Inflation during February's first half driven by higher automobile prices

February 23, 2017

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Alejandro Padilla
Director de Estrategia
Renta Fija y Tipo de Cambio
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
FX Strategist
juan.alderete.macal@banorte.com

Santiago Leal
Analyst Fixed Income and FX
santiago.leal@banorte.com

- ***INEGI* just published its inflation report for the first half of February**
- **Headline inflation (1H-Feb): 0.33%2w/2w (Banorte-Ixe: 0.13% 2w/2w; consensus: 0.30% 2w/2w)**
- **Core inflation (1H-Feb): 0.46%2w/2w (Banorte-Ixe: 0.24% 2w/2w; consensus: 0.28%2w/2w)**
- **Inflation in the first half of February was explained by pressures on other goods prices along with increases in processed foods prices**
- **With these numbers, annual inflation stands at 4.71% vs. 4.66% in December**
- **We expect year-end inflation at 5.7%**
- **Local assets depicted a strong momentum despite a higher than expected inflation print**

Consumer prices increased 0.33% 2w/2w in January (Banorte-Ixe: 0.13% 2w/2w). In addition, core inflation was 0.46% vs. our 0.24% estimate (consensus: 0.28% 2w/2w). The main deviation from our forecast comes from: (1) A higher than expected contribution of processed foods (15.6bp vs our 5bp); (2) an underestimation of other goods prices (8.1bp vs our 4bp); and (3) a higher than expected contribution of energy prices (3.6bp vs our 5.4bp), as shown in the table below.

1H-February inflation by major subcomponent
Bi-weekly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.33	0.13	0.21
Core	0.34	0.17	0.17
Goods	0.24	0.09	0.15
Processed foods	0.08	0.04	0.04
Other goods	0.16	0.05	0.11
Services	0.11	0.08	0.02
Housing	0.03	0.02	0.01
Education	0.01	0.01	0.00
Other services	0.07	0.06	0.01
Non-core	-0.01	-0.05	0.04
Agricultural	-0.08	-0.08	0.00
Fresh fruits and vegetables	-0.08	-0.09	0.01
Meat and egg	0.00	0.01	-0.01
Energy and government regulated	0.07	0.03	0.04
Energy	0.04	0.02	0.03
Government regulated	0.03	0.02	0.01

Source: INEGI, Banorte-Ixe
Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

Inflation in the first half of February was explained by pressures on other goods prices along with increases in processed foods prices. According to *INEGI*, among the items with the most change in prices were other goods (0.84% 2w/2w), mainly due to the 1.09% 2w/2w increase in automobile prices. Moreover, another sub-index with substantial changes was processed foods (0.51% 2w/2w), mainly driven by increases in pastries (2.63% 2w/2w) and other prepared foods (1.51% 2w/2w).

On the other hand, the biggest decreases were seen in the fresh fruits and vegetables prices, which declined 2.36% 2w/2w, driven by lower prices of tomatoes (-15.59% 2w/2w) and onions (-13.43% 2w/2w) among others.

With these numbers, annual inflation stands at 4.71% vs. 4.66% in December. Moreover, core inflation in January increased from 3.95% last month to 4.20%. Looking ahead, we consider that inflation will be impacted by: (1) The increase and liberalization of gasoline prices; and (2) second round effects stemming from the higher pass-through effect of the depreciation of the Mexican peso and higher energy costs to prices. We expect it to close 2017 at 5.7% yoy.

From our fixed income and FX strategy team

Local assets depicted a strong momentum despite a higher than expected inflation print. Mexican bonds have been able to maintain a three-day rally despite the evidence of inflationary pressures, mainly in the core component, but benefited by the effect of the FEC's announcement on Tuesday in tandem with strong gains in global sovereign bonds this week. More details in our research note "*Reassessing our rates and peso forecasts after the FEC's new mechanism*" <pdf>, published on February 21st, 2017. The short-end is gaining 4-5bps, while the mid part of the curve is rallying 10bps and longer tenors 9bps. Breakevens are hovering around 4.00% in 3- and 5-year horizons, while 10- and 30-year tenors are trading at 3.85%. This suggests that the market has already priced in a complex CPI scenario for 2017 but with an effect that is likely to water down in the mid- and long-term. We see no interesting relative value in CPI-adjusted Udibonos. Taking into account current conditions, we remain positive in terms of the belly of the yield curve, but not so constructive with respect to the long-end, especially after the recent rally and flattening bias. As a result, we hold our trade idea opened on February 15th, 2017 of a 5y10y steepener position in TIIE-IRS (long/receive 5y TIIE-IRS (65x1) and short/pay 10y TIIE-IRS (130x1)) with an entry level of 28bps, target of 43bps, stop-loss of 18bps, and currently trading at 31bps. More details in our research note "*Trade Idea: 5y10y TIIE-IRS steepener*" <pdf>.

In the FX market, the Mexican peso pushed higher after the report, from 19.75 to 19.68 per dollar and +1.1% on the day, with the strongest move after positive comments for Mexico by the US Treasury Secretary. Inflation pressures coupled with Banxico's strong credibility support the expectation of rate hikes while the backdrop of low volatility has increased appetite for carry trades, which has improved significantly for MXN. In this context, we reiterate our recommendation of peso longs on an intraday basis, with a support in the 19.50-19.55 zone, near the convergence of the 200-day MA (19.51) and a Fibonacci level (19.54).

BANORTE IXE

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Economic Analysis			
Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Francisco José Flores Serrano	Economist, National	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Fixed income and FX Strategy			
Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Equity Strategy			
Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates / Financials/ Mining / Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research Analyst – Airlines / Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Corporate Debt			
Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 1670 - 2248
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
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) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454