January inflation – Mixed performance, albeit with the core still pressured

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- **Headline inflation (January): 0.59% m/m; Banorte: 0.56%; consensus: 0.54% (range: 0.48% to 0.58%); previous: 0.36%**
- **Core inflation (January): 0.62% m/m; Banorte: 0.59%; consensus: 0.58% (range: 0.52% to 0.61%); previous: 0.80%**
- **Differences between the core and non-core components remained. In the former, goods (1.0%) were still elevated on tax adjustments and cost pressures. Services (0.2%) were relatively high despite benign seasonal trends in tourism-related categories. The latter was more mixed. Agricultural goods rose 0.1%, albeit with fruits and vegetables lower (-2.2%). In contrast, energy (0.8%) was affected at the margin by low-grade gasoline and a reversal higher in LP gas in the second fortnight**
- **Annual headline inflation moved slightly lower, at 7.07% from 7.36% on average in December. Nevertheless, the core stood at a 20-year high of 6.21% from 5.94%, in the same order**
- **We expect Banxico to hike the reference rate by 50bps this week, in line with consensus. A difficult inflation backdrop and signals of a faster normalization globally suggest the need of continuing the hiking cycle**
- **The market also expects a 50bps rate hike tomorrow**

Inflation at 0.59% m/m in January. This was higher than consensus (0.54%) but slightly closer to our 0.56%. Yearly tax adjustments and seasonal factors help explain part of the results, although the report shows remaining challenges, especially at the core. In this sense, goods (1.0%) remain pressured, especially processed foods (1.3%), while ‘others’ advanced 0.6%. Services (0.2%) were benefited by lower airfares (-39.0%) and tourism services (-16.3%). Nevertheless, those excluding housing and education are still high. The non-core was more mixed. Positively, fruits and vegetables were lower (-2.2%) despite high volatility in key items. In contrast, meat and egg (2.2%) was mainly affected by chicken and beef. In energy (0.8%), renewed pressures were seen in the second half in LP gas –although after declining in the first half– and gasoline, with these goods reacting to the increase in international benchmarks.

January inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.59	0.56	0.03
Core	0.46	0.44	0.02
Goods	0.39	0.38	0.02
Processed foods	0.27	0.26	0.01
Other goods	0.12	0.11	0.01
Services	0.06	0.06	0.00
Housing	0.04	0.04	0.00
Education	0.02	0.02	0.00
Other services	0.01	0.01	0.00
Non-core	0.13	0.12	0.01
Agriculture	0.02	-0.01	0.03
Fruits & vegetables	-0.12	-0.12	0.00
Meat & egg	0.13	0.11	0.02
Energy & government tariffs	0.12	0.13	-0.02
Energy	0.08	0.09	-0.01
Government tariffs	0.04	0.05	-0.01

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

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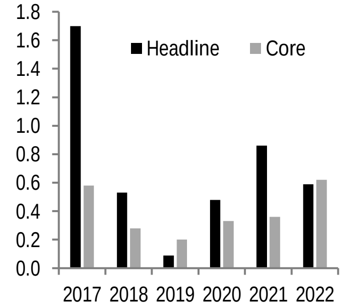
STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Headline and core inflation in January
% m/m



Source: INEGI

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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
Lemons	11.3	68.8
Low-grade gasoline	8.3	1.7
Dining away from home	7.7	1.6
Chicken	7.4	4.4
Potatoes	4.8	15.5
Goods and services with the largest negative contribution		
Tomatoes	-25.6	-32.7
Airfares	-10.8	-39.0
Tourism services	-5.9	-16.3
Husk tomatoes	-5.1	-26.4
Serrano chilies	-3.4	-26.8

Source: INEGI

Annual inflation stays elevated, with concerns centered around the core. Headline inflation reached 7.07% y/y from 7.36% on average in December, its second month in a row lower, helped in part by base effects. The core increased further, to 6.21% from 5.94%. This is the highest since September 2001 and in our view still a cause for concern. Our forecasts imply another increase in February followed by a gradual decline, albeit remaining above 6% until mid-May. In the short-term, we will keep looking closely at: (1) Energy prices, with oil trending up since mid-December; (2) FX dynamics, with risks of renewed dollar strength on a more hawkish Fed; (3) signals of additional pass-through, especially at core services ex. housing, education, and tourism-related categories; and (4) potential demand- and supply-side effects from the rise of Omicron cases.

Banxico to hike 50bps again. Given the most recent inflation prints, the shift towards a more hawkish stance by the Fed and most global central banks, and the need to maintain a prudent stance, we expect Banxico to hike the reference rate by 50bps on Thursday, to 6.00%. This is in line with analysts' consensus. Nevertheless, it is likely that the decision will not be unanimous, with heightened concerns about the cyclical position of the economy and only modest revisions to inflation forecasts. We will look closely at potential changes in the statement, the balance of risks and guidance, especially as it is the first decision of new Governor Victoria Rodríguez. For further details, see our document, *Ahead of the Curve*.

From our fixed income and FX strategy team

The market also expects a 50bps rate hike tomorrow. High inflation prints keep supporting market expectations of a more hawkish stance by Banxico this year. In this sense, the market is fully discounting a 50bps rate hike tomorrow, in line with our call. Specifically, the short-end has priced-in cumulative hikes of +83bps, +170bps, and +201bps for 1Q22, 2Q22, and year-end, in the same order. Regarding real rates, the Udibonos' curve has shown a flattening bias this year. Short-term securities have sold off +90bps, while long-term ones have depreciated +38bps on average. Given this dynamic and less abrupt movements in nominal rates, breakevens have compressed at a faster pace on the short-end. For example, the 3-year tenor stands at 3.96%, an 8-month low after falling 87bps YTD. Amid a still complex inflationary backdrop –at least in the short term–, we maintain our recommendation of paying 2-year TIIE-IRS (26x1) with a target of 8.10% and stop-loss at 7.15%. Moreover, we think short-term Udibonos are more attractive relative to other maturities and have the highest value for trading positions.

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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 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.

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