August inflation – Stays elevated even after considering seasonal pressures

- **Headline inflation (August): 0.70% m/m; Banorte: 0.69%; consensus: 0.68% (range: 0.60% to 0.73%); previous: 0.74%**
- **Core inflation (August): 0.80% m/m; Banorte: 0.83%; consensus: 0.80% (range: 0.74% to 0.84%); previous: 0.62%**
- **Pressures at the core extended because of goods (1.1%), especially processed foods (1.4%), but with 'others' (0.8%) also slightly higher. On the contrary, services (0.4%) moderated, helped by tourism categories, although partly offset by tuitions. At the non-core, energy declined 0.3%. Meanwhile, agricultural goods (1.0%) were affected by fruits and vegetables (3.0%)**
- **Annual inflation keeps rising, with the headline at 8.70% on average from 8.15% in the previous month, and the core at 8.05% from 7.65%**
- **Given the difficult inflation backdrop and global monetary restriction –especially by the Fed–, we expect Banxico to hike by 75bps to 9.25% on September 29th**
- **The market is now convinced that Banxico's next hike will be 75bps**

August's inflation once again high, at 0.70% m/m. On the other hand, the core reached 0.80%, extending the pressures seen in the 1st half. Goods were up 1.1%, with processed foods still leading at 1.4%, resenting the announcement of price increases in items such as milk and sodas, among other factors. 'Others' grew 0.8%, affected at the margin by the return to classes. On the contrary, services (0.4%) moderated relative to the previous month, with tuitions higher due to its seasonality, but helped by airfares (-15.4%) and tourism (-4.6%) because of the end of the holiday period. Nevertheless, dining away from home (1.2%) remains very high. The non-core was lower (0.39%), helped by energy (-0.3%), especially electricity (-0.4%), LP gas (-1.8%) and natural gas (-2.8%). Low-grade gasoline was stable (0.0%). Agricultural goods (1.0%) were mixed, with fruits and vegetables rebounding (3.0%), but with meat & egg (-0.7%) benefitted by chicken and eggs, among the most relevant.

August inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.70	0.69	0.01
Core	0.60	0.62	-0.03
Goods	0.46	0.47	-0.01
Processed foods	0.31	0.30	0.01
Other goods	0.15	0.16	-0.01
Services	0.13	0.15	-0.02
Housing	0.04	0.04	0.00
Education	0.04	0.04	0.00
Other services	0.06	0.07	-0.01
Non-core	0.10	0.06	0.03
Agriculture	0.11	0.07	0.04
Fruits & vegetables	0.16	0.12	0.04
Meat & egg	-0.04	-0.04	0.00
Energy & government tariffs	-0.02	-0.01	-0.01
Energy	-0.03	-0.02	-0.01
Government tariffs	0.02	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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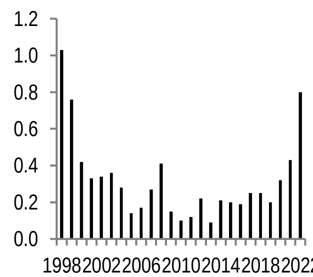
STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

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
Onions	14.0	54.4
Dinner away from home	5.8	1.2
Corn tortilla	5.1	2.4
Potatoes	3.2	6.4
Housing	3.0	0.3
Goods and services with the largest negative contribution		
Avocados	-6.3	-16.1
Chicken	-5.8	-3.2
LP Gas	-4.0	-1.8
Air fairs	-3.9	-15.4
Squash	-1.8	-24.5

Source: INEGI

Annual headline and core inflation above 8%. So far, the upward trend for both metrics continues. The first stood at 8.70% y/y from 8.15% on average in the previous month, while the second reached 8.05% from 7.65% in the same period. It is possible that the headline is close to the peak or that it even reached it this fortnight, supported by an accumulated reduction in gasoline and food prices during the last two months through August of 20.6% (based on the US average price) and 4.6% (according to the FAO index). To the latter we must add some exchange rate stability, particularly in August. Nevertheless, the decline in domestic prices could be more modest due to the rise in other costs. In this respect and as mentioned in the previous print, attention will be on the upcoming negotiations of the 2023 Minimum Wage. According to reports, the increment could be close to 20% or even higher. Based on our forecasts, the core could keep increasing towards 8.3-8.4% by the fourth quarter. Therefore, we believe that difficulties in the inflation front prevail, which in turn will keep Banxico vigilant and cautious for longer than anticipated by the market.

Banxico will likely follow the Fed. The latest communications, among them the minutes and *Quarterly Report*, suggest that most Board members maintain a hawkish tone. Although there is some debate among analysts about the possible magnitude of the adjustment in the decision to be held on September 29th, we reiterate our call of a 75bps hike, to 9.25%. This is mainly based on the view of an increase of the same magnitude by the Fed on September 21st: We believe the potential cost of decoupling from the US monetary authority is very high, even if it is also estimated that the monetary stance is already in 'restrictive' territory. Mostly because we are still in an environment in which the domestic inflation backdrop remains difficult and uncertain, while the risk of a de-anchoring of expectations is still present.

From our fixed income and FX strategy team

The market is now convinced that Banxico's next hike will be 75bps. Global central banks maintain a hawkish tone to curb inflation, with some even surprising consensus expectations. For example, Chile hiked to 10.75% on Tuesday vs an expected rate of 10.50%. In addition, Canada moved by +75bps, resulting in the highest interest rate among developed economies at 3.25%. Locally, inflation prints keep supporting market expectations of a more restrictive stance by Banxico. Specifically, the curve is pricing-in implicit hikes of 150bps for the remainder of the year, including +75bps on September 29th, in line with our call. In terms of strategy, we expect that nominal yields to extend its flattening bias and even invert further as the normalization process continues.

After the strong adjustment seen in August, long-term Mbonos begin to show better relative value. We flag Mbonos Nov'38 and Nov'42, which trade above 9.00%. Nevertheless, we continue preferring relative value trades given high market volatility. In this sense, we maintain our trade idea to pay TIIE-IRS (26x1) and receive 2-year SOFR initiated on August 18th with an entry of 583bps and target of 620bps (current: 599bps). In addition, we do not see attractive levels in CPI-linked bonds given its expensive relative valuation, mainly in short-term tenors. In this sense, the 3-year breakeven stands at 5.13% from 4.67% at the beginning of August, significantly above its 12-month average and Banxico's inflation target.

Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivos Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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	Reference
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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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