

Annual inflation at a new historical low, yet again

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- **INEGI just published its inflation report for in the first half of September**
- **Headline inflation (Sep): 0.32%2w/2w (Banorte-Ixe: 0.29%2w/2w; consensus: 0.26%2w/2w)**
- **Core inflation (Sep): 0.27%2w/2w (Banorte-Ixe: 0.32%2w/2w; consensus: 0.26%2w/2w)**
- **Inflation in the first half of September was explained by pressures on education prices along with increases in other merchandise prices**
- **With these numbers, annual inflation is at 2.53% vs. 2.59% in previous month**
- **Sell-off in local rates as concerns increase on the effects of FX dynamics on Banxico's stance and inflation**

Fixed income and FX Strategy

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Consumer prices increased 0.32%2w/2w in in the first half of September, above expectations. Core inflation was 0.27% vs. our 0.32% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of services prices (8.8bps vs. our 13.1bps); (2) a larger than expected contribution of energy prices (0.6bps vs. our 0.4bps); (3) an underestimation of merchandise prices (11.7bps vs. our 11bps); (4) an underestimation of government tariffs (1.8bps vs. our 0.2bps); (5) a larger than expected contribution of agricultural prices (9bps vs. our 4bps), as shown in the table below.

1H-September inflation by components

% bi-weekly incidence

| | INEGI | Banorte-Ixe | Difference |
|-----------------------------|-------|-------------|------------|
| Total | 0.32 | 0.29 | 0.03 |
| Core | 0.20 | 0.24 | -0.04 |
| Goods | 0.12 | 0.11 | 0.01 |
| Processed foods | 0.03 | 0.07 | -0.03 |
| Other goods | 0.08 | 0.05 | 0.04 |
| Services | 0.09 | 0.13 | -0.04 |
| Housing | 0.013 | 0.017 | 0.00 |
| Education | 0.11 | 0.11 | -0.01 |
| Other services | -0.03 | 0.00 | -0.03 |
| Non-core | 0.12 | 0.05 | 0.07 |
| Agriculture | 0.09 | 0.04 | 0.05 |
| Fruits & vegetables | 0.07 | 0.02 | 0.05 |
| Meat & eggs | 0.02 | 0.02 | 0.00 |
| Energy & government tariffs | 0.02 | 0.01 | 0.02 |
| Energy | 0.01 | 0.00 | 0.00 |
| Government tariffs | 0.02 | 0.00 | 0.02 |

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.

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Inflation in the first half of September was explained by pressures on education costs along with increases in other merchandise prices. In the first case, merchandise prices increased 0.34%2w/2w on the back of an increase of 0.21% in food prices. Meanwhile, other goods were up 0.44%, which could suggest some pass-through from the exchange rate depreciation to inflation. Meanwhile, services prices increased 0.22%, as a result of housing costs up 0.07%, while education costs increased 2%, explained by seasonal increases given the *back to school* season. In fact, the report mentioned tuition costs for primary (3.97%), high-school (3.71%), college (3.62%), and preschool education (3.62%), among the items with increasing prices. In the non-core, agricultural prices were up 0.98%2w/2w due to higher prices of fruits and vegetables (2.1%) along with an increase of 0.38% in “meat and egg”. *INEGI* mentioned tomatoes (7.41%) and onion (11.74%), among the products with rising prices. In addition, government tariffs increased 0.33%, as a result of increases in urban bus fares, among others.

A new historical low. With these data, 12-month inflation stands at 2.53% vs. 2.59% in the previous month. Meanwhile, the core inflation remains unchanged at 2.3% yoy.

From our fixed income and FX strategy team

Sell-off in local rates as concerns increase on the effects of FX dynamics on Banxico's stance and inflation. The local fixed-income market has been strongly affected by the risk aversion observed worldwide. The uncertainty on several factors such as Fed and China has steered EM risk *premia* higher. In addition, market participants have depicted their concern on pent up inflation given recent FX dynamics that could result in a pass-through effect (not seen at the moment). Today's CPI report put additional pressure on local rates, as it came in above market expectations, despite an annual print reaching new lows. In this sense, we expect market correction to continue on the back of current global conditions. However, we acknowledge that the short-end of the curve is approaching once again interesting entry levels for long positions. On the other hand, short-term Mexican linkers benefited today from the inflation reading, in addition to a cheap relative valuation vis-à-vis nominal-rate securities. In the FX market, the Mexican peso continues on a downward trend, currently trading at a new historical low of 17.32 per dollar, although with scarce evidence of a strong reaction to the report. Nevertheless, concerns over pass-through effects to prices from FX weakness should stay as the currency remains pressured in a highly volatile and uncertain external environment, particularly after the latest Fed decision. Since that moment we have been recommending to buy USD/MXN on dips, with the peso still vulnerable given low carry levels and Banxico's reticence to hike rates ahead of the US. We maintain this view in spite of the recently strong depreciation which could entice some investors for long peso positions, at least on a tactical basis. After breaching the 17.00 per dollar level and trying to weaken past its previous historical low at 17.31, we do not discard that further volatility in global markets that could push the peso to test the psychological of 17.50 in coming days as the next relevant technical level.

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