

CPI changes methodology as of the 1st half of August

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- On August 23rd, *INEGI* will publish CPI figures with a new base year as well as a new methodology
- Among these changes, we highlight the modification to the index weights, which will add more percentage to the non-core index
- We believe that these changes will result in a better measurement of inflation
- In this context, we maintain our year-end forecast at 4.3%, which already includes the aforementioned changes
- In this regard, we expect inflation to increase 0.39% 2w/2w in the first half of August. Moreover, the core component could rise 0.15% 2w/2w
- Inflation in the period will be explained by pressures on fresh fruits and vegetables as well as energy prices
- With these results, 12-month inflation will stand at 4.86, while the core index could climb 3.58%

Changes in CPI methodology. On August 23rd, *INEGI* will publish consumer price figures for the first half of August using a new methodology and changing the base year. These changes were already announced back on August 23, 2017, when we published a research note outlining some of the modifications [Research note: “*INEGI – New CPI in August 2018*” <PDF>], among which are:

- (1) Change in base year: The current methodology considers the second half of December 2010 as base 100, while the new index will take as reference the second half of July 2018;
- (2) Wider geographical coverage: The current CPI measurements are taken in 46 cities, while the new index will add 9 more: Atacomulco, Cancun, Coatzacoalcos, Esperanza, Izúcar de Matamoros, Pachuca, Saltillo, Tuxtla Gutiérrez and Zacatecas; and
- (3) Increase in the number of generic products covered: The new index will be made up from 299 generic products, up from current 283, as shown in the following table

New basket of goods and services

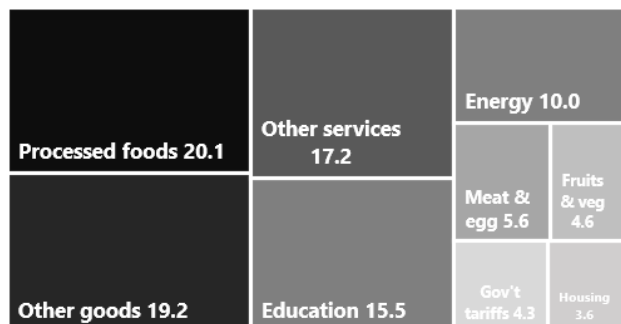
Status	Number of generic items		Difference	New weights
	New basket	Previous basket		
No changes	265	265	0	95.9
New addition	10	-	10	0.5
Deleted	-	2	-2	-
Disaggregated	19	9	10	2.4
Merged	5	7	-2	1.2
Total	299	283	16	100

Source: INEGI

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- (4) Changes in weights: *INEGI* will change the weights within the index. The core component will now represent around 75.55% of the total (vs. 77.44% in the current methodology), with which the non-core index goes to 24.45% (vs. 22.56%), as shown in the following charts.

New Weights (2018)
% of total CPI



Source: Banorte with data from INEGI

Current Weights (2010)
% of total CPI



Source: Banorte with data from INEGI

Significant changes in the weights of some specific goods and services.

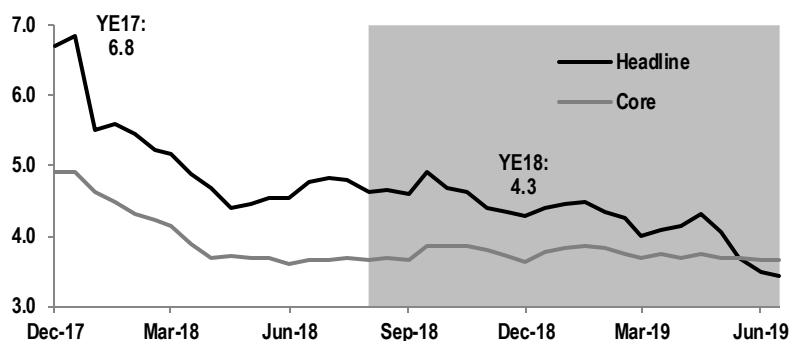
Among the items that will have a greater weight in the index include: (1) Low-grade gasoline (+157bps, 2018: 5.36%); (2) soft drinks (+97bps, 2018: 2.06%); (3) dining away from home items (+70bps, 2018: 4.58%); (4) LP gas (+69bps, 2018: 2.17%); and (5) car maintenance (+46bps, 2018: 0.66%). By contrast, the five categories that are being modified to the downside are: (1) Housing and accommodation –for purchase–, (-214bps, 2018: 12.01%); (2) electricity tariffs (-132bps, 2018: 1.49%); (3) Housing and accommodation –rentals–, (-121bps, 2018: 2.17%); (4) automobiles (-100bps, 2018: 1.9%); and (5) cellphone services (-83bps, 2018: 1.28%).

A more volatile index. With the higher weight of the non-core component, we expect the general index to present greater variation than with the current methodology. Making an exercise with annual data since December 2011 –and analyzing only the differences at the core and non-core levels–, we observe that the new methodology adds on average 6.2bps to the general index, with a standard deviation of 4.7bps. In addition, the maximum difference between methodologies is 16.9bps. Despite the introduction of greater volatility in the index, we believe that it will not have further implications on the approach Banxico takes on monetary policy.

Our 4.3% estimate for YE18 already incorporated the methodology change. While we agree that the changes to the methodology will lead to a better measurement of the CPI -one of the fundamental variables for markets-, as we already commented above, we recognize that, in the short-term, it could lead to slightly higher inflation levels. It should be noted that our estimate for the end of this year -published on January 5-, already contemplated the impact of the methodology changes. In fact, our trajectory incorporates relatively high levels of inflation in the following prints due to: (1) Higher international reference prices of gasoline; and (2) a pickup in the prices of fresh fruits and vegetables. We expect this rebound to be temporary, with inflation converging to our estimate at the end of the year.

Inflation forecasts 2018-2019

% yoy, bi-weekly frequency



Source: INEGI, Banorte

Taking these changes into account, we expect inflation to climb 0.39% 2w/2w in the first half of August. In addition, we forecast a 0.15% 2w/2w increase in the core component. Inflation during the period in question will be mainly explained by the increase in the price of fresh fruits and vegetables. In addition, we also expect pressures from energy prices, particularly gasoline, along with higher prices of other goods. With these results, 12-month inflation will stand at 4.86% in the first half of August, higher than the 4.81% seen in July. Moreover, we forecast core inflation at 3.58% yoy (previous: 3.63% yoy).

1H-August inflation by components

% bi-weekly incidence

	2018 F	2017	Difference
Headline	0.39	0.31	0.08
Core	0.11	0.15	-0.04
Goods	0.07	0.14	-0.07
Processed foods	0.03	0.04	-0.01
Other goods	0.04	0.10	-0.06
Services	0.04	0.01	0.03
Housing	0.01	0.02	0.02
Education	0.04	0.05	-0.04
Other services	-0.01	-0.07	0.05
Non-core	0.28	0.16	0.12
Agricultural	0.15	0.08	0.07
Fresh fruits and vegetables	0.15	0.06	0.09
Meat and egg	0.01	0.02	-0.02
Energy and government regulated	0.13	0.07	0.05
Energy	0.12	0.06	0.07
Government regulated	0.00	0.01	-0.01

Source: Banorte, INEGI

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Aderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer and Francisco José Flores Serrano 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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