

# We estimate 2020 inflation at 3.6%, after closing last year at 2.8%

- **Headline inflation (December): 0.56% m/m; Banorte: 0.50%; consensus: 0.50% (range of estimates: 0.41%-0.53%); previous: 0.81%**
- **Core inflation (December): 0.41% m/m; Banorte: 0.40%; consensus: 0.41% (range of estimates: 0.39%-0.42%); previous: 0.22%**
- **As expected, we observed pressures within services, mostly in categories more closely related to the holiday season, along higher prices in agricultural goods and energy within the non-core component**
- **As a result, annual inflation in 2019 reached 2.83%, below our expectations and the previous month at 2.97%. Core inflation also inched lower, at 3.59% from 3.65% in November**
- **We establish our year-end 2020 estimates for annual headline and core inflation at 3.6% and 3.5%, respectively. Both are slightly higher than consensus, at 3.5% and 3.4%, in the same order**
- **We expect a further flattening of the yield curve and a stronger demand for CPI-linked Udibonos**

**Consumer prices increased 0.56% m/m in December.** This was 6bps above consensus (0.50%), which almost matched our 0.51% forecast. Meanwhile, core inflation edged-up 0.41%, 1pb above our estimate. The main deviation from our forecast came from: (1) A higher contribution of fresh fruits and vegetables (+16bps vs. our +8bps); (2) greater pressures in other services (+17bps vs. our +15bps); (3) a lower contribution from other goods (+3bps vs. our +4bps), and (4) a lower effect in energy (+6bps vs. our +7bps), as shown in the table below.

**December inflation by components**

% monthly incidence

	INEGI	Banorte	Difference
Total	0.56	0.50	0.06
Core	0.31	0.30	0.01
Goods	0.10	0.11	-0.01
Processed foods	0.07	0.07	0.00
Other goods	0.03	0.04	-0.01
Services	0.21	0.19	0.01
Housing	0.04	0.04	0.00
Education	0.00	0.00	0.00
Other services	0.17	0.15	0.02
Non-core	0.25	0.19	0.06
Agriculture	0.18	0.11	0.07
Fruits & vegetables	0.16	0.08	0.07
Meat & eggs	0.03	0.03	0.00
Energy & government tariffs	0.07	0.08	-0.01
Energy	0.06	0.07	-0.01
Government tariffs	0.01	0.01	0.00

Source: INEGI, Banorte.

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

January 9, 2020

www.banorte.com  
@analisis\_fundam

**Gabriel Casillas**

Chief Economist and Head of Research  
gabriel.casillas@banorte.com

**Alejandro Padilla**

Executive Director of Economic Research and Financial Market Strategy  
alejandropadilla@banorte.com

**Juan Carlos Alderete, CFA**

Director of Economic Research  
juan.alderete.macal@banorte.com

**Francisco Flores**

Senior Economist, Mexico  
francisco.flores.serrano@banorte.com

**Fixed income and FX Strategy**

**Santiago Leal Singer**

Senior Strategist, Fixed-Income and FX  
santiago.leal@banorte.com

**Leslie Orozco**

Strategist, Fixed Income and FX  
leslie.oroazco.velez@banorte.com

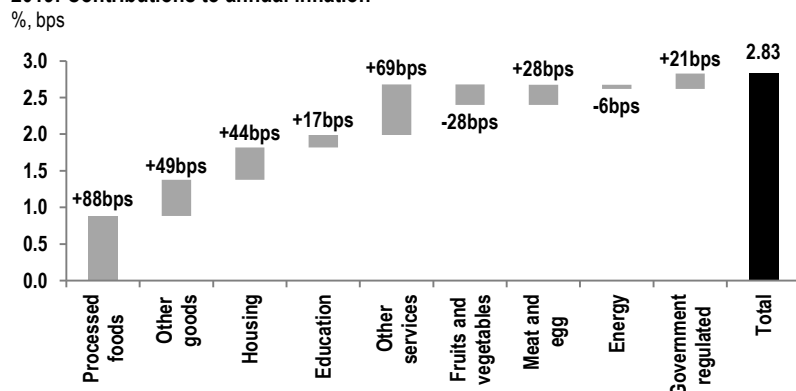
Document for distribution among public

**Inflation was driven by some pressures within services, along increases in some categories within the non-core component.** Regarding core inflation, we highlight the 1.0% m/m increase in other services, adding 17bps in total contribution. As is typical in the period, the most significant increases were in items such as air fares (26.0%) and tourism services (11.4%), both related to the holiday season. Dining away from home was also up by 0.8%. On the other hand, goods increased 0.3%, resulting in a 10bps contribution. This was more heavily distributed in processed foods (7bps) instead of other goods (3bps), with some benefit in the latter from discounts during the latest part of the second fortnight as the holiday season unwounded.

The non-core component picked up 1.0% m/m, resulting in a 25bps contribution. Low-grade gasoline extended the move higher of the first half of the month, up 0.3% (1.8bps). Nonetheless, the full-year move was barely 0.6%, returning to positive for the first time since September. Although recent upward pressures, explained in part by the rise in tensions between the US and Iran, have moderated, we do not rule out that going forward, some other geopolitical events could result in a higher price of fuel. Moreover, LP gas increased 2.0%, also among goods with the highest impact (4bps). Agricultural goods also edged higher, both in fresh fruits and vegetables, (3.4%) and to a lesser extent in meat and egg (0.5%). Those with the highest impact included tomatoes (11.3%), onions (27.9%), nopal cactus (18.3%), and pork (3.0%). Nevertheless, there were relevant declines in goods such as avocados (-4.7%), oranges (-6.5%), and lemons (-5.7%), among others.

**With these, annual inflation stood at 2.83% yoy, lowest since August 2016.** Core inflation also inched lower, at 3.59% from 3.65% in November. As shown in the chart below, we highlight two drivers behind the decline throughout 2019, both from the non-core component: (1) A very benign dynamic in fresh fruits and vegetables within agricultural goods, subtracting 28bps; and (2) energy, as already mentioned, was helped to a great extent by low-grade gasoline resulting in this category contributing with -6bps.

**2019: Contributions to annual inflation**

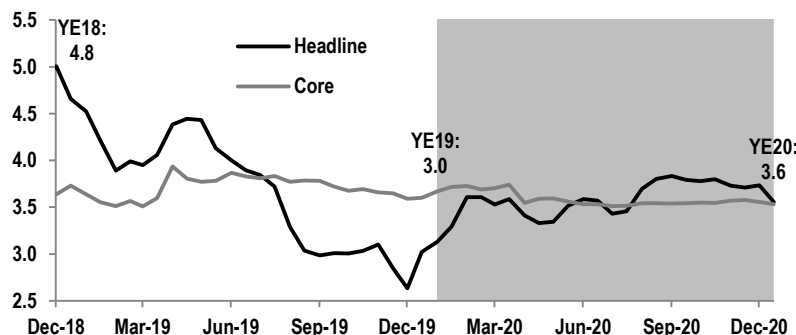


Source: INEGI

**We establish our year-end 2020 inflation forecast at 3.6%.** Moreover, we estimate core inflation to decline slightly from its current level during the year, to 3.5% (see chart below). Both are slightly above consensus according to the latest central bank survey, with the median at 3.5% and 3.4%, in the same order.

**Inflation forecasts**

% yoy, bi-weekly frequency



Source: INEGI, Banorte

**Inflation forecasts**

% yoy, quarterly average

	1Q20	2Q20	3Q20	4Q20
<b>Banorte</b>				
Headline	3.5	3.5	3.7	3.7
Core	3.7	3.6	3.5	3.6
<b>Banxico</b>				
Headline	3.5	3.1	3.1	3.0
Core	3.6	3.2	3.1	2.9

\* Central bank forecasts included in the 3Q19 Quarterly Report

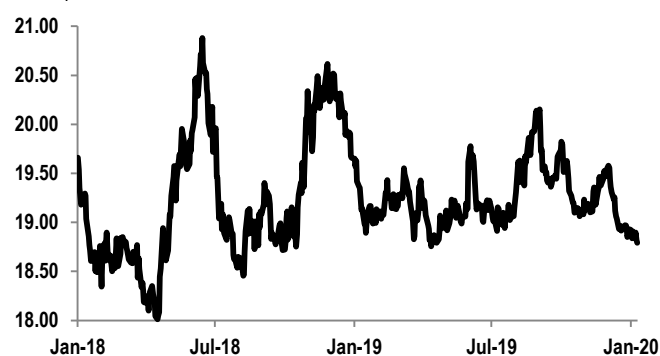
Source: Banxico, Banorte

Broadly speaking, we believe [the 20% increase in the minimum wage \(MW\) for 2020](#) will help maintain the relative resistance to the downside of core inflation, particularly within other services, for which we anticipate a 4.1% yoy increase. Nonetheless, we pencil-in a relatively modest effect on prices, based on two factors. First, the year-to-date accumulated advance of formal wage negotiations in 2019 has been 5.4% in nominal terms until November, suggesting the direct and so-called “lighthouse effect” on inflation has been modest. We forecast mean wages to increase between 7.9-9.8% this year (4.1-5.9% in real terms), which in our view should be manageable. Second, it is our take that high economic slack, with our current estimate of the output gap at -1.8% of potential GDP, will serve to compensate for this, with the net effect resulting in basic wages advancing closer to the low end of about 4% and modest pressures on inflation. Moreover, we anticipate the brunt of the effect of higher wages to be felt in the dynamism of formal job creation, pushing the unemployment rate to about 3.7% by the end of the year from its current level of 3.5%.

An additional factor taken into account is the resilient performance of the currency last year, which in our view will result in a relatively limited pass-through effect. In particular, the USD/MXN averaged 19.26 in 2019 (low: 18.77; high: 20.17), with the peso practically unchanged relative to its average in the previous year (19.25). However, we think the exchange rate could be somewhat pressured in 2020, so we do not discard a limited effect to start building up for tradeable goods, particularly processed foods and other goods, more so considering that volatility could pick-up on the back of geopolitical risks, including the US elections. Apart from base-effects –which should help start push annual inflation higher since mid-1Q20–, we also highlight other drivers considered in our forecast path, including: (1) The increase in several state taxes, most of them related to updated government tariffs, albeit also including higher rates in other categories such as alcoholic beverages and lodging services; and (2) our expectation of a recovery in prices of fresh fruits and vegetables, given that they were unusually low during 2019 (-5.4% yoy in December).

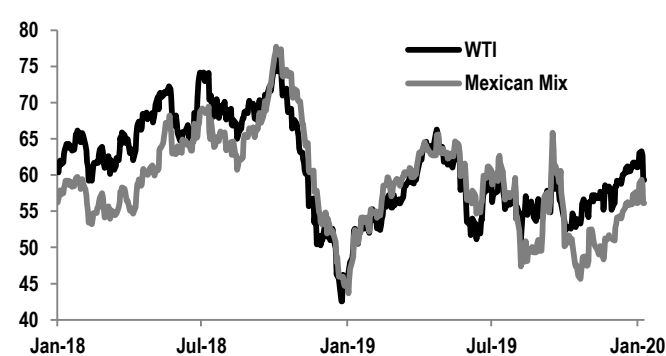
In terms of risks, we believe the most relevant to the upside include: (1) The possibility that the minimum wage increase has a more sizable impact, particularly as the gap with median wages compresses and the share of the working population that could benefit increases; (2) geopolitical risks, such as the US-Iran conflict and the US election, which could have an effect on price dynamics and volatility of assets such as crude-oil and the exchange rate (see charts below); and (3) potential pressures in other food categories such as pork meat, considering news that the impact of the swine fever in China could exacerbate imbalances between supply and demand after the New Year, and given that this category was well-behaved most of 2019. On the contrary, among those to the downside, we consider: (1) The government’s policy commitment of maintaining energy prices constant in real terms –gasoline, gas and electricity–, expecting a 3.3% yoy increase in 2020, albeit still with ample room for increasing fiscal subsidies in the former; and (2) a higher downward effect of wide economic slack relative to our expectations, including in heavyweight items such as housing, in a context in which we anticipate domestic demand will remain limited.

**USD/MXN**  
Pesos per dollar



Source: Bloomberg

**WTI and Mexican oil mix**  
US\$/bbl



Source: Bloomberg

All in all, it is our take that the inflation outlook is consistent with Banxico extending the easing cycle in a prudent manner. We reiterate our view of three consecutive 25bps rate cuts in the next three meetings (in February, March, and May). In our view, the central bank’s cautious approach has been reaffirmed in recent communications and speeches, highlighting the statement in the latest communique –also reinforced in the minutes– that they could adjust upwards their inflation forecasts contained in the 3Q19 *Quarterly Report*. Moreover and as mentioned in previous publications, our conviction about the total magnitude of the cycle has diminished. This is based on our perception of higher concerns about the outlook for inflation, which may be driven more by structural rather than temporary factors. Last but not least, and although some financial stability risks have waned, we think Banxico sees fit to remain prudent as the risk of a reversal higher in volatility remains elevated. This could be due to global and domestic factors, staying as a potential source of pass-through to core prices, particularly as the carry advantage of the currency erodes gradually.

*From our fixed income and FX strategy team*

**We expect a further flattening of the yield curve and a stronger demand for CPI-linked Udibonos.** The local market starting today's session mildly pressured (+2bps) following the higher than expected CPI number for December, and the performance of US Treasuries and other sovereign bonds worldwide (+1bps). In our view, current conditions will remain supportive for an additional flattening of the Mexican yield curve, as market participants continue adjusting their expectations about monetary policy with a more gradual approach in terms of rate cuts, in tandem with the long-end finishing last year with a more attractive relative valuation. The market is pricing-in less than 100bps of rates cuts coming from Banxico in 2020, acknowledging several risks to its most recent outlook and taking into account comments from Board members in the latest minutes. In terms of real rates, we are observing an appealing valuation in the short-end (3-year) with: (1) A breakeven that has declined 90bps in the last year and traded in recent sessions almost at 3%, mimicking the performance in annual headline inflation, moving from 4.83% to 2.83% in 2019 (-200bps); and (2) several risks for inflation in 2020 that should result in an upward trend throughout the year, as detailed in this research note.

**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 Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Jorge Antonio Izquierdo Lobato and Eridani Ruibal Ortega, 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 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	When the share expected performance is greater than the MEXBOL estimated performance.
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.

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, Head of Research and IRO	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

**Economic Research and Financial Market Strategy**

Alejandro Padilla Santana	Executive Director of Economic Research and Financial Market Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

**Economic Research**

Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707

**Market Strategy**

Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
-------------------------	-----------------------------	----------------------------	------------------

**Fixed income and FX Strategy**

Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

**Equity Strategy**

Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755

**Corporate Debt**

Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

**Economic Studies**

Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220

**Wholesale Banking**

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
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.cebaldos@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 Corporate Banking	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 Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454