

August inflation – Diverging performance in the headline and core components

- **Headline inflation (August): 0.19% m/m; Banorte: 0.21%; consensus: 0.20% (range: 0.16% to 0.57%); previous: 0.59%**
- **Core inflation (August): 0.43% m/m; Banorte: 0.44%; consensus: 0.42% (range: 0.39% to 0.45%); previous: 0.48%**
- **Non-core inflation stood at -0.52% m/m, benefited by lower LP gas prices in the first half (-14.5%). Low-grade gasoline was stable (0.0%), but agricultural goods stayed pressured (2.0%), especially fruits and vegetables (3.9%). At the core, processed foods (0.7% m/m) remain on the upside, while other goods (0.7%) were affected by an adverse seasonality. Services were relatively modest (0.1%) with tourism categories declining as the summer holiday period ended**
- **Annual inflation declined to 5.59% from 5.81% in July. Nevertheless, the core picked up to 4.78% from 4.66%. In our view, the latter should maintain most Banxico members cautious about the outlook for prices, with a hawkish bias**
- **We hold a view of a more compelling value in mid-term Udibonos**

Inflation at 0.19% m/m in August. This was slightly lower than consensus (0.20%) and our 0.21%. [As already known](#), the print was benefitted by lower LP gas prices (-14.5% m/m), albeit with a marginal increase in the second half. Moreover, at the non-core, low-grade gasoline was stable (0.0%), but agricultural goods stayed pressured (2.0%), especially fruits and vegetables (3.9%). We do not rule out some initial impacts to the latter from hurricanes *Grace*, *Nora*, and to a lesser extent *Ida*. Meat and egg (0.5%) also increased. At the core, processed foods (0.7%) remain on the upside, while other goods (0.7%) were affected by an adverse seasonality –the end of summer discounts on clothing–. Services edged up 0.1%, with more modest pressures on education (0.7%) than historically, likely related to the pandemic. Tourism-related categories also helped, but restaurants and ‘dining away from home’ are still concerning, affected by cost pressures, albeit decelerating at the margin.

August inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.19	0.21	-0.02
Core	0.32	0.33	-0.01
Goods	0.28	0.29	-0.01
Processed foods	0.14	0.15	-0.01
Other goods	0.14	0.14	-0.01
Services	0.04	0.04	0.00
Housing	0.03	0.03	0.00
Education	0.03	0.02	0.00
Other services	-0.01	-0.02	0.00
Non-core	-0.13	-0.11	-0.02
Agriculture	0.22	0.22	-0.01
Fruits & vegetables	0.19	0.19	0.00
Meat & egg	0.03	0.04	-0.01
Energy & government tariffs	-0.35	-0.34	-0.01
Energy	-0.35	-0.34	-0.01
Government tariffs	0.01	0.01	0.00

Source: INEGI, Banorte.

Note: Contributions might not add due to the number of decimals allowed in the table.

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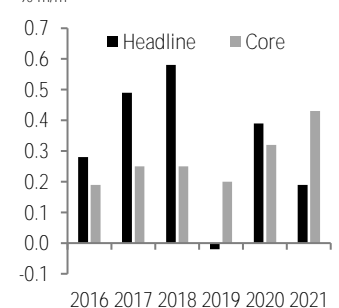
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Headline and core inflation in August
% m/m



Source: INEGI

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August inflation: Goods and services with the largest contributions

% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% m/m
Serrano chilies	4.3	46.9
Avocadoes	3.2	12.1
Onions	2.8	15.0
Corn tortillas	2.5	1.2
Milk	2.2	1.5
Goods and services with the largest negative contribution		
LP Gas	-37.4	-14.5
Airfares	-4.6	-18.2
Tourism services	-2.0	-6.2
Chicken	-1.3	-0.8
Bananas	-1.0	-3.6

Source: INEGI

Despite lower LP gas, core inflation climbed further. Headline inflation fell to 5.59% from 5.81% in July. Apart from base effects, the non-core component was favorable, reaching 8.14% from 9.39%. Nevertheless, the core increased to 4.78% from 4.66%, remaining at highs not seen since end 2017. Specifically, goods are still leading at 6.0% y/y, while services declined at the margin, to 3.4% from 3.5% in July.

Most central bank members will likely remain cautious. In our view, the absence of lower core inflation since November 2020 will remain a concern for most central bank Board members. In this respect, three of them will likely keep seeing the need of adjusting the reference rate higher in the short term, helping to maintain expectations well anchored. Nevertheless, we recognize that the decision is difficult on uncertainty about the impact on prices and activity from ‘delta’. In this respect, Banxico will remain very data dependent. Given a divided Board about the best monetary policy stance, we cannot rule out a pause in the hiking cycle before our call. For now, given the complex outlook for prices, we still see three consecutive increases of 25bps, with the rate reaching 5.25% by year-end. Moreover, we anticipate two more hikes of the same magnitude at the start of 2022 and one at the end, closing said period at 6.00%.

From our fixed income and FX strategy team

We hold a view of a more compelling value in mid-term Udibonos. Today’s inflation report supports our view of a more attractive valuation in mid-term CPI-linked Udibonos, especially in Udibonos Nov’28 and Nov’31. In this sense, recent price action has shown a defensive performance in this area of the Udibonos’ curve. Meanwhile, the Mbonos’ curve has flattened in recent weeks with a defensive performance in long-term tenors, while mid- and short-term securities have experienced pressures. Consequently, inflation breakevens trade at high levels and above their 12-month average with the 5-year reading reaching 12-month highs on Tuesday at 4.62%. Considering today’s inflation figures, the curve’s pricing for Banxico will hold the recent adjustment to incorporate implied hikes of +60bps for the year-end from +50bps a week before. However, this expectation is still lower than our estimate of a benchmark rate closing this year at 5.25%.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Álvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Juan Barbier Arizmendi, 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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