Inflation in the 1H-September explained by pressures on energy and education prices

- ***INEGI* just published its inflation report for the first half of September**
- **Headline inflation (1H-Sep): 0.22% 2w/2w; Banorte: 0.36%; consensus: 0.3% (range of estimates: 0.19% - 0.46%); previous: 0.30%**
- **Core inflation (1H-Sep): 0.19% 2w/2w; Banorte: 0.29%; consensus: 0.26% 2w/2w (range of estimates: 0.18% - 0.29%); previous: 0.09%**
- **Inflation in the first half of September was explained by pressures on energy and education prices**
- **With these numbers, annual inflation stood at 4.88%, below the 4.90% seen in the previous month**
- **Local bonds rallying 3-4bps in the aftermath of today's better-than-expected CPI report**

Consumer prices increased 0.22% 2w/2w in in the first half of September. This number was higher than both the consensus (0.30%) and our forecast (0.36%). Meanwhile, core inflation edged-up 0.19% vs. our 0.29% estimate.

The main deviation from our forecast comes from: (1) A lower than expected contribution of agriculture prices (-4bps vs. our 10bps); (2) a lower than expected impact of other services (-3bps vs. our 1bp); (3) a higher than expected contribution of energy prices (12bps vs. our 7bps); and (4) a lower impact from processed foods (4bps vs. 6bps), as shown in the table below.

1H-September inflation by components
% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.22	0.36	-0.14
Core	0.14	0.22	-0.07
Goods	0.08	0.11	-0.02
Processed foods	0.04	0.06	-0.02
Other goods	0.05	0.05	0.00
Services	0.06	0.11	-0.05
Housing	0.02	0.02	0.00
Education	0.07	0.08	-0.01
Other services	-0.03	0.01	-0.04
Non-core	0.08	0.15	-0.07
Agriculture	-0.04	0.07	-0.11
Fruits & vegetables	-0.06	0.04	-0.10
Meat & eggs	0.02	0.03	-0.01
Energy & government tariffs	0.12	0.08	0.04
Energy	0.12	0.07	0.04
Government tariffs	0.00	0.01	0.00

Source: Banorte 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

September 24, 2018

www.banorte.com
@analisis_fundam

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

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

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

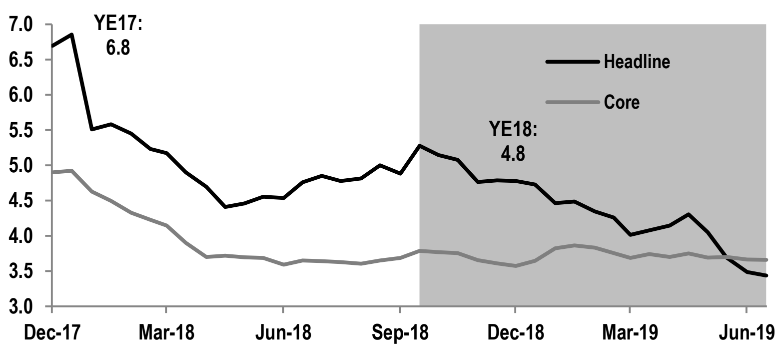
Leslie Orozco
Fixed Income and FX Strategist
leslie.orozco.velez@banorte.com

Inflation in the first half of September was explained by pressures on energy and education prices. Energy prices increased 1.2% 2w/2w given the rise in LP gas (+3.7%) and low-grade gasoline prices (+0.8%), despite the 0.7% fall in electricity. Continuing with the non-core component, agricultural prices declined 0.4% on the back of the 1.3% contraction in the price of fresh fruits and vegetables. In particular, INEGI highlights the reduction in the prices of oranges (-14.1%), potatoes (-6.2%), and bananas (-2.6%), among others.

Turning to the core index, services posted a 0.2% 2w/2w expansion given the 2% rise in education costs. This was explained by the increase in pre-school (+4.5%), elementary (+4.1), middle-school (+3.9%), and college tuitions (+0.8%). However, this was partially offset by the 0.2% contraction in other services, given the fall in professional (-17.2) and tourism services (-2.8%). In addition, goods prices edged-up 0.2% 2w/2w on the back of a 0.18% and 0.25% increases in the processed foods and other goods sub-indices.

With these figures, 12-month inflation stands at 4.88%, marginally below the 4.90% seen in August. Similarly, core inflation was 3.56%, below the 3.63% seen in the previous month. For the next print we anticipate an increase in the annual comparison stemming from a base effect, remembering that after the September 19th earthquake, the payment for certain services was suspended in the metropolitan area of Mexico City, in particular public transportation. After this effect is eliminated we anticipate that inflation will show a slight deceleration to start converging towards our 4.8% year-end estimate.

Inflation forecast
% yoy, bi-weekly trajectory



Source: INEGI, Banorte

From our fixed income and FX strategy team

Local bonds rallying 3-4bps in the aftermath of today's better-than-expected CPI report. Inflation for the first half of September came in below market consensus for the first time since June, with an annual reading moving from 5.00% to 4.88%, still above the upper bound of Banxico's confidence range. This report in tandem with a stable peso (observed in the last two weeks) is steering a 3-4bps rally this morning in the Mbonos and TIIE-IRS curve, with market participants pricing in 16bps of implied rate hikes for the remainder of 2018 *vs* 19bps printed the previous week. This situation is taking place despite some pressures in U.S. Treasuries ahead of the policy decision from the Federal Reserve to take place on Wednesday, with an expectation of a hawkish hike (+25pb). In terms of our trade recommendation, the CPI-linked Jun'22 is selling off nearly 3bps following this positive inflation report, after a 7bps relief rally observed the previous week. We are holding this trade idea in spite of today's inflation print, acknowledging several risks for prices for the rest of the year.

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We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete 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, Francisco José Flores Serrano, Francisco Duarte Alcocer and Leslie Thalía Orozco Vélez, 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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BANORTE

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 Godinez	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	hugoa.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.ceballos@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
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454