Inflation 1H-January – Challenging outlook at the start of the year

- **Headline inflation (1H-Jan): 0.49% 2w/2w; Banorte: 0.39%; consensus: 0.38% (range: 0.29% to 0.50%); previous: 0.48%**

- **Core inflation (1H-Jan): 0.25% 2w/2w; Banorte: 0.25%; consensus: 0.25% (range: 0.19% to 0.41%); previous: -0.01%**

- **The print was partially impacted by an unfavorable seasonality, with turn-of-the-year increases affecting several categories. In this sense, we note the expansion in some items within the core such as processed foods (0.3%) and 'other services' (0.2%) –even with declines in tourism-driven sectors. Notwithstanding, the point to highlight is that fruits and vegetables (5.0%) remained pressured, adding three fortnights of relevant increases. Energy items (0.0%) were mixed, with increases in electricity (0.2%) and low-grade gasoline (0.1%), but with LP gas lower (-0.4%)**

- **In bi-weekly terms, annual inflation accelerated to 4.90% from 4.86%. The core fell to 4.78% from 4.98%, its lowest level since August 2021**

- **The short-term outlook remains challenging, especially for the non-core. Nevertheless, we still believe that Banxico's first rate cut will materialize in March**

Prices up 0.49% 2w/2w in the 1st half of January. This period is impacted by a mostly negative seasonality, with prices in several categories suffering from usual turn-of-the-year adjustments, as well as by updates to several taxes and government tariffs. As such, in the core (0.25%) we highlight the 0.3% increase in processed foods –noting cigarettes (2.4%) and sodas (0.7%)– and 0.2% in 'other services' –with the latter up despite declines in items such as airfares (-20.3%) and tourism services (-4.7%). We also note the 0.8% increase in 'dining away from home', in our opinion driven by both higher raw materials costs and the [20% adjustment to the minimum wage](). In the remainder of the category, 'other goods' (0.1%) were relatively contained, with housing somewhat high (0.3%). Turning to the non-core (1.22%), pressures continued in fruits and vegetables at +5.0% –adding three fortnights with strong increases–, with the expansion driven by tomatoes, onions, and husk tomatoes. On the contrary, meat and egg came in at 0.0%, helped by eggs. Energy (0.0%) was mixed inside, with increases in electricity (0.2%) and low-grade fuel (0.1%) –the latter impacted by the update to the excise tax–, although with LP gas down by -0.4% (with favorable international price dynamics at the end of December and at the start of the year). Finally, government tariffs grew 0.5%.

1H-January inflation: Goods and services with the largest contributions
% 2w/2w; bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
Tomatoes	23.5	25.6
Dining away from home	3.9	0.8
Onions	3.0	7.2
Cigarettes	2.2	2.4
Housing	1.8	0.2
Goods and services with the largest negative contribution		
Air fares	-5.4	-20.3
Eggs	-1.8	-1.9
Poblano chilies	-1.7	-17.3
Tourism services	-1.6	-4.7
Papaya	-1.2	-9.1

Source: INEGI

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Acceleration in the annual print, with the non-core rising. With these results, headline inflation climbed to 4.90% from 4.86% y/y in the 2nd half of December, adding four fortnights to the upside. The expansion is explained by an additional increase in non-core inflation to 5.24% (previous: 4.49%). The core moderated to 4.78% (previous: 4.98%). Nevertheless, it is relevant to mention some factors behind the dynamics in each item. Starting with the core, the decline has been clearly concentrated in goods –reaching 4.4%, its lowest level since mid-2020 and, in our view, with an important support from MXN strength–, with services showing more persistence to the upside. Specifically, its annual comparison came in at 5.2%, remaining above 5% since mid-2022. In this sense, we believe risks remain for this component, stemming mainly from higher costs, both on inputs –mainly for processed foods, despite energy being more stable– and wages –anticipating a greater pass-through from the minimum wage hike than in previous years. Turning to the non-core, we continue to believe that challenges persist for agricultural goods, with adverse weather conditions currently and in previous months weighing on crops. In this context, our call is that prices for these goods will remain under pressure at least in the short-term, with the annual comparison for fruits and vegetables currently at 20.7%. Finally, we think that the outlook for energy is more favorable at the margin, with high inventories in the US and Europe helping to cope with some cold streaks, while the view of a global slowdown has also helped to keep prices relatively contained despite heightened geopolitical tensions. Thus, we maintain our estimate that inflation will close the year at 4.6%, above market consensus at 4.0%.

Despite challenging dynamics, we think Banxico will signal that the start of easing is close. With attention turning to the next monetary policy decision on February 8th, we believe the institution will opt to show a less hawkish tone, finalizing the groundwork for a first rate cut at the March meeting through changes in its forward guidance –in line with our -25bps estimate at that time. We expect members to focus on the core inflation, highlighting its downward trajectory. However, it will be very relevant to see how much weight they give to non-core dynamics, especially if they believe that current pressures are more transitory or permanent in nature. At the margin, we still think that other factors, such as a looser global monetary stance and a high ex-ante real interest rate, will be key in driving the start of easing.

Analyst Certification.

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Santiago Leal Singer, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Carlos Hernández García, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Daniel Sebastián Sosa Aguilar, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Juan Carlos Mercado Garduño, Jazmin Daniela Cuautencos Mora, Andrea Muñoz Sánchez and Paula Lozoya Valadez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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