Inflation in January pressured by agricultural goods prices

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- ***INEGI* just published its inflation report for January**
- **Headline inflation (Jan): 0.38%m/m (Banorte-Ixe: 0.34%m/m; consensus: 0.28%m/m)**
- **Core inflation (Jan): 0.19%m/m (Banorte-Ixe: 0.21%m/m; consensus: 0.2%m/m)**
- **Inflation in January was explained by pressures on "fruits & vegetables" prices along with increases in "government tariffs" prices**
- **With these numbers, annual inflation is at 2.61% vs. 2.13% in previous month**

Consumer prices increased 0.38%m/m in January. According to *INEGI's* report published today, consumer prices increased 0.38% m/m in January, above consensus' forecast (+0.28% m/m), but similar to our 0.34% estimate. Moreover, core inflation was 0.19% vs. our 0.21% estimate. The main deviation from our forecast comes from: (1) A larger than expected contribution of agriculture prices (24.9bps vs. our 21.8bps); (2) an underestimation of energy prices (-8.3bps vs. our -10.3bps); (3) an underestimation of government tariffs prices (6.1bps vs. our 5.5bps); (4) a lower-than-expected contribution of goods prices (8.9bps vs. our 9.6bps); and (5) an overestimation of services prices (5.6bps vs. our 6.5bps), as shown in the table below

January's inflation by components
% monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.38	0.34	0.04
Core	0.14	0.16	-0.02
Goods	0.09	0.10	-0.01
Processed foods	0.06	0.07	-0.01
Other goods	0.03	0.03	0.00
Services	0.06	0.07	-0.01
Housing	0.04	0.04	0.00
Education	0.02	0.02	0.00
Other services	-0.01	0.00	-0.01
Non-core	0.24	0.18	0.06
Agriculture	0.25	0.22	0.03
Fruits & vegetables	0.24	0.18	0.06
Meat & eggs	0.01	0.04	-0.03
Energy & government tariffs	-0.02	-0.04	0.03
Energy	-0.08	-0.10	0.02
Government tariffs	0.06	0.05	0.01

Source: Banorte-Ixe with data from INEGI and Banco de México.
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 January was explained by pressures "fruit and vegetables" prices, as well as government tariffs. Within the core sub-index, goods prices increased 0.26% m/m given the 0.37% hike in "processed foods" prices. Moreover, services prices edged-up 0.14% m/m as a result of higher educational services (universities tuitions increased 1.01% m/m at the beginning of January's semester).

Within the non-core sub-index, agricultural prices increased 2.68% m/m as a result of the 7% hike in "fruits and vegetables" prices. In this regard, *INEGI* highlights the higher prices of onions (+ 36.5% m/m), zucchinis (+ 42.8% m/m), and tomatoes (+ 5.6% m/m). Similarly, government rates edged-up 1.1% m/m given the 2.7% hike in the prices of water supply. Finally, energy prices fell -0.08% m/m as a result of the reduction in the price of low-grade (-1.76%) and the high-grade gasoline (-1.75%), which together subtracted 9.3bps to total inflation during January.

With these numbers, annual inflation is at 2.61% vs. 2.13% in previous month. Moreover, core inflation is at 2.64% from 2.41% in December. We believe that 12-month inflation will remain around 2.5%yoy in the next couple of months.

From our fixed income and FX strategy team

Inflation confirming Banxico's concerns. Today's report confirmed Banxico's assessment of a modest deterioration regarding short-term inflation dynamics, especially driven by seasonal factors and a weaker FX. As a result, Mexican linkers extended the rally observed last week (mainly in the Jun'19, security that will be auctioned today), while nominal-rate Mbonos depreciated further. Taking into consideration the recent concerns from the central bank we decided yesterday to close the investment strategy opened on November 12, 2015 regarding receiving the 1-year TIIE-IRS with an entry level of 3.92%, target of 3.67%, stop-loss of 4.10% and currently trading at 3.87%. For further details of the rationale behind this trade idea please refer to our research note *"Trade Idea: Receive 1-year TIIE-28 IRS (13x1)"* <pdf>.The holding period return for this strategy was 5pbs of capital gains + 17pbs of carry and roll-down gains The reason behind closing this trade recommendation before reaching the target lies in a complex FX scenario going forward that could increase market implied hikes for Banxico in coming months despite benign inflation dynamics that could prevail in the short-term and an economy growing below its potential. However, we acknowledge that Banxico could turn more hawkish in terms of the FX pass-through on inflation if the peso continues affected by several risks in the global environment, as portrayed in its recent communiqué released last Thursday. For more details please refer to our research note *"Banxico – Concerned about pass-through, but no preemptive hikes"* <pdf> published on February 4, 2016. The Mexican yield curve currently prices in 2 hikes of 25bps each this year, which is in line with our base case scenario, but with a slightly upside risk, especially after recent comments from Governor Carstens in the media. On the other hand, we expect Mexican linkers (Udibonos) to continue rallying on a favorable valuation. Moreover, short-term Mbonos (3- and 5-year) could represent an appealing defensive strategy given the attractive carry and the policy normalization path embedded in the yield curve.

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