October inflation – Explained by the end of summer discounts in electricity tariffs

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- ***INEGI* just published its inflation report for October**
- **Headline inflation (October): 0.61% m/m; Banorte-Ixe: 0.58%; consensus: 0.64% (range of estimates: 0.58% to 0.67%); previous: 0.48%**
- **Core inflation (October): 0.28% m/m; Banorte-Ixe: 0.26%; consensus: 0.29% (range of estimates: 0.26% to 0.33%); previous: 0.48%**
- **Inflation in October was explained by pressures on electricity tariffs, given the end of summer discounts, along with increases in "other goods" prices as a result of a higher pass-through from the depreciation of the Mexican currency to prices**
- **With these numbers, annual inflation is at 3.06% vs. 2.97% in September**
- **No strong case for a long directional position in CPI-adjusted securities.**

Consumer prices increased 0.61% m/m in October. In addition, core inflation was 0.28% vs. our 0.26% estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of "other goods" prices (6.1bps vs. our 4.7bps); (2) an underestimation of processed foods prices (8bps vs. our 7bps); and (3) an underestimation of fruits and vegetables (0bps vs. our -1bps), as shown in the table below.

Inflation by components in the first half of October
% monthly incidence

	Observed	Banorte-Ixe	Difference
Headline	0.61	0.58	0.02
Core	0.21	0.19	0.02
Goods	0.14	0.12	0.02
Processed foods	0.08	0.07	0.01
Other goods	0.06	0.05	0.01
Services	0.07	0.08	-0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.04	0.04	0.00
Non-core	0.40	0.40	0.00
Agricultural	0.00	0.00	0.00
Fruits and vegetables	0.00	-0.01	0.01
Meat and eggs	0.00	0.01	-0.01
Energy and government tariffs	0.42	0.41	0.00
Energy	0.42	0.41	0.01
Government tariffs	0.01	0.01	0.00

Source: Banorte-Ixe with data from INEGI and Banco de México.
Note: Contributions might not add due to the number of decimals allowed in the table.
Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

Inflation in October was explained by pressures on electricity tariffs. According to *INEGI*, electricity tariffs increased 20.3%, given the end of summer discounts in some regions of the country. In addition, there were some pressures in energy and fresh fruit sectors. In particular, the report mentions low grade gasoline (+0.6% m/m) and tomatos (+5.62%), among the items with increasing prices.

In addition, merchandise inflation was up 0.4% m/m, with higher prices of both processed food (+0.5% 2w/2w) and “other goods” (+0.32%). In this context, we believe that the upward trend in the latter is explained by the significant depreciation of the Mexican currency, which has induced a higher pass-through effect to prices. Within the non-core index, agricultural prices fell as a result of the 0.5% contraction in the “meat and eggs” sub-index.

12-month inflation maintains an upward trend. With today’s figures, 12-month inflation is at 3.06% vs. 2.97%, in September. In addition, core inflation is at 3.1% from 3.07% in the previous month. Looking ahead, we expect inflation will hover around this level and will stand at our 3.1% forecast for year-end.

From our fixed income and FX strategy team

No strong case for a long directional position in CPI-adjusted securities. Local rates are trading in tandem with the global assessment on U.S. elections and putting less attention on today’s CPI report. Mexican bonds are paring early losses after Banxico decided to stay put and wait for its ordinary meeting on November 17th to consider any policy action derived from the U.S. elections outcome. Sovereign rates are trading with a 35-40bps sell-off along the entire yield curve, with a strong likelihood of a bear flattening bias in coming sessions. On the other hand, despite the significant FX correction, we expect inflation dynamics to remain relatively stable in a 12-month horizon, limiting the risk reward of CPI-adjusted securities, despite breakevens hovering around 3.1% in every tenor. UDIS carry gains are attractive for the rest of the year (6.86% annualized carry for 52 days), however, this effect fades away in a significant fashion through coming months: 6M @ 3.77%, 12M @ 3.08%, 2Y @ 3.17% and 3Y @ 3.36%.

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