January inflation – Pressures at the start of the year keep annual rates high

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- **Headline inflation (January): 0.68% m/m; Banorte: 0.70%; consensus: 0.67% (range: 0.53% to 0.70%); previous: 0.38%**
- **Core inflation (January): 0.71% m/m; Banorte: 0.77%; consensus: 0.70% (range: 0.61% to 0.77%); previous: 0.65%**
- **The month has a negative seasonality due to adjustments in several categories at the start of the year. Among the most-impacted categories at the core, we note processed foods (1.2%), although with services also high (0.5%), noting sizable adjustments in housing and education. At the non-core, energy grew (0.4%) –despite domestic gas moving lower, while agricultural items picked up (0.5%), with pressures in meat and egg (0.6%)**
- **Annual inflation climbed to 7.91% from 7.82%, adding two months higher. Similarly, the core rose to 8.45% from 8.35%**
- **Considering last week's 25bps hike by the Fed and a still difficult inflation backdrop, we expect Banxico to hike its reference rate to 10.75% (+25bps) today**
- **Markets recognize that the reference rate will stay high for longer**

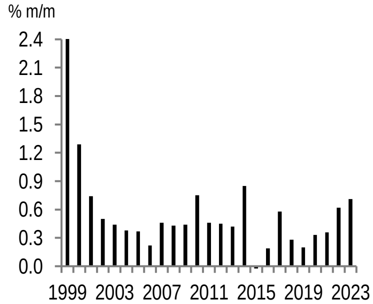
Inflation at 0.68% m/m, impacted by an adverse seasonality. The core came in at 0.71%, both above their five-year averages. Many of the adjustments were already seen in the 1st half, mainly those related to usual price adjustments at the start of the year and updates on taxes. Nevertheless, we believe a lag prevailed for some products, affected by inventory management and other issues, extending their impact. As such, processed foods increased 1.2%, noting higher prices in key categories such as sodas and cigarettes. In 'other goods' (0.5%), the impact was more modest on the back of seasonal discounts on clothing. In services (0.5%), housing surprised higher at 0.5%, while education (0.5%) adjusted due to college tuitions. At the non-core (0.57%), energy (0.4%) was skewed to the upside, boosted by electricity (0.9%) and low-grade gasoline (0.9%), albeit with natural (-3.1%) and LP gas (-1.3%) on the downside. In agricultural (0.5%), fruits and vegetables were more contained at 0.4% –noting the beginning of a favorable seasonality for tomatoes, with meat and egg at 0.6%, impacted by chicken.

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
Dining away from home	7.8	1.6
Cigarettes	4.4	4.8
Low-grade gasoline	4.3	0.9
Bananas	4.1	17.2
Soda	3.6	1.6
Goods and services with the largest negative contribution		
Air fares	-6.1	-24.5
Tourism services	-3.9	-11.1
Serrano chilies	-2.9	-13.5
LP gas	-2.3	-1.3
Onions	-2.2	-10.1

Source: INEGI

Core inflation in January
% m/m



Source: INEGI

Second consecutive increase in annual headline inflation. Headline inflation went from 7.82% y/y to 7.91%, its second rise in a row after moderating to 7.80% in November. Meanwhile, the core increased from 8.35% to 8.45%. As a result, the outlook seems more complicated at the margin, with the latter component maintaining its stickiness to the downside. This is more evident when looking at the recent trend in services, which adds up to the pressures already seen in goods. Specifically, we highlight housing –accelerating to 3.4% y/y, highest since 2009– and other items within 'other services', such as professional and healthcare. In this sense, we remain cautious about the potential effects from the minimum wage hike –along with the lighthouse effect to the rest of wages– to businesses' cost structures and if this leads to higher consumer prices. On the other hand, risks for the non-core seem to have moderated, at least in some *commodities.* Despite news of a faster Chinese reopening, prices of some energy goods –mainly crude oil– have been stable relatively to the levels seen in December, which should help annual rates to start moderating from February –as at the end of said month, the war in Ukraine started–, but specially in March. The MXN has stayed below 19.00 per dollar since January 11th –except for February 6th–, contributing to an additional slowdown. Broadly speaking, we believe that the environment remains uncertain, but it is our take that the balance of risks to our call of 4.8% by year-end is still balanced.

Banxico to hike 25bps today. Despite a complex inflation scenario, we believe the central bank will reduce its hiking pace for a second consecutive time. Hence, Banxico would not decouple from the Fed just yet. Nevertheless, financial market dynamics and accumulated rate hikes in this restrictive cycle would also influence in the decision. Specifically, we expect +25bps to 10.75% today, followed by another increase of the same magnitude in March to reach 11.00% by the end of 1Q23, with the latter level estimated as the terminal rate of this cycle.

From our fixed income and FX strategy team

Markets recognize that the reference rate will stay high for longer. February started with higher financial market volatility. Sovereign bonds have been influenced by Treasuries, in turn affected by the view of a higher terminal rate in the US. In this backdrop, short-term rates have increased by 16pbs, while long-term tenors have seen few changes. Hence, both Mbonos and TIIE-IRS yield curves have deepened their inversion. Market expectations have remained anchored to a terminal rate of 11.00%, equivalent to a 25bps hike today and another of the same magnitude in March. Nevertheless, the market has recognized that the benchmark rate will stay high for longer, diluting bets of easing from the beginning of 2H23 towards 4Q23. Currently, the curve is pricing-in cuts of -105bps from -136bps at the end of January, and -180bps at the beginning of the year. The latter is closer to our call of two consecutive cuts of 50bps each, in November and December. This suggests increasingly attractive value in short-term instruments. Although we still do not recommend directional positions, we reaffirm our preference for nominal vs real rates, especially if inflation surprises positively going forward.

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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, Daniel Sebastián Sosa Aguilar and Andrea Muñoz Sánchez, 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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