

# 1H December inflation explained by the holiday season

- **INEGI just published its inflation report for the first half of December**
- **Headline inflation (1H-December): 0.42% 2w/2w (Banorte-Ixe: 0.31% 2w/2w; consensus: 0.34% 2w/2w)**
- **Core inflation (1H-December): 0.47% 2w/2w; (Banorte-Ixe: 0.34% 2w/2w; consensus: 0.3% 2w/2w)**
- **Inflation in the first half of December was explained by pressures on the prices of services, particularly in airfares and tourism services**
- **Moreover, INEGI's report highlights pressures on merchandise prices, as a result of a higher costs both processed foods and other goods**
- **With these numbers, annual inflation is at 3.48% vs. 3.3% in November**
- **Inflation dynamics deteriorating: We hold our trade ideas of long positions in Udibonos Jun'19, Dec'20 and Jun'22**

Consumer prices increased 0.42% 2w/2w in the first half of December. In addition, core inflation was 0.47% vs. our 0.34% estimate. The main deviation from our forecast comes from: (1) An underestimation of merchandise prices (12.7bps vs. our 10bps); and (2) a larger than expected contribution of services prices (22.2bps vs. our 15.2bps), as shown in the table below.

**Dec-1H CPI inflation by major subcomponent**  
Bi-weekly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.42	0.31	0.11
Core	0.35	0.25	0.10
Goods	0.13	0.10	0.03
Processed foods	0.06	0.05	0.01
Other goods	0.07	0.05	0.02
Services	0.22	0.15	0.07
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.21	0.13	0.07
Non-core	0.06	0.06	0.01
Agricultural	0.04	0.04	0.00
Fresh fruits and vegetables	0.00	0.03	-0.03
Meat and egg	0.05	0.01	0.04
Energy and government regulated	0.02	0.02	0.00
Energy	0.01	0.02	0.00
Government regulated	0.01	0.00	0.01

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 services prices, particularly in airfares and tourism services.** According to *INEGI*, services increased 1.2% 2w/2w, on the back of higher airfares (33.3% 2w/2w) and tourism services (14.4% 2w/2w) given the start of the Christmas and New Year's holiday season. In addition, there were pressures on merchandise prices, amid higher prices of processed foods and other merchandise (0.36% 2w/2w each respectively), explained in part by pass-through effect from the depreciation of the Mexican currency. Within the non-core index, agricultural prices rose 0.46% 2w/2w as a result of the increase in the prices of eggs (+3.92%), onions (+9.06) and pork meat (+1.38%).

**Inflation on an annual basis continues to edge up.** With today's figures, 12-month inflation is at 3.48% vs. 3.30%, in November. In addition, core inflation is at 3.46.

*From our fixed income and FX strategy team*

**Inflation dynamics deteriorating: We hold our trade ideas of long positions in Udibonos Jun'19, Dec'20 and Jun'22.** Today's CPI report came in above market expectations, depicting evidence of higher FX pass-through effects that are likely to prevail in 2017. Local rates extended early losses after the inflation print, with MBonos trading 5-7bps higher vis-à-vis yesterday's closing mark. We expect investors to continue adjusting their inflation assessment for coming years and increasing their demand for CPI-linked Udibonos. In this regard, breakevens are currently trading at 4.13% for the 3-year tenor, 4.24% for the 5-year, 4.02% for the 10-year and 3.79% for the 30-year horizon. Inflation next year could be severely impacted by three factors, mainly: (1) An additional pass-through effect from peso weakness to prices, (2) gasoline price liberalization, and (3) the increase in minimum wages. Taking into account this scenario, we hold our trade recommendations of long positions in Udibonos Jun'19, Dec'20, and Jun'22.

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