

Inflation in 1H-November below consensus due to lower pressure in energy prices

November 22, 2018

www.banorte.com
@analisis_fundam

- **INEGI** just published its inflation report for the first half of November
- **Headline inflation (1H-Nov): 0.61% 2w/2w; Banorte: 0.63%; consensus: 0.67% (range of estimates: 0.48%-0.99%); previous: 0.14%**
- **Core inflation (1H-Nov): 0.19% 2w/2w; Banorte: 0.17%; consensus: 0.19% (range of estimates: 0.15%-0.25%); previous: 0.10%**
- **Inflation in the period was explained by the reversal of some of the subsidies to electricity tariffs but with a downward surprise in LP gas, along with higher agricultural prices**
- **With these figures, annual inflation fell to 4.56% from 4.90%. On the other hand, core-inflation decreased to 3.63% from 3.73%**
- **Despite an inflation print below expectations, we suggest holding defensive positions in floating-rate securities**

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

Juan Carlos Alderete, CFA
Senior Economist, Mexico
juan.alderete.macal@banorte.com

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

Consumer prices increased 0.61% 2w/2w in the first half of November. This number was below consensus (0.67%) and slightly lower than our forecast (0.63%). Meanwhile, core inflation stood at 0.19% vs. our 0.17% estimate.

Fixed income and FX Strategy

Alejandro Padilla
Head Strategist – Fixed-Income and FX
alejandro.padilla@banorte.com

Santiago Leal Singer
Fixed-Income and FX Strategist
santiago.leal@banorte.com

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

The main deviation from our forecast came from: (1) A lower than expected contribution from energy (33bps vs. our 43bps); (2) a higher than expected impact from agricultural goods (14bps vs. our 6bps); (3) a stronger contribution from core goods (9bps vs. our 5bps); and (4) a lower than estimated advance in other services (3bps vs. our 7bps), as shown in the table below.

1H-November inflation by components

% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.61	0.63	-0.01
Core	0.14	0.13	0.01
Goods	0.09	0.05	0.04
Processed foods	0.05	0.03	0.02
Other goods	0.04	0.02	0.02
Services	0.05	0.08	-0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.07	-0.03
Non-core	0.47	0.50	-0.03
Agriculture	0.14	0.06	0.08
Fruits & vegetables	0.12	0.02	0.10
Meat & eggs	0.02	0.04	-0.02
Energy & government tariffs	0.33	0.44	-0.11
Energy	0.33	0.43	-0.11
Government tariffs	0.00	0.01	0.00

Source: INEGI, Banorte.

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

Document for distribution among public

Inflation in the period was explained by the reversal of some of the subsidies to electricity tariffs but with a downward surprise in LP gas, along with higher agricultural prices. Energy prices picked up 3.1% 2w/2w as a result of the seasonal electricity price increase (+23.4%) as summer discounts ended. This added 40bps to the headline index. On the contrary, we observed a steep decrease in LP gas, falling 3.6% (-8.1bps), while low-grade gasoline grew only by 0.2%. It is worth noting that the fall in international oil benchmarks likely had a more favorable effect on gasoline, outweighing for a relatively steep reduction in the fiscal stimulus provided by the Federal Government. Meanwhile, agricultural prices were 1.4% higher, driven by the increase of 2.7% in fresh fruits and vegetables and of 0.3% in meat and egg. In this respect, *INEGI* highlighted that 5 out of 10 of the goods with the steepest increase were from this category, highlighting tomatoes (+9.4% 2w/2w), husk tomatoes (+21.6%), and chicken (+2.1%), among others. On the contrary, avocados fell 4.5% while onions decreased 2.0%, among those with the highest negative contributions.

Core inflation stood at 0.19% 2w/2w, slightly higher than the 0.17% of the previous print but still pretty stable. This explained 14.4bps of the bi-weekly print, driven by higher goods' prices (+0.24%), particularly in processed foods (+0.27%). Going into services, these grew 0.14%, due in greater part to other services (+0.19%). Looking into the details, we believe that the holiday period during the first half of the month, along purchases ahead of the local holiday on November 20th, could have influenced this increase, as suggested by airfares (4.4%). Moreover, we believe that maintenance works in the *Cutzamala* water system could also have had an impact, which may explain the increase in the "dining away from home" items (+0.2%).

In annual terms, inflation moderated to 4.56% from 4.90%. We maintain our 4.8% year-end estimate, above the consensus forecast of 4.5%. In this respect, we recognize that risks to our year-end forecasted are tilted to the downside, particularly because of the steep decrease in crude-oil (and relatedly, in gasoline) prices in the global market. On the contrary, some pressures were observed in agricultural prices after declining in recent months, which could support our forecast. Last but not least, core inflation was slightly higher than the YTD average of 0.15% 2w/2w, which along the recent depreciation of the currency, could have a greater impact in the following prints, particularly due to adjustments in core goods, given that they are among the most exposed to exchange rate variations.

From our fixed income and FX strategy team

Despite an inflation print below expectations, we suggest holding defensive positions in floating-rate securities. This Thursday's inflation report came with a positive surprise printing fairly in line with our expectation but below market consensus, with a bi-weekly reading at 0.61% (Banorte 0.63%) leaving the annual rate at 4.56% (Banorte 4.57%) from 4.87% in the previous fortnightly report. With these readings, the local fixed-income market depicted a positive reaction yet with limited movements, as local liquidity has been significantly reduced on the back of the U.S. Thanksgiving holiday. Particularly, the Mbonos curve registered a 1-2bps rally, with similar dynamics in the TIIE-28 swap curve yet with the MXN limiting an initial positive reaction. In this sense, the curve is pricing in implicit hikes for Banxico with few variations after the report, at +14bps for the remainder of 4Q18, +43bps for 1Q19 and +61bps for 2Q19. Meanwhile, and as a result of this morning's data, Udibonos reacted negatively though with a moderate magnitude as well, experiencing a 1-2bps sell-off throughout the curve. Recently, these securities' valuation has become considerably expensive, with breakevens breaching record highs. Yesterday, these metrics took a breather but hold very close to their maximum levels trading at 4.32%, 4.38%, 4.62%, and 4.87%, for the 3-, 5-, 10-, and 30-year tenors, in the same order. Considering this backdrop and with a local risk premia which has deteriorated to its highest since 2009 when approximated by the 10-year spread between Mbonos and Treasuries (trading around 596bps), we consider prudent to hold defensive positions in floating-rate securities.

Disclaimer

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

Certification of Analysts.

We, Gabriel Casillas Olivera, 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, Francisco Duarte Alcocer, Jorge Antonio Izquierdo Lobato and Leslie Thalia 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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte Ixe and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	<i>When the share expected performance is greater than the MEXBOL estimated performance.</i>
HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

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 Godínez	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
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	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
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Francisco Duarte Alcocer	Analyst	francisco.duarte.alcocer@banorte.com	(55) 1103 - 4000 x 2707
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
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	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@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.cebillos@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
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454