# December CPI – Headline inflation closes the year at 7.82%, helped by the non-core

January 9, 2023

- **Headline inflation (December): 0.38% m/m; Banorte: 0.42%; consensus: 0.39% (range: 0.33% to 0.47%); previous: 0.58%**
- **Core inflation (December): 0.65% m/m; Banorte: 0.68%; consensus: 0.65% (range: 0.61% to 0.69%); previous: 0.45%**
- **The print is affected by several seasonal trends. In the core, 'other goods' (0.6%) rebound after discounts in *El Buen Fin*, with 'other services' (0.8%) impacted by increases in tourism. In addition, pressures persisted in processed foods (0.9%). In the non-core, energy (-1.7%) remained to the downside, especially LP gas (-4.9%). Finally, agricultural items advanced 0.5%, driven by fruits and vegetables (1.2%)**
- **As such, annual inflation closed the year at 7.82% from 7.80% in the previous month. Meanwhile, the core showed its first moderation after 24 months increasing, standing at 8.35% from 8.51%**
- **Considering recent dynamics in energy –and despite a still challenging outlook for the core–, we revise out 2023 year-end estimate to 4.8% (previous: 5.4%)**
- **Breakevens have decreased slightly on inflation downward surprises**

**Inflation at 0.38% m/m, with adverse seasonality at the core.** This last category came in at 0.65%, still above its medium- and long-term averages. A part is explained by the payback from *El Buen Fin* discounts, particularly impacting 'other goods' (0.6%), but to a lesser extent also on 'other services' (0.8%). We note that the latter were also driven by increases in tourism-related categories, such as intercity buses (2.5%) and tourism packages (5.7%). Meanwhile, processed foods remained pressured (0.9%), likely impacted by price adjustments announced by some large producers in the month (*e.g.* FEMSA and Bimbo). The non-core fell 0.40%, helped by a energy (-1.7%). Inside we highlight LP gas (-4.9%) and low-grade gasoline (-1.1%). Within agricultural items (0.5%), the expansion centered in fruits and vegetables (1.2%), noting advances in goods such as serrano chilies and tomatoes. Meat and egg were more modest (-0.1%) despite adverse news for chicken by the end of the period because of the bird flu.

December 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 |
|---|---|---|
| Serrano chilies | 6.1 | 39.7 |
| Dining away from home | 3.8 | 0.8 |
| Sodas | 3.1 | 1.4 |
| Tomatoes | 2.8 | 3.9 |
| Housing | 2.8 | 0.3 |
| **Goods and services with the largest negative contribution** | | |
| LP gas | -9.1 | -4.9 |
| Low grade gasoline | -5.3 | -1.1 |
| Onions | -4.9 | -18.3 |
| Chicken | -2.2 | -1.3 |
| Natural gas | -2.1 | -8.6 |

Source: INEGI

www.banorte.com
@analisis_fundam

Alejandro Padilla
Chief Economist and Head of Research
alejandro.padilla@banorte.com

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

Cintia Nava
Senior Economist, Mexico
cintia.nava.roa@banorte.com

Fixed income and FX Strategy

Manuel Jiménez
Director of Market Strategy
manuel.jimenez@banorte.com

Leslie Orozco
Senior Strategist, Fixed Income and FX
leslie.orozco.velez@banorte.com

Isaías Rodríguez
Strategist, Fixed Income and FX
isaias.rodriguez.sobrino@banorte.com

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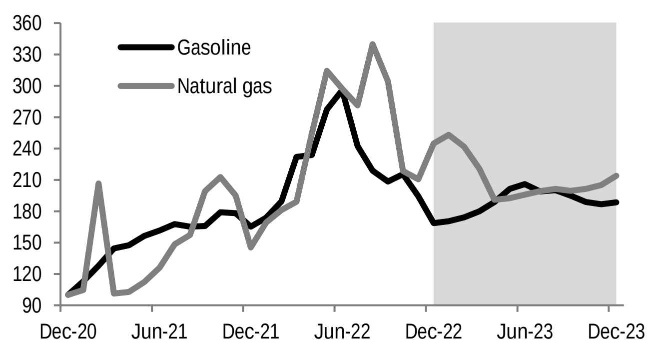
**Annual inflation closes 2022 at 7.82%.** Despite representing an acceleration relative to the previous month (7.80%), it was mostly explained by a more challenging base effect. As such, we believe the path for inflation going forward will be to the downside. Meanwhile, the core fell for the first time in 24 months, moderating to 8.35% from 8.51% in the previous period. Inside, goods keep concentrating most of the advance (11.1%), albeit with services also high (5.2%). In the non-core, despite increasing to 6.27% (vs. 5.73% in November), energy has been the main driver of the moderation in the last couple of months, standing at 2.9%. Moreover, agricultural items (9.5%) have been modest than we had originally thought.

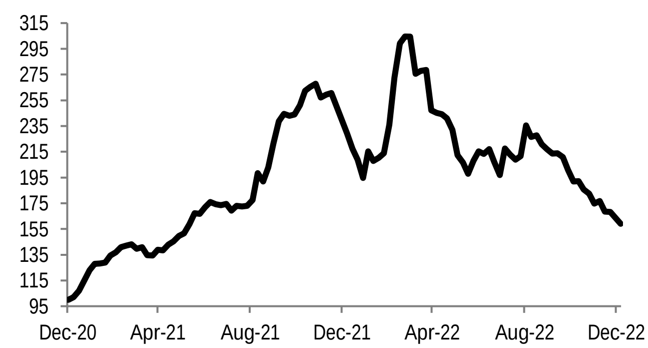
**Considering recent dynamics, we revise our 2023 year-end forecast to 4.8% from 5.4%.** The improvement is mainly explained by two factors: (1) A better outlook for energy –both LP gas and gasolines; and (2) the expectation of more modest increases in agricultural goods. Regarding the first point, much of the recent performance is due to a more modest winter in Europe, a situation which has allowed an adequate management of hydrocarbons' inventories despite the extension of the war in Ukraine. This could set the stage for a tighter behavior in international references in coming months, as shown in several futures curves and forecasts from international agencies (see chart below, left). Global recession fears could help dampen some price pressures, albeit with China's reopening and eventual responses from OPEC and allies as potential offsets to this. On the latter, our expectation is based on the recent behavior of fertilizer prices (chart below, right), which we expect to translate into larger supply –and a lower price of said goods. In addition, the recent announcement of an extension and wider scope of the measures related to international trade as part of the *Plan Against Inflation* could also help in this front.

Price estimates for gasoline (PADD 3) and natural gas (Henry Hub)
Index 100 = Dec-31-2020




Source: Banorte with data from EIA

North America fertilizer price index
Index 100 = Dec-31-2020



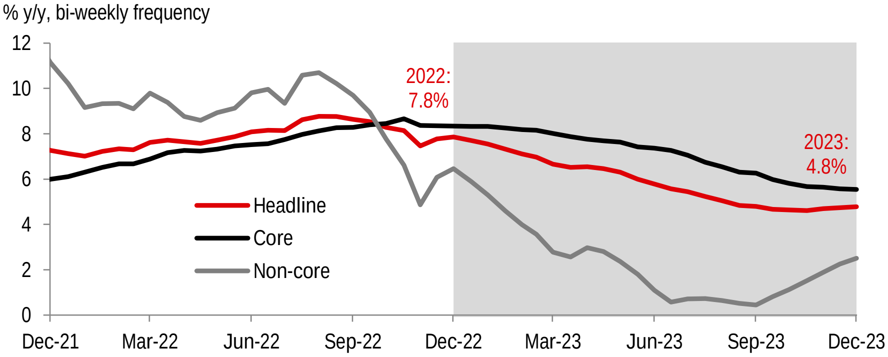

Source: Banorte with data from Bloomberg, Green Markets

On the other hand, risks persist, particularly for the core. As such, our estimate for this component stands at 5.6% (previous: 5.7%). We believe pressures could continue, stemming from: (1) The [20% increase to the minimum wage](); (2) the possibility of higher resiliency in economic activity; and (3) heftier price increases in tourism given changes on labor laws. Specifically, the former could have a larger impact than in the previous year considering accumulated progress as well as prevailing cost pressures. Regarding the second, signs for economic activity have been more favorable than we originally anticipated, likely resulting in a tighter output gap.

On the third point, changes to the Federal Labor Law incorporate more vacation days for workers. If this induces larger demand for vacations and/or a further rise in companies' costs, prices could be adjusted upwards. On the other hand, some mitigating factors exist that could partly offset for the latter, mainly related to lower costs in other categories. Among them, we highlight our view for both energy and agricultural items, which could have a positive spillover in processed foods and 'dining away from home'. Meanwhile, an additional normalization in supply chains –given the end of the zero-COVID policy in China– and the expectation of global lower prices could help this component, especially given lower transportation and logistics costs, to mention a few.

In general, we expect positive effects to be larger, helped by restrictive monetary policy –both globally and locally. However, given lagged effects, a stronger deceleration could happen in the second half of the year –also considering a more challenging base–, as seen in the following chart.

Inflation forecasts
% y/y, bi-weekly frequency




Source: Banorte with data from INEGI

*From our fixed income and FX strategy team*

**Breakevens have decreased slightly on inflation downward surprises.** Local fixed income began the year with a rally in long-term securities. Both the Mbonos and TIIE-IRS curves registered a flattening bias, with gains of around 40bps at the long-end and few changes at the short-end. In a similar fashion, CPI-linked bonds (Udibonos) recorded average gains of 16bps. Hence, breakevens have declined for all maturities except for the 3-year, standing below their 12-month averages. It is worth noting that we still do not see enough value in Udibonos despite the compression in breakevens. On monetary policy, the market is pricing-in that Banxico will raise the benchmark rate for the last time in February to 11.00%, equivalent to a 50bps hike, in line with our call. In this way, the restrictive cycle that started in June 2021 will conclude from a reference rate of 4.00% to unprecedent levels (+700bps).

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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 |
| María Fernanda Vargas Santoyo | Analyst | maria.vargas.santoyo@banorte.com | (55) 1103 - 4000 |
| **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 |
| Cintia Gisela Nava Roa | Senior Economist, Mexico | cintia.nava.roa@banorte.com | (55) 1103 - 4000 |
| Luis Leopoldo López Salinas | Manager Global Economist | 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 |
| Isaías Rodríguez Sobrino | Strategist, Fixed Income, FX and Commodities | isaias.rodriguez.sobrino@banorte.com | (55) 1670 - 2144 |
| **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 1746 |
| **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 |
| José De Jesús Ramírez Martínez | Senior Analyst, Quantitative Analysis | jose.ramirez.martinez@banorte.com | (55) 1103 - 4000 |
| Daniel Sebastián Sosa Aguilar | Analyst, Quantitative Analysis | daniel.sosa@banorte.com | (55) 1103 - 4000 |
| **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 |