November's inflation below consensus, favoring the extension of the easing cycle

- **Headline inflation (Nov): 0.81% m/m; Banorte: 0.85%; consensus: 0.82% (range: 0.79% - 0.91%); previous: 0.54%**
- **Core inflation (Nov): 0.22% m/m; Banorte: 0.23%; consensus: 0.23% (range: 0.19% - 0.26%); previous: 0.25%**
- **The seasonally high print was driven by the reversal in subsidies to electricity tariffs in some states (23.3% m/m, contributing 40bps). We also observed some pressures in agricultural goods (+19bps) and other services (10bps)**
- **With these, annual headline inflation reached 2.97%, 5bps below October's print. Core inflation stood at 3.65% (previous: 3.68%), lowest since March but still above target. Non-core inflation fell again after climbing in the previous month, coming in at 0.98% from 1.01% previously**
- **In our view, these dynamics should help Banxico to continue easing monetary policy this month and into 2020, despite some lingering risks**
- **Today's report is contributing to the expectations of a rate cut on December 19th**

Consumer prices increase 0.81% m/m in November. This figure was lower than both consensus (0.82%) and our 0.85% estimate. Core inflation rose 0.22%. The main deviation came from: (1) A lower than expected contribution in other goods (0bps vs our +3bps), driven in large part by larger than expected discounts during *El Buen Fin* (Mexico's version of Black Friday); (2) lesser pressures in fresh fruits and vegetables (+13bps vs our +15bps); (3) a more modest impact in meat and egg (6bps vs. our 8bps), as shown below.

November inflation by components
% monthly incidence

	INEGI	Banorte	Difference
Total	0.81	0.85	-0.05
Core	0.17	0.17	-0.01
Goods	0.05	0.06	-0.02
Processed foods	0.05	0.04	0.01
Other goods	0.00	0.03	-0.03
Services	0.12	0.11	0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.08	0.01
Non-core	0.64	0.68	-0.04
Agriculture	0.19	0.23	-0.04
Fruits & vegetables	0.13	0.15	-0.02
Meat & egg	0.06	0.08	-0.03
Energy & government tariffs	0.45	0.45	0.00
Energy	0.43	0.43	0.01
Government tariffs	0.02	0.00	0.01

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

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Pressures in some components within non-core inflation extend further. As already known, the highest contribution came from the reversal of electricity tariffs' subsidies in some states (23.3% m/m, contributing 40bps). Apart from this and extending the move observed in the previous bi-weekly print, we also highlight pressures in some energy and agricultural goods within the non-core component. Regarding the former, LP gas picked up 2.0% m/m, now adding three consecutive months of increases. Low-grade gasoline stayed contained despite an upward adjustment in both the MXN and the reference price in the US, along a slight decrease in the tax subsidy.

More importantly, agricultural goods picked up 1.8% m/m, (19bps contribution), with additional pressures also suggested by our monitoring. Among the products with the highest impact were tomatoes (17.9% m/m), eggs (6.5%), husk tomatoes (25.5%), nopal cactus (31.1%). It should be mentioned that the US International Trade Commission (USITC) informed on November 22nd that they voted unanimously that US industry is indeed threatened by imports of fresh tomatoes from Mexico. Given that a suspension agreement, signed in September, is in place –which suspended tariffs of 17.5% to imports of this good in exchange of tougher measures to detect and stop anti-dumping practices–, no new tariffs will be unveiled as long it stands and complied with. Nevertheless, they could be re-imposed immediately if this were not the case. Moreover, the report with the views of the USITC will be released on December 30th. On the contrary, these increases were partially offset by avocadoes (-11.9%), lemon (-14.3%), and oranges (-8.7%), among others.

On the other hand, the core component grew 0.22%, resulting in a 17bps contribution. Goods were up 0.1%, driven by the +0.2% increase in processed foods, while other goods remained unchanged. In particular, the latter seem to have benefited from discounts during *El Buen Fin*, considering that during the second half of the month these fell 0.3% 2w/2w. This contrasted with our expectation of a more muted impact, given that one day of the discount period was observed during the first half of the month. Going to services, housing maintained a moderate advance, growing 0.2%. Meanwhile, other services continue to be pressured, increasing 0.6% with a total contribution of 9bps.

Banxico to continue easing monetary policy in a prudent manner. Headline inflation stood at 2.97% yoy, 5bps below the level observed at the end of the previous month. This was coupled with a slight decline in the core component, at 3.65% from 3.68%, while non-core inflation decreased to 0.98 from 1.01%. with the latter slowing down after an uptick in October. In our view, these dynamics are still favorable enough for Banxico to keep easing monetary policy prudently. In this respect, we believe Board members remain very attentive to the upcoming decision on the minimum wage increase, which should be announced anytime now, given that it was ranked as the second most important risk to the upside for prices in recent communications. Other services, which is arguably the most sensitive component to wage adjustments, reached 4.16% from 3.91% in the previous month, in our view still high considering the stability of the exchange rate and the widening of the output gap, among other factors.

Despite this increase, the broad direction observed in recent months has been to the downside, declining from as high as 4.98% at the end of April. We believe this backdrop, coupled with the weak economy (likely to have extended at least into 4Q19), is consistent with gradual easing by the central bank.

From our fixed income and FX strategy team

Today's report is contributing to the expectations of a rate cut on December 19th. Market participants are betting on a 25bps rate cut from Banxico on December 19th (its last policy meeting of 2019), most likely decoupling from the Federal Reserve, and taking into account some idiosyncratic factors that require loose monetary conditions. Within this context, today's CPI report for November came in slightly better than expected, with an annual reading breaching Banxico's target to 2.97% for the first time since September 2016. This backdrop, in tandem with lower inflation expectations (*e.g.* breakevens trading 35bps lower with respect to 12-month means), is supporting some of the more dovish arguments within board members. However, it is worth mentioning that most of the gains in headline inflation throughout the year came from the non-core component, while core inflation has been consistently hovering around 3.71% (the average of the year) with a mild recovery from 3.85% in June to 3.65% currently. As a result, the yield curve is pricing in gradual 25bps rate cuts in coming months, totaling -127bps until 2020-end. In the afertmath of today's report, local rates are trading 6bps lower with respect to Friday's close. The positive performance of U.S. Treasuries this morning has also fueled the current rally in Mexican bonds. In terms of strategy, we wait for better entry levels and market conditions for new directional recommendations, stressing out a more attractive valuation in the long-end of the Mbonos curve.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato, Eridani Ruibal Ortega and Leslie Thalía Orozco Vélez, 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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	Reference
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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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