

Inflation in 1H-October surprises to the downside on lower agricultural prices

October 24, 2018

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@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

Juan Carlos Alderete, CFA

Senior Economist, Mexico
juan.alderete.magal@banorte.com

Francisco Flores

Economist, Mexico
francisco.flores.serrano@banorte.com

- **INEGI** just published its inflation report for the first half of October
- **Headline inflation (1H-Oct): 0.40% 2w/2w; Banorte: 0.53%; consensus: 0.47% (range of estimates: 0.39%-0.63%); previous: 0.10%**
- **Core inflation (1H-Oct): 0.17% 2w/2w; Banorte: 0.19%; consensus: 0.16% (range of estimates: 0.10%-0.20%); previous: 0.18%**
- **Inflation in the period was explained by the reversal of some of the subsidies to electricity tariffs, adding 26bps to the headline figure**
- **With these figures, annual inflation fell to 4.94% from 5.02%. On the other hand, core-inflation picked up to 3.74% from 3.67%**
- **Apart from the seasonal effect from electricity, we highlight the negative contribution to headline from agricultural prices, subtracting 5bps to the fortnightly print**
- **Despite a better-than-expected CPI report, investors are acknowledging that inflation's balance of risks continues tilted upwards, supporting our trade idea in the real-rate Udibono Jun'22**

Consumer prices increased 0.40% 2w/2w in the first half of October. This number was below both consensus (0.47%) and our forecast (0.53%). Meanwhile, core inflation remains pretty stable, printing at 0.17% vs. our 0.19% estimate.

The main deviation from our forecast came from: (1) A lower than expected contribution from energy (32bps vs. our 38bps), both in electricity and LP gas; (2) a lower than expected impact from agricultural goods (-5bps vs. our 0bps); (3) a more modest contribution from processed foods (2bps vs. our 6bps); and (4) a higher than estimated advance in other services (6bps vs. our 4bps), as shown in the table below.

1H-October inflation by components

% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.40	0.53	-0.13
Core	0.13	0.14	-0.01
Goods	0.05	0.09	-0.03
Processed foods	0.02	0.06	-0.04
Other goods	0.03	0.03	0.01
Services	0.07	0.06	0.02
Housing	0.01	0.02	-0.01
Education	0.00	0.00	0.00
Other services	0.06	0.04	0.02
Non-core	0.27	0.39	-0.12
Agriculture	-0.05	0.00	-0.05
Fruits & vegetables	-0.04	-0.01	-0.03
Meat & eggs	-0.02	0.01	-0.03
Energy & government tariffs	0.32	0.39	-0.07
Energy	0.32	0.38	-0.07
Government tariffs	0.00	0.01	0.00

Source: INEGI, Banorte.

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

Fixed income and FX Strategy

Alejandro Padilla

Head Strategist – Fixed-Income and FX
alejandro.padilla@banorte.com

Santiago Leal Singer

Fixed-Income and FX Strategist
santiago.leal@banorte.com

Leslie Orozco

Fixed Income and FX Strategist
leslie.orozco.velez@banorte.com

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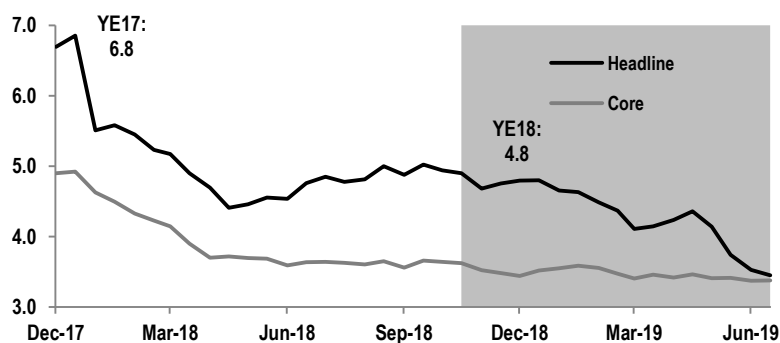
Inflation in the period was explained by the reversal of some of the subsidies to electricity tariffs, adding 26bps to the headline figure. It is worth remembering that this is a typical seasonal effect, with another increase scheduled for the first half of November. In particular, electricity prices increased 17.8% 2w/2w, below the 20.2% average observed in the last three years. Moreover, LP gas increased 0.4%, while low-grade gasoline increased 0.7%, practically in line with its bi-weekly average compound rate during the last twelve months. Meanwhile, agricultural prices surprised to the downside, with fresh fruits and vegetables falling 0.8%, its third consecutive fall in a bi-weekly basis. In this respect, 9 out of 10 of the goods with the highest negative contribution in today's print were from this category, highlighting potatoes (-8.3% 2w/2w), oranges (-11.5%), and avocado (-4.6%), among others. However, tomatoes increased 5.8% while husk tomatoes picked up 13.4%.

Core inflation stood at 0.17% 2w/2w on the back of higher prices in other services (0.4%), adding 6bps to this sub index. Core-goods were well behaved, with processed foods up 0.1% and other goods 0.2%. In this respect, core inflation was a tick lower than recent prints, a situation that could provide some relief to Banxico given its heightened concern of a potentially higher pass-through effect from pressures in the non-core component.

In annual terms, inflation moderated to 4.94% from 5.02%. We maintain our 4.8% year-end estimate, above the consensus forecast of 4.5%. In our view, non-core will remain elevated mostly as a result of gasoline price increases. In this respect, it is worth noting that the government subsidy of the gasoline excise tax for the week from October 20 to 26 was decreased to its lowest level so far this year, which could at least limit the potential downside in prices at the retail level in spite of the recent fall in crude-oil prices.

Inflation forecast

% yoy, bi-weekly trajectory



Source: INEGI, Banorte

From our fixed income and FX strategy team

Despite a better-than-expected CPI report, investors are acknowledging that inflation's balance of risks continues tilted upwards, supporting our trade idea in the real-rate Udibono Jun'22. The CPI report released today depicted a fortnightly increase of 0.40%, below consensus, however confirming the start of the seasonally high-inflation prints (4Q18). Despite a relatively benign inflation figure this morning, the yield curve is flat *vis-à-vis* yesterday's close, with investors acknowledging several headwinds for EM that could continue affecting the embedded risk premia in addition to some factors that could steer inflation higher in coming months (*e.g.* gasoline prices). It is also worth stressing out that global dynamics have increased the volatility of the Mexican peso in recent sessions, which is trading 0.8% weaker today, overshadowing the positive effect of this report. In the aftermath of this backdrop, we hold a cautious view about Mbonos while endorsing our defensive trade recommendation of long positions in the CPI-linked Udibono Jun'22. More details about our assessment of the local market in our “*Fixed-Income, FX, and Commodities - 4Q18 Outlook*” <[pdf](#)>, published on October 19th, 2018.

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 1670 - 1698

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Francisco Duarte Alcocer	Analyst	francisco.duarte.alcocer@banorte.com	(55) 1670 - 2707
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454