Slightly lower-than-expected inflation in November

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- ***INEGI* just published its inflation report for November**
- **Headline inflation (November): 0.78% m/m; Banorte-Ixe: 0.80% m/m; consensus: 0.82% m/m (range of estimates: 0.74% to 0.87%); previous: 0.61% m/m**
- **Core inflation (November): 0.22% m/m; Banorte-Ixe: 0.26% m/m; consensus: 0.29% m/m; (range of estimates: 0.18% to 0.32%); previous: 0.28%**
- **Inflation was explained by pressures on electricity tariffs, given the end of summer discounts**
- **However, higher discounts in this year's edition of *"The Good Weekend"* (Mexico's Black Friday) pushed down merchandise prices**
- **With these numbers, annual inflation is at 3.32% vs. 3.29% in October**
- **Stronger pressures in short-term Udibonos as opposed to Mbonos after the inflation report**

Consumer prices increased 0.78% m/m in November. In addition, core inflation was 0.22% vs. our 0.26% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of *"other goods"* prices (-0.5bps vs. our 4.6bps forecast); (2) an underestimation of the prices of non-tourism services (4.5bps vs. our 1.5bps); and (3) higher than expected services prices (4.8bps vs. our 3.3bps); as shown in the table below.

November's CPI inflation by major subcomponent
Monthly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.78	0.80	-0.02
Core	0.17	0.20	-0.03
Goods	0.04	0.09	-0.05
Processed foods	0.05	0.05	0.00
Other goods	0.00	0.05	-0.05
Services	0.12	0.10	0.02
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.07	0.02
Non-core	0.63	0.62	0.01
Agricultural	0.07	0.05	0.02
Fresh fruits and vegetables	0.05	0.03	0.01
Meat and egg	0.02	0.02	0.00
Energy and government regulated	0.57	0.57	0.00
Energy	0.57	0.58	0.00
Electricity tariffs	0.01	0.00	0.00
Government regulated	0.78	0.80	-0.02

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

Fixed income and FX Strategy

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Inflation in November was explained by pressures on electricity tariffs. According to *INEGI*, electricity tariffs increased 25.61% m/m, given the end of summer discounts in some regions of the country. In addition, we observed some pressures on services prices, given the increases seen in the prices of air fares (+9.58 m/m) and tourism services (4.48% m/m), as a result of the holiday that took place on November 21st.

Moreover, *"other goods"* prices –which consist of non-food products– posted 0.02% m/m contraction as a result of *"The Good Weekend"* discounts (Mexico's Black Friday) that took place in the third weekend of November.

12-month inflation maintains an upward trend. With today's figures, 12-month inflation is at 3.31% vs. 3.06% in October. In addition, core inflation reached 3.29%. Looking ahead, we believe that year-end inflation will stand at 3.34% yoy. In addition, we expect inflation to maintain an upward trend in 2017, which will be explained by: (1) The higher pass-through effect of the depreciation of the Mexican peso to prices; (2) the impact of the 9.58% increase in Mexico's minimum wage; and (3) the liberalization of oil prices.

From our fixed income and FX strategy team

Stronger pressures in short-term Udibonos as opposed to Mbonos after the inflation report. Today's report printed below consensus expectations, resulting in slightly higher pressures in the short end of the Udibonos curve when compared to similar-maturity Mbonos. In spite of the latter, annual inflation keeps trending higher at 3.31%, its highest level in almost two years. The market is pricing inflation breakevens hovering around 3.8% in every tenor from 3.3% a month ago. In this context and taking into account current conditions, we continue suggesting reducing exposure in Mbonos and increasing positions in CPI-linked Udibonos, as a defensive relative value strategy. The Udibonos with the most attractive pricing are the ones maturing on Jun'19, Dec'20 and Jun'22. In Mexico, the yield curve has observed a significant correction throughout this quarter, especially in November, following a threefold condition: (1) Higher U.S. Treasuries, (2) wider country risk premia, and (3) upward adjustment on inflation premium. The 10-year spread between Mbonos and Treasuries increased in a significant fashion, moving from 447pb by the end of the 3Q17 to 496bps actually. We anticipate this rate differential to remain wider in 2017 vis-à-vis previous years. More details in our research note "Fixed-Income, FX, and Commodities Update – The Trump Aftershock" <pdf>, published on December 2nd, 2016. On the other hand, last week's minutes released by Banxico concurred with its recent Quarterly Inflation Report, highlighting a shift of a strategy that will be likely align with the policy path of the Federal Reserve in coming months. Banxico stressed out the risks on inflation and growth associated with current global conditions, starring the outcome of U.S. elections. However, it seems that monetary policy has a limited space going forward. Taking into consideration these conditions, we acknowledge that the short-end of the yield curve is depicting an overshooting in terms of implied rate hikes priced in. The market is discounting 129bps of cumulative increases in the 12 months ahead. On the other hand, current inflation dynamics could have important implications in 2017. Recent polls have depicted important forecast adjustments for next year to levels close to 4.0%yoy from a previous 3.2%-3.4% range. Even Banxico has increased its expected inflation for the next year.

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