

October's inflation explained by the end of summer discounts in electricity tariffs as well as the rebound in public transportation tariffs

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- **INEGI just published its inflation report for October**
- **Headline inflation (Oct): 0.63% m/m; Banorte: 0.66% m/m; consensus: 0.60% m/m; (range of estimates: 0.54% to 0.66%); previous: 0.31% m/m**
- **Core inflation (Oct): 0.25% m/m; Banorte: 0.26% m/m; consensus: 0.24% m/m (range of estimates 0.22% to 0.26%); previous: 0.28% m/m**
- **Inflation in October was explained by the end of the summer discounts on electricity tariffs as well as the rebound in the prices of public transportation and mobile phone services**
- **With these numbers, annual inflation is at 6.37% vs. 6.35% in previous month**
- **Inflation dynamics suggest an extended hawkish bias from Banxico**

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Consumer prices increased 0.63% m/m in October, marginally below our 0.66% m/m forecast. Core inflation was 0.25% m/m vs. our 0.26% m/m estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of agricultural prices (-19bps vs. our -13bps); (2) a higher than expected contribution of energy (51bps vs. our 47bps); and (3) a lower than expected impact of goods (8bps vs. our 10bps), as shown in the table below.

October's inflation by major subcomponent

Monthly incidence, %

	Observed	Banorte-ixe forecast	Difference
Headline	0.63	0.66	-0.04
Core	0.19	0.20	-0.01
Goods	0.08	0.10	-0.02
Processed foods	0.03	0.05	-0.01
Other goods	0.04	0.05	-0.01
Services	0.11	0.10	0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.08	0.07	0.01
Non-core	0.44	0.47	-0.03
Agricultural	-0.19	-0.13	-0.06
Fresh fruits and vegetables	-0.16	-0.12	-0.04
Meat and egg	-0.03	-0.01	-0.02
Energy and government regulated	0.63	0.59	0.03
Energy	0.51	0.47	0.04
Government regulated	0.11	0.12	0.00

Source: INEGI, Banorte

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

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Inflation in October was explained by the end of the summer discounts on electricity tariffs as well as the rebound in the prices of public transportation and mobile phone services. Particularly, energy rose 5.28% m/m, mainly driven by the increase in electricity (19.99% m/m), LP gas (7.41% m/m) and low-grade gasoline (0.86% m/m). Moreover, we highlight the 2.08% m/m increase in government tariffs, as a result of the rebound after suspension of highway tolls and public transportation after the September 19th earthquake. It is worth noting that subway tariffs increased 30.7% m/m due to this same effect. In addition, prices of fresh fruits and vegetables declined 4.05% m/m on the back of lower prices of tomatoes (-27.03% m/m), avocados (-10.74% m/m) and husk tomatoes (-12.32% m/m) among others.

Regarding the core index, other services rose 0.28% m/m, given the 2.87% m/m rebound in the mobile phone prices as well as the increases in housing (0.20% m/m) and professional services (7.23% m/m). On the other hand, we saw a 0.22% m/m growth in goods, given the 0.21% m/m in processed foods coupled with a 0.22% expansion in other goods.

With these numbers, annual inflation edges up to 6.37% vs. 6.35% in September. Moreover, core inflation decreased to 4.77% (vs. 4.80% in September). Looking ahead we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI. Considering this we still expect inflation at 6.4% by year-end 2017.

From our fixed income and FX strategy team

Inflation dynamics suggest an extended hawkish bias from Banxico. Today's CPI print came moderately below our forecasts but slightly above the market consensus'. In this sense, local rates kept the pressures registered before the report in the case of Mbonos (1-3bps) whereas real-rate Udibonos rallied 1-2bps. This scenario, in tandem with the uncertainty about Fed future actions, Trump's tax-cut plan and the process of NAFTA negotiations is likely to shed light on Banxico staying put for longer, holding a hawkish rhetoric today and in December, similar to what is priced in the yield curve. IRS are discounting 9bps of implied hikes for year-end (not feasible *vis-à-vis* our expectations), 15bps in a 12-month horizon, but a rate again at 7.00% by the end of 2018. In our view this will result in a flatter curve between the front-end and the 2- and 3-year area, especially with an attractive 2y2y forward rate at 7.17%, granting significant carry gains. However, we expect several factors to increase the risk and term premiums in longer tenors, resulting in a possible steepening of the yield curve between the mid- and long-ends. Overall, we believe that relative value tactical strategies are more convenient, especially targeting steepeners in the TIE-IRS curve such as 2s5s (currently at -11bps) and 2s10s (+9bps).

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