

Annual inflation falls to 5.5% from 6.8% in January

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- **INEGI just published its inflation report for January**
- **Headline inflation (January): 0.53% m/m; Banorte: 0.49% m/m; consensus: 0.5% m/m; (range of estimates: 0.4% to 0.55%); previous: 0.59% m/m**
- **Core inflation (January): 0.28% m/m; Banorte: 0.26% m/m; consensus: 0.27% m/m (range of estimates 0.22% to 0.3%); previous: 0.42% m/m**
- **Inflation in January was explained by the increase in energy prices, which was mitigated by the decrease in the price of fresh fruits and vegetables along with the price of other services**
- **Despite the monthly increase in energy prices, annual inflation fell to 5.55% from 6.77% given the high comparison base derived from the increase in gasoline prices at the beginning of 2017**
- **We hold our trade recommendation on 5-year Bondes D given current inflationary conditions and the strong likelihood of a rate hike from Banxico later today**

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Consumer prices increased 0.53% m/m in January, standing above both our forecast (0.49% m/m) and the consensus (0.5% m/m). Core inflation was 0.26% m/m vs. our 0.28% m/m estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution from the prices of processed foods (14bps vs. our 12bps) and (2) a greater impact from fruits and vegetables prices (-7bps vs. our 9bps), as shown in the table below.

January inflation by major subcomponent
Monthly incidence, %

	Observed	Banorte forecast	Difference
Headline	0.53	0.49	0.04
Core	0.21	0.19	0.02
Goods	0.19	0.18	0.02
Processed foods	0.14	0.12	0.02
Other goods	0.05	0.06	-0.01
Services	0.02	0.02	0.00
Housing	0.05	0.05	-0.01
Education	0.02	0.02	0.00
Other services	-0.05	-0.06	0.00
Non-core	0.32	0.29	0.02
Agricultural	0.00	-0.02	0.02
Fresh fruits and vegetables	-0.07	-0.09	0.01
Meat and egg	0.08	0.07	0.01
Energy and government regulated	0.32	0.32	0.00
Energy	0.26	0.26	0.00
Government regulated	0.06	0.05	0.01

Source: INEGI, Banorte

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 January was explained by the increase in energy prices, which was mitigated by the decrease in the prices of fresh fruits and vegetables as well as in the prices of other services. Energy prices increased 2.44% m/m on the back of and higher prices of low-grade gasoline (3.19% m/m) and LP gas (2.99% m/m). Moreover, prices of fruits and vegetables fell 1.93% m/m, driven by lower prices of tomatoes (-18.11% m/m), onions (-13.64% m/m) and other chilies (-18.76% m/m). However, the price of bananas and potatoes posted an increase of 20.21% m/m and 7.71% respectively. In addition, egg prices rose 7.71% m/m, pushing the meat and egg component up 1.35% m/m.

In the core index, we highlight the 0.31% m/m decrease in the costs of other services on the back of lower airfares (-39.44% m/m) and tourism services. (-9.8% m/m). However, the cost of dining away from home items rose 0.88% m/m while the price of restaurants climbed 0.96% m/m. Moreover, education costs increased 0.44% m/m given the 1.06% m/m growth in university tuitions. Finally, processed foods prices increased 0.9% m/m while other goods expanded 0.27% m/m.

With these figures, annual inflation stood at 5.55% vs. 6.77% in December. Additionally, core inflation edged down to 4.56% from 4.87% seen in the previous month. It is worth mentioning that the sharp fall in the month is due to a base effect, given that inflation in the same period of the previous year showed a strong increase derived from the liberalization of energy prices. We expect inflation to continue showing a downward trend to finish 2018 at 4.3%. In the coming months, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

From our fixed income and FX strategy team

We hold our trade recommendation on 5-year Bondes D given current inflationary conditions and the strong likelihood of a rate hike from Banxico later today. The local fixed-income market is trading with a negative tilt as a result of the recent correction in global rates, especially in the U.S. Treasuries. The slightly higher than expected CPI print released today in Mexico is contributing to a cautious tone among market participants ahead of today's policy decision from Banxico. We expect that the current inflationary backdrop will steer another rate hike today by the central bank (+25bps), especially if we take into account that market inflation expectations are 85bps higher *vis-à-vis* Banxico's target (*e.g.* breakevens trading around 3.85%). The Mexican yield curve is pricing in nearly 80% of implied probability for a rate hike later today. In the aftermath of current market dynamics we hold our trade recommendation on defensive 5-year floating-rate Bondes D, with more attractive valuation and characteristics than CPI-linked Udibonos at this high-inflation environment given the hawkish tone from Banxico.

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