November 25, 2021

Latam Daily: Mexico 1H November Inflation; Debt Market Outflows

- **Mexico: Annual inflation keeps upward trend; Outflows and adjusting the debt market**

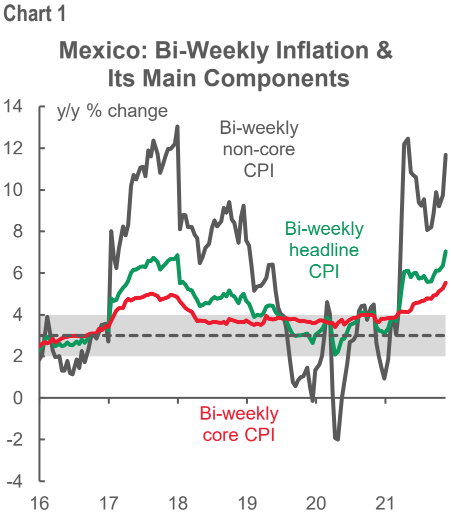
MEXICO: ANNUAL INFLATION KEEPS UPWARD TREND; OUTFLOWS AND ADJUSTING THE DEBT MARKET

I. Annual inflation reaches highest level since 2001 in first half of November; boosts consensus estimate for end-2021

According to statistical agency, INEGI, in the first fortnight of November, annual inflation accelerated to its highest level since 2001—from 6.36% y/y to 7.05% y/y (chart 1)—again beating consensus expectations (6.86% y/y). Core inflation also maintained an upward trajectory, as it moved from 5.26% y/y to 5.53% y/y. Merchandise led the upsurge, from 7.29% y/y to 7.52% y/y, while services rose from 3.70% y/y to 3.85% y/y (chart 2). Non-core inflation also accelerated to 11.68% y/y from 9.73% y/y previously, as energy prices rose to 15.25% y/y from 14.22% y/y and food prices increased to 12.37% y/y from 8.95% y/y previously (chart 3).

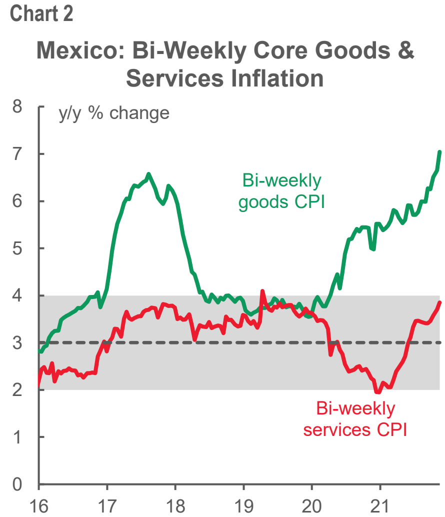
In its sequential biweekly comparison, inflation accelerated from 0.38% 2w/2w to 0.69% 2w/2w, beating the consensus of 0.50% 2w/2w—its highest level since 1H November 2017. Core inflation moderated less than expected from 0.20% 2w/2w to 0.15% 2w/2w (0.09% 2w/2w consensus). Merchandise prices (0.07% 2w/2w vs 0.21% 2w/2w previously) benefited from *El Buen Fin* sales days (the Mexican Black Friday sales), which took place the last week of the fortnight, compared to last year, when the Black Friday sales extended over two weeks owing to the COVID-19 restrictions. However, services increased to 0.19% 2w/2w to 0.25% 2w/2w. The non-core component accelerated from 0.93% to 2.29% 2w/2w, in particular energy and regulated prices went up 2.38% 2w/2w (vs. 0.63% previous) owing to the end of the summer subsidies program in electricity prices; food also edged up, from 1.32% 2w/2w to 2.17% 2w/2w.

Chart 1



Sources: Scotiabank Economics, INEGI.

Chart 2



Sources: Scotiabank Economics, INEGI.

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Consensus in the Citibanamex survey now foresees an annual inflation by the end of 2021 of 6.94% y/y up from the 6.67% y/y in the previous estimate, which would place it as the highest end of period inflation since 2000. For the end of 2022, expectations moved from 3.91% to 3.97% y/y.

In terms of monetary policy implications, we maintain our outlook for a 25 bp hike to 5.25% at the Bank of Mexico's last policy meeting of the year on December 16, although we remain cautious on the next comments the Board might have regarding inflation drivers (mostly supply side) and the extent of transitory base effects. Our view could change in the coming weeks, depending on the monthly inflation data for November and other related events.

—Miguel Saldaña

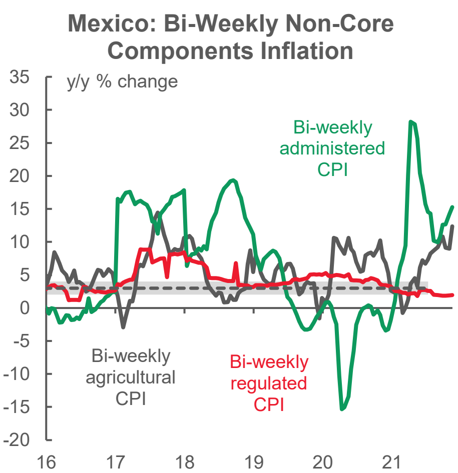
II. Portfolio flows into Mexico continue to show weak appetite

It has now been almost 3 years of continued declines in the foreign holdings of Mexican bonds by foreign investors (chart 4). As we have written in the past, in 2020 and 2021, the contraction in bank lending led local banks to absorb an important share of bonds dumped by foreign investors. Going forward, as bank lending picks up with the economic rebound, the logical result will be for banks to start reducing their exposure to public debt. At that point, one of three things could help adjust the debt market: 1) a return of foreign investors, which is possible with positioning being much lighter and Mexican yields rising ahead of USTs, 2) further upwards adjustments in yields to entice foreigners back into the market, or 3) the government's debt strategy could increase the weight of floating rate and inflation-indexed debt to make the adjustment happen in the absence of the above- mentioned factors.

However, it is not just Mexican public debt seeing weak demand from abroad. According to the IIF's estimates of portfolio flows into Mexico, year-to-date debt and equity markets have seen cumulative outflows of US$17.8 bn (chart 5). As Bloomberg reported on this issue, if the IIF's estimates are proved correct later this week, this will be the first year since the 1990s where Mexico recorded 3 consecutive quarters of sequential outflows from both the equity and fixed income markets. The central bank, Banxico, is scheduled to publish data on this topic later today (Thursday, November 25).

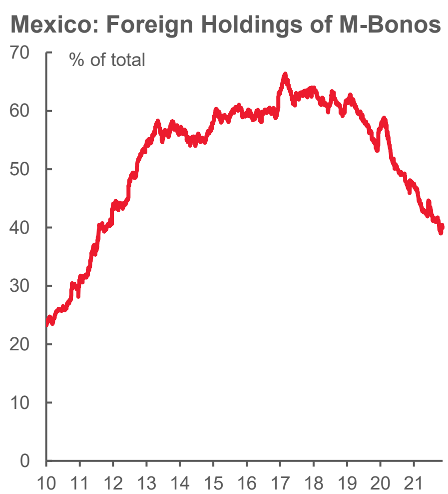
—Eduardo Suárez

Chart 3



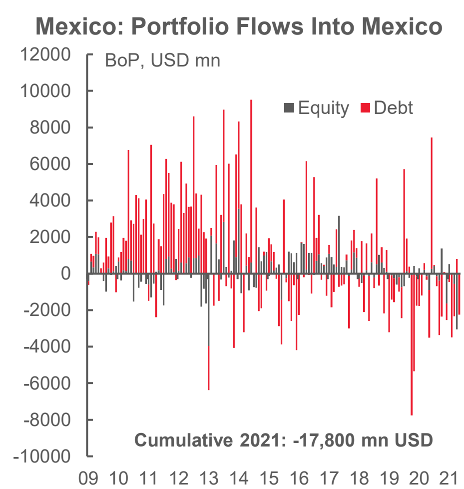
Sources: Scotiabank Economics, INEGI.

Chart 4



Sources: Scotiabank Economics, Banxico.

Chart 5



Sources: Scotiabank Economics, IIF.