, in 'other goods' (0.3%) –helped by winter discounts in clothing. In services (0.3%), we note the uptick in education (0.3%), albeit with housing also surprising to the upside (0.3%). In 'other services' (0.3%) performance was mixed, with declines in tourism services. However, other categories such as 'dining away from home' also adjust at the turn of the year, not ruling out an additional boost from the minimum wage hike. At the non-core (0.51%), energy rose 0.6%, driven by electricity (0.9%) –with tariff adjustments from CFE– and low-grade gasoline (0.6%) –with global benchmarks and excise taxes higher. In agricultural items (0.4%), both fruits and vegetables (0.4%), and meat & egg (0.3%) advanced. Finally, government tariffs rose 0.9%, remembering that several of them are linked to accumulated inflation in the previous year.

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
Dining away from home	5.0	1.0
Low-grade gasoline	3.2	0.6
Cigarettes	2.9	3.1
Sodas	2.3	1.0
Bananas	2.1	8.5
Goods and services with the largest negative contribution		
Airfares	-4.0	-17.7
Packaged tourism services	-2.6	-7.8
Onions	-1.2	-5.8
Cellphone service	-0.8	-0.8
Serrano chilies	-0.8	-3.7

Source: INEGI

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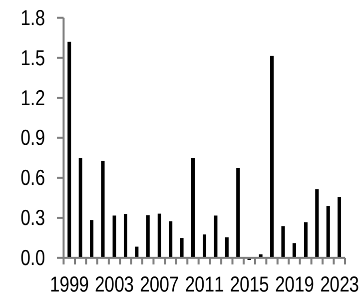
Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Headline inflation in 1H-Janaury
% 2w/2w



Source: INEGI

An uptick in annual inflation… Headline inflation reached 7.94% from 7.86% in the previous fortnight, showing some stability since the beginning of December and leaving further behind a cycle-high of 8.77% in the second half of August. The core accelerated at the margin, to 8.45% from 8.34%, still not consolidating a clear downward trend. We believe the backdrop keeps favoring a gradual path lower for both components, albeit at different speeds. This would be explained by a more substantial moderation in the non-core, based on two main factors: (1) A more favorable outlook for fertilizers, helping agricultural items; and (2) more positive dynamics for energy. Nevertheless, risks for the latter have increased due to a more vigorous reopening in China that has boosted international oil prices in the last few weeks. A factor that has helped to offset for this is currency strength, with USD/MXN below 19.00 since January 11th. This could also have a positive spillover at the core through the price of imported goods. Meanwhile, we believe it is still soon to evaluate the potential effect to 'other services' from the minimum wage hike. Nevertheless, it may well impact costs meaningfully. Given this diversity of factors, we believe the balance of risks to our 4.8% estimate by year-end is balanced, albeit still warranting caution ahead.

…favoring additional tightening from Banxico. Given an inflation outlook that remains complex and the view that the Fed will extend its hiking cycle –anticipating +25bps in next week's decision–, it is our take that Banxico will keep increasing the reference rate. Specifically, we expect two more hikes of 25bps each, materializing in the meetings to be held on February and March, reaching a terminal rate of 11.00% by the end of 1Q23.

From our fixed income and FX strategy team

Markets expect the end of the restrictive cycle in 1Q23. The market keeps expecting that Banxico will conclude its hiking cycle in 1Q23. Nevertheless, inflation dynamics remain challenging, as evidenced by today's surprise. The TIIE-IRS curve has flattened in January, with few changes at the short-end and a 46bps rally at the long-end. With this, the curve is pricing-in two consecutive 25bps hikes, in February and March, to reach a terminal rate of 11.00%, in line with our call. Meanwhile, breakevens have declined slightly and they are below their 12-month averages except for short-term tenors. This was driven by Mbonos (-40bps) outperforming Udibonos (-6bps). It is worth noting that we do not see enough attractiveness in Udibonos yet, even after this correction.

Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal and Daniel Sebastián Sosa Aguilar, 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.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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