

October inflation – Another upward surprise, with the core at highs since mid-2009

- **Headline inflation (October): 0.84% m/m; Banorte: 0.79%; consensus: 0.79% (range: 0.71% to 0.84%); previous: 0.62%**
- **Core inflation (October): 0.49% m/m; Banorte: 0.49%; consensus: 0.47% (range: 0.38% to 0.50%); previous: 0.46%**
- **Energy prices picked up 4.6% m/m, with electricity contributing 27bps. LP gas increased 8.2%, with pressures extending to the second half. Agricultural goods had a breather, up only 0.2%. At the core, goods grew 0.6% and services 0.4%. We highlight the marginal acceleration in ‘others’ (0.7%) in the former and in tourism-related categories, in the latter, in our view adjusting higher ahead of discounts in *El Buen Fin***
- **Annual inflation increased to 6.24% from 6.00% in September. The core advanced to 5.19% from 4.92%, a new high since May 2009**
- **We expect Banxico to hike the reference rate by 25bps on Thursday, to 5.00%. Nevertheless, we see a relevant risk of a 50pbs increase given difficult price dynamics and less monetary largesse globally**
- **The yield curve reflects a high probability of a 50bps rate hike on Thursday**

Inflation at 0.84% m/m in October. This was higher than consensus (0.79%), which matched our call. We keep seeing pressures, albeit with [different dynamics than in the first half](#). Energy prices climbed 4.6%, with electricity tariffs up 18.8% given the reversal of summer discounts in some cities. LP gas (8.2%) was pressured at the margin and low-grade gasoline (-0.4%) was more favorable, helped by a high subsidy to excise taxes. Agricultural goods were up only 0.2% despite some pressures in fresh fruits and vegetables in the second half. At the core, goods (0.6%) remain at a faster pace than services (0.4%). In our view, some upward adjustments were influenced by the upcoming discount period of *El Buen Fin* (Mexico’s Black Friday). Among them, we highlight ‘other goods’ (0.7%), airfares (10.3%) and tourism services (5.7%).

October inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.84	0.79	0.05
Core	0.37	0.37	0.00
Goods	0.24	0.24	0.00
Processed foods	0.11	0.11	0.00
Other goods	0.13	0.12	0.00
Services	0.13	0.13	0.00
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.10	0.10	0.00
Non-core	0.47	0.42	0.04
Agriculture	0.02	-0.01	0.03
Fruits & vegetables	0.00	-0.03	0.04
Meat & egg	0.02	0.02	0.00
Energy & government tariffs	0.45	0.43	0.01
Energy	0.45	0.43	0.01
Government tariffs	0.00	0.00	0.00

Source: INEGI, Banorte.

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

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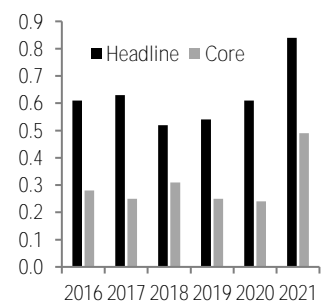
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Headline and core inflation in October
% m/m



Source: INEGI

Document for distribution among the general public

October 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
Electricity tariffs	26.8	18.8
LP Gas	18.9	8.2
Onions	5.2	19.3
Eggs	3.7	4.5
Husk tomatoes	3.1	25.6
Goods and services with the largest negative contribution		
Tomatoes	-6.3	-8.5
Chicken	-4.6	-2.7
Oranges	-3.2	-17.7
Avocadoes	-2.4	-8.6
Low-grade-gasoline	-1.8	-0.4

Source: INEGI

Annual inflation keeps climbing, with the core at highs since May 2009.

Headline inflation climbed to 6.24% y/y from 6.00% in September despite a slightly less challenging base effect. The core picked up for an eleventh month in a row, to 5.19% from 4.92%. The latter broke with the 5% level to the upside for the first time since August 2017 (which was very brief) and is a high not seen since May 2009, when it reached 5.35%. Despite a relative stabilization in energy commodities in recent days, it is likely that accumulated pressures and bottlenecks in supply chains have affected prices further. We cannot rule out further moves higher due to holiday sales, with several companies expressing concerns about the possibility of not having enough inventories for the season. Given the relative persistence of these factors, inflation risks remain skewed to the upside.

Banxico to hike 25bps to 5.00% this week, although with risks of a more sizable move. The central bank's decision will be on Thursday, in which we see an unchanged 25bps hiking pace, increasing the rate to 5.00%. We believe most Board members will support this magnitude due to the economic slowdown seen in 3Q21, as well as mid- and long-term inflation expectations in surveys that remain anchored close to 3.5%. Nevertheless, this will be a very difficult decision due to the diversity of opinions among members and high uncertainty about the outlook for prices. Specifically, we see a relevant risk of a 50bps hike, to 5.25%. We cannot rule out this scenario given current inflation dynamics –with Banxico likely moving its estimates higher again– and less monetary largesse globally. For further details, see our document, [Ahead of the Curve](#).

From our fixed income and FX strategy team

The yield curve reflects a high probability of a 50bps rate hike on Thursday.

Today's reading will support the market's perception about a more restrictive stance from Banxico, with the yield curve pricing in +89bps by year-end, practically two 50bps rate hikes in the remainder of 2021, though lower vs +95bps a week ago. Despite the remaining drivers this week (including Powell's speech and US CPI), we consider this pricing is unlikely to moderate materially ahead of Banxico's decision on Thursday, with participants discussing the magnitude of the rate hike. In this backdrop, inflation breakevens trade still high mainly in short-term tenors, despite a breather last week. Hence, we see greater relative value in mid-term Udibonos, highlighting the Nov'28 maturity. Moreover, we prefer to wait for better market conditions for directional strategies, although we favor positions that benefit from flatter slopes in light of the global monetary policy conditioning.

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We, Alejandro Padilla Santana, 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, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez and Gerardo Daniel Valle Trujillo, 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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