

# Inflation continued edging down in 1H-December to 2% yoy

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## Fixed income and FX Strategy

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- **INEGI just published its inflation report for the first half of December**
- **Headline inflation (1H-Dec): 0.26% 2w/2w (Banorte-Ixe: 0.21%2w/2w; consensus: 0.3% 2w/2w)**
- **Core inflation (1H-Dec): 0.27% 2w/2w (Banorte-Ixe: 0.27%2w/2w; consensus: 0.23% 2w/2w)**
- **Inflation in the first half of December was explained by pressures on other services prices along with increases in “fruits & vegetables” prices**
- **With these numbers, annual inflation is at 2% vs. 2.21% in previous month**
- **Tamed inflation supportive for the valuation of the Mexican yield curve.**

**Consumer prices increased 0.26% 2w/2w in the first half of December (Banorte-Ixe: 0.21%).** Moreover, core inflation edged-up 0.27%, in line with our forecast. The main deviation from our forecast comes from: (1) A lower than expected contribution of goods prices (5.5bps vs. our 9.2bps); (2) an underestimation of services prices (14.7bps vs. our 10.8bps); and (3) a larger than expected contribution of agriculture prices (9.6bps vs. our 5.5bps), as shown in the table below

### 1H-December inflation by components

% bi-weekly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.26	0.21	0.052
Core	0.20	0.20	0.004
Goods	0.06	0.09	-0.037
Processed foods	0.04	0.05	-0.016
Other goods	0.02	0.04	-0.021
Services	0.15	0.11	0.040
Housing	0.02	0.02	-0.001
Education	0.00	0.00	0.000
Other services	0.13	0.09	0.043
Non-core	0.05	0.01	0.047
Agriculture	0.10	0.06	0.041
Fruits & vegetables	0.09	0.02	0.065
Meat & eggs	0.01	0.04	-0.022
Energy & government tariffs	-0.05	-0.05	0.002
Energy	-0.05	-0.06	0.006
Government tariffs	0.00	0.01	-0.005

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.

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**Inflation in the first half of December was explained by pressures on other services prices along with increases in “fruits & vegetables” prices.**

Within the core index, goods prices increased 0.16% 2w/2w as a result of the 0.23% hike in the processed foods sub-index. Moreover, the services prices increased 0.37% 2w/2w as a result of the 0.76% growth in the “other services” sub-index. Taking a look at the breakdown, airfares (+24.48% 2w/2w) and tourism services prices (+10.31% 2w/2w) posted a significant hike given the beginning of the holiday season. Moreover, within the non-core index, agricultural prices increased 1.04% 2w/2w, as a result of higher “fruits and vegetables” prices (+ 2.53%).

**Year-end inflation will stand at 2.1% in 2015, and 2.8% in 2016.** With these numbers, annual inflation is at 2% vs. 2.21% in previous month, reaching a record low. Meanwhile, core inflation is at 2.39% from 2.34% in November. Our estimate for 2H-December shows that inflation could end the year around 2.1% yoy. With these figures, we revise down our estimate for 2016 year-end inflation to 2.8% from 3.5%. The downward trend, not only in the prices of energy but also in other raw materials has resulted in a much lower inflation. Additionally, the pass-through from the FX depreciation to prices has been limited, with only moderate pressures on prices of durable goods. In this context, our new forecast also includes a marginally higher pass-through effect of the exchange rate to prices, especially taking into account a significant recovery in domestic demand and the expected trend in gasoline prices.

*From our fixed income and FX strategy team*

**Tamed inflation supportive for the valuation of the Mexican yield curve.**

Today's inflation report confirmed once again the absence of significant FX pass-through on the CPI, which grants Banxico the opportunity to be gradual throughout the monetary normalization process begun last week. Taking into consideration these dynamics, we reiterate our positive view regarding valuations in Mexican fixed-income securities (both in terms of the implied path for policy rates in coming years and the slope of the curve), particularly against other emerging markets and some developed countries. In this respect, we hold a positive view in term of the belly of the Mbonos curve, especially the tenors between the Dec'18 and Dec'24 securities. In accordance with this view, we hold our trade idea opened on November 12<sup>th</sup> of receiving 1-year TIIIE-28 IRS (13x1) with an entry level of 3.92%, target of 3.67%, stop-loss of 4.10%. For further details regarding this recommendation please refer to “*Trade Idea: Receive 1-year TIIIE-28 IRS (13x1)*” <[pdf](#)>. On the other hand, we hold a pessimistic view on Mexican linkers despite a valuation that looks attractive for investments with long-term horizons. Current inflation dynamics are likely to undermine the demand for inflation-linked securities (e.g. Udibonos), which could extend the recent sell-off on the back of a positive assessment on inflation for 2016.

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