

Economic Research

Mexico

1H-September inflation – Upward surprise amid signals of broader pressures

- **Headline inflation (1H-Sep): 0.42% 2w/2w; Banorte: 0.29%; consensus: 0.28% (range: 0.20% to 0.38%); previous: 0.18%**
- **Core inflation (1H-Sep): 0.31% 2w/2w; Banorte: 0.21%; consensus: 0.24% (range: 0.20% to 0.30%); previous: 0.17%**
- **We highlight an acceleration at the core, driven by goods (0.4%). Services picked up 0.2%, with education at 1.2% on an adverse seasonal effect because of the return to classes. Moreover, the non-core stood at 0.76%, with pressures in fresh fruits and vegetables (2.4%). Energy also increased (0.8%), with LP gas again higher, at 2.3%**
- **Annual inflation increased to 5.87% from 5.59% on average in August, with an upward trend likely to remain going into the end of the year. The core reached 4.92% from 4.78% in the same period**
- **Given inflation data and the Fed's decision yesterday, we still see three 25bps in the upcoming meetings of this year, closing 2021 at 5.25%**
- **We hold a view of greater relative value in mid-term Udibonos**

Inflation at 0.42% 2w/2w in 1H-Sep. This was much higher than consensus at 0.28%, and to our 0.29%. First, and contrary to our view, we highlight an acceleration at the core. This was driven by goods (0.4%), both processed foods (0.4%) and others (0.5%). We saw strong adjustments in sodas, cooking oil, milk and autos. Services increased 0.2%, with education at 1.2% due to the return to school, albeit relatively low even as some students returned to in-person classes. As usual, professional services fell, by 13.9%. Moreover, the non-core was also pressured, at 0.76%. We note fresh fruits and vegetables (2.4%), particularly tomatoes and onions. We do not rule out an impact from hurricanes in the period, particularly *Nora* in the Pacific and *Grace* in the Atlantic. Energy was also high (0.8%), particularly LP gas (2.3%) which rebounded again given a complicated external backdrop.

1H-September inflation by components
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.42	0.29	0.14
Core	0.23	0.16	0.07
Goods	0.17	0.10	0.08
Processed foods	0.09	0.05	0.04
Other goods	0.09	0.05	0.04
Services	0.06	0.07	-0.01
Housing	0.02	0.01	0.00
Education	0.04	0.06	-0.02
Other services	0.00	-0.01	0.01
Non-core	0.19	0.13	0.06
Agriculture	0.10	0.10	0.01
Fruits & vegetables	0.12	0.09	0.03
Meat & egg	-0.02	0.01	-0.03
Energy & government tariffs	0.09	0.03	0.06
Energy	0.08	0.03	0.05
Government tariffs	0.01	0.00	0.01

Source: INEGI, Banorte.

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

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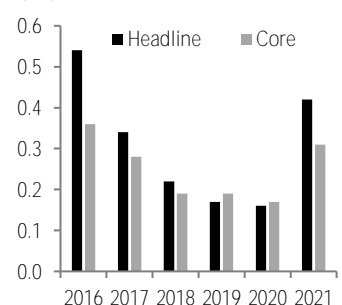
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Headline and core inflation in 1H-Sep
% 2w/2w



Source: INEGI

Document for distribution among the general public

1H-September 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	7.9	11.9
LP Gas	5.0	2.3
Onions	3.6	16.0
Low-grade gasoline	1.9	0.4
Sodas	1.6	0.7
Goods and services with the largest negative contribution		
Professional services	-3.0	-13.9
Chicken	-2.2	-1.3
Bananas	-1.5	-5.8
Avocados	-1.3	-4.5
Oranges	-1.2	-5.7

Source: INEGI

Annual inflation keeps going higher. The headline stood at 5.87% from 5.59% on average in August, while the core inched up to 4.92% from 4.78% in the same period. We believe the former will maintain an uptrend going into the end of the year. Meanwhile, we see sizable upside risks to our 4.7% for the core by December. Going forward, we will keep paying close attention to commodity prices –given added pressures in international markets recently, despite concerns about China’s growth on financial fragilities– as well as supply restrictions because of their potential second-round effects in other goods and services. In turn, we think the pandemic is still influencing price dynamics, particularly with signs of higher caution among consumers that suggest some weakness in domestic demand, even with mobility levels remaining quite strong so far.

Banxico to hike again by 25bps next week. Considering the overall inflation backdrop –especially today’s strong surprise– and the Fed’s decision yesterday, we maintain our call that the majority of Banxico members will opt to hike the reference rate by 25bps next week. Regarding the Fed, they pointed to the start of tapering soon, in our view announcing it in November for a start in December. The market’s reaction was relatively muted, although caution is granted as: (1) EM countries may see some financial instability due to concerns about China, focused on Evergrande’s debt; and (2) other countries have been less accommodative, highlighting Brazil which raised the Selic by 100bps yesterday. Considering other potential episodes of volatility (due to the fiscal *impasse* in the US, for example), we expect Mexico’s central bank to remain prudent despite the diversity of opinions within the Board.

From our fixed income and FX strategy team

We hold a view of greater relative value in mid-term Udibonos. We acknowledge that today’s reading and complex local price dynamics will mostly favor short-term Udibonos in the very next days. However, we hold a view of more attractive valuation in the belly, especially tenors Nov’28 y Nov’31. Recent Udibonos performance has been favorable, averaging gains of 4bps in the week, as opposed to Mbonos that have sold-off 7bps. Hence, 3- and 5-year breakevens have reached 4.65%, widening the spread vs their 12-month average to 81bps and 74bps, respectively, from 55bps and 65bps a week ago. In the current backdrop, we prefer to wait better levels for long positions in long-term Mbonos. Regarding market’s pricing for Banxico, the yield curve has implied hikes of 61bps by year-end from 49bps a week before, renewing the debate of a third 25bps hike, leaving the benchmark rate at level of 5.25% in 2021, as we anticipate.

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We, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalia 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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