

1H-October inflation – Non-core prices behind another decline in the annual rate

- **Headline inflation (1H-Oct): 0.44% 2w/2w; Banorte: 0.49%; consensus: 0.53% (range: 0.44% to 0.63%); previous: 0.10%**
- **Core inflation (1H-Oct): 0.42% 2w/2w; Banorte: 0.33%; consensus: 0.36% (range: 0.28% to 0.47%); previous: 0.15%**
- **Inflation was helped by the non-core. Despite the first price increase in electricity (17.5%) as summer subsidies ended, LP gas fell strongly (-5.0%), with agricultural goods (-0.5%) also favorable. Nevertheless, the core remains high, especially processed foods (0.6%). Services (0.3%) continued to be pressured due to cost pass-through and the reversal of previous discounts, while some tourism discount campaigns do not seem to have had a notable impact**
- **In bi-weekly frequency, annual inflation declined for a third consecutive time, to 8.53% from 8.64%. The core remains to the upside, at 8.39% from 8.29% previously**
- **We stay cautious about the possibility that annual inflation has already passed its peak. Given this, and a difficult monetary backdrop globally, we reiterate our call of +75bps by Banxico in its upcoming decision**
- **Market expects a higher terminal rate for Banxico**

Inflation at 0.44% 2w/2w, below to its five-year average. The latter was mainly because of a good result at the non-core, reaching 0.48%. This component has an upward bias because of the first increase in electricity tariffs (17.5%) as summer subsidies end, adding 26bps to the headline. Nevertheless, it benefitted from the strong fall of 5.0% in LP gas, subtracting 10bps. Low-grade gasoline was marginally higher, but agricultural goods (-0.5%) were more favorable. In fresh fruits and vegetables (-0.9%), we saw important adjustments in tomatoes, onions, and avocados (see table below); in meat & egg (-0.1%), we highlight chicken (-0.5%). Despite of this, the core (0.42%) remains high, especially because of processed foods (0.6%), where we still see a limited effect from the [complementary agreement to the Plan Against Inflation](#). Services rose 0.3%, still high when excluding education and housing ('Other services': +0.5%). It seems that the *Hot Travel* campaign did not have a significant downward impact on tourism categories, while dining away from home (0.6%) remains with relevant pressures.

1H-October 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
Electricity	25.6	17.5
Tomatoes	5.7	9.3
Dinning away from home	3.0	0.6
Corn tortilla	2.0	0.9
Low-grade gasoline	1.8	0.4
Goods and services with the largest negative contribution		
LP gas	-10.3	-5.0
Potatoes	-5.1	-10.2
Onions	-4.8	-11.2
Avocados	-2.7	-10.2
Oranges	-2.6	-10.6

Source: INEGI

October 24, 2022

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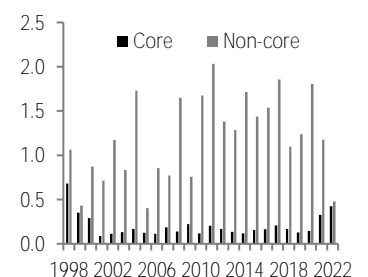
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Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*



Core and non-core inflation in 1H-October
% 2w/2w



Source: INEGI

Document for distribution among the general public

Annual inflation with three consecutive fortnights lower, but we stay cautious. In bi-weekly frequency, annual headline inflation fell at the margin, to 8.53% from 8.64% previously, further away from the latest high of 8.77% in August's second half. The core stayed up, at 8.39% from 8.29%. Although the former is positive, we are cautious as pressures in the latter category prevail, which in turn could lead to a new rise of the headline going into year-end. Energy has helped in the last fortnights, but the market remains fragile. [OPEC+ cut its production](#) in a bid to stem more price declines, with the US responding with the release of 15 million barrels from its Strategic Petroleum Reserve. Nevertheless, they could limit gasoline exports, not at all clear if this could affect our country. Locally, concerns about food price dynamics are still present, including in corn tortillas and other basic goods. In this backdrop, President López-Obrador talked with Walmart's CEO for international operations Judith McKenna, agreeing to limit further increases in food prices. On the other hand, we are still looking for more modest discounts during *El Buen Fin* (Mexico's Black Friday) due to lower retailers' profit margins. Despite recent news with a positive bias, price dynamics remain complicated worldwide. We reiterate our year-end forecast at 9.0% y/y, with risks that seem tilted slightly to the downside.

Banxico will keep fighting against a challenging inflationary environment. Despite of the latter, we believe most Board members remain concerned about inflation dynamics, exhibiting an [even more hawkish tone in the latest minutes](#). Moreover, the latest central bank survey showed a renewed increase in inflation expectations for this year and 2023, as well as for the mid- (one to four years) and long-term (five to eight years). Given this, as well as a backdrop that remains very difficult for global monetary policy, we reiterate our call of a 75bps hike on the meeting to be held on November 10th, following a move of the same magnitude and direction from the Fed on November 2nd.

From our fixed income and FX strategy team

Market expects a higher terminal rate for Banxico. Local rates quickly assimilated negative inflation surprises in several regions –pointing out the latest figure in the US, Canada, and the UK. In this sense, the curve is pricing- 194bps of accumulated rate hikes to end Banxico's tightening cycle in February 2023 at 11.19%, up from 148bps as of October 12th. This scenario is slightly more aggressive than our call of 11.00% at the end of 1Q23. In this backdrop, we expect volatility to continue, mainly in short-term rates, given high uncertainty about the duration and magnitude of restrictive cycles. Despite a growing attractiveness in long-term Mbonos –particularly tenors Nov'38 and Nov'42–, we reaffirm our preference for relative value strategies and maintain [our recommendation to pay TIE-IRS \(26x1\) and receive 2-year SOFR](#). For its part, inflation hedges are becoming even more expensive in relative terms, with breakevens for all maturities at 12-month highs. For example, the 3-year figure stands at 5.41%, well above Banxico's inflation target. Therefore, we do not see enough attractiveness in CPI-linked bonds (Udibonos), at least for now.

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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, Isaiás Rodríguez Sobrino, Paola Soto Leal, 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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