Inflation continued edging down in November to 2.2%y/y

- ***INEGI* just published its inflation report for November**
- **Headline inflation (Nov): 0.55%m/m (Banorte-Ixe: 0.6%m/m; consensus: 0.61%m/m)**
- **Core inflation (Nov): 0.04%m/m (Banorte-Ixe: 0.08%m/m; consensus: 0.07%m/m)**
- **Inflation November was explained by pressures on electricity tariffs prices, particularly in the first half of the month**
- **With these numbers, annual inflation is at 2.21% vs. 2.48% in previous month**
- **Tamed inflation supportive for the short- and mid-ends**

Consumer prices increased 0.55%m/m in November, slightly below expectations. Core inflation was 0.04% vs. our 0.08% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of services prices (-3.7bps vs. our -1.2bps); (2) a lower than expected contribution of agricultural prices (4bps vs. our 5.6bps); and (3) an overestimation of merchandise inflation (6.4bps vs. our 7.3bps), as shown in the table below.

November inflation by components
% monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.55	0.60	-0.053
Core	0.03	0.06	-0.034
Goods	0.06	0.07	-0.009
Processed foods	0.04	0.04	0.001
Other goods	0.02	0.03	-0.010
Services	-0.04	-0.01	-0.025
Housing	0.03	0.03	0.000
Education	0.00	0.00	0.000
Other services	-0.07	-0.05	-0.025
Non-core	0.53	0.55	-0.019
Agriculture	0.04	0.06	-0.016
Fruits & vegetables	0.06	0.08	-0.020
Meat & eggs	-0.02	-0.03	0.005
Energy & government tariffs	0.50	0.51	-0.002
Energy	0.51	0.51	0.000
Government tariffs	0.01	0.01	-0.002

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.

December 9, 2015

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes
Senior Economist, Mexico
alejandro.cervantes@banorte.com

Fixed income and FX Strategy

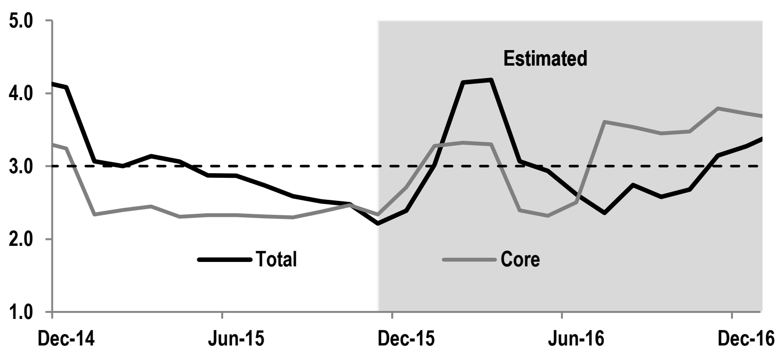
Alejandro Padilla
Director de Estrategia
Renta Fija y Tipo de Cambio
alejandro.padilla@banorte.com

Santiago Leal
Analyst Fixed Income and FX
santiago.leal@banorte.com

November inflation was explained by pressures on electricity tariffs, particularly in the first half of the month. Energy prices increased 4.95%m/m, on the back of a 24.4% increase in electricity tariffs as summer discounts have now come to an end. Such increase was offset by the reduction in the price of low-grade gasoline (-0.56%) and domestic natural gas (-5.17%). Meanwhile, merchandise inflation was up 0.18%m/m explained by higher prices of processed foods (0.28%m/m) and other goods (0.11%), adding 6.4pbs to total CPI variation. Meanwhile, services inflation was down 0.09%m/m on the back of a reduction of 0.41% in *"other services"* prices as mobile phone costs dropped a whopping 11.57%, more than offsetting the increases observed in the cost of restaurants (0.38%), other dining away from home items (0.24%) and professional services (5.92%). Finally, agricultural prices increased 0.43%, due to higher prices of fruits and vegetables (+1.88%) along with a decline of 0.36% in “meat and egg” prices.

With these numbers, annual inflation is at 2.21% vs. 2.48% in previous month. Meanwhile, core inflation edged up to 2.34% from 2.47% in October. We expect inflation to end the year at around 2.5%yoy. For next year, we estimate that inflation will remain under control, with our forecast at 3.2% for year-end 2016.

Inflation forecast
%yoy



Source: Banorte Ixe with data from INEGI

From our fixed income and FX strategy team

Tamed inflation supportive for the short- and mid-ends. Annual inflation continues portraying an important downward trend, with evidence of a low FX pass-through effect on prices and important structural changes that have influenced market inflation expectations for coming years (or at least 2016). In this regard, inflation breakevens are currently trading below Banxico’s 3% target in every tenor: 3-year at 2.38%, 5-year at 2.71%, 10-year at 2.91% and 30-year at 2.97%. The implications for this benign inflation dynamics are at least twofold. First, it suggests that Banxico may start hiking rates in tandem with the Federal Reserve next week and will likely continue this way at the beginning of 2016. However, low inflation and an effect of slack in the economy could halt the restrictive cycle by mid-year, with realized cumulative hikes for the following 12 months maybe lower *vis-à-vis* the 104bps currently priced in the yield curve.

The key factor will be the performance of the Mexican peso. Taking into consideration these variables and the recent market correction we hold a positive view in term of the belly of the Mbonos curve, especially the tenors from the Dec'18 security to the Dec'24. In accordance with this view, we hold our trade idea opened on November 12th of receiving 1-year TIIE-28 IRS (13x1) with an entry level of 3.92%, target of 3.67%, *stop-loss* of 4.10%, and currently trading at 3.92%. For further details regarding this recommendation please refer to "*Trade Idea: Receive 1-year TIIE-28 IRS (13x1)*, <pdf>. The second important implication suggests a difficult scenario for 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. Yesterday's auction considering the the 30-year Udibono Nov'46 was a confirmation of this situation, with a higher yield and a low bid-to-cover ratio. For more details refer to our research note "*Mexico: 20Y Mbono and 30Y Udibono auction results*" <pdf> published yesterday.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
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.ceballos@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 Asset Management	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 Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454