

September's CPI – We now expect year-end inflation at 3.1%

October 7, 2016

www.banorte.com
www.ixe.com.mx
@analisis_fundam

- We now expect year-end inflation at 3.1% (previous forecast: 2.8%)
- **Headline inflation (September): 0.61% m/m; Banorte-Ixe: 0.6%; consensus: 0.56% (range of estimates: 0.4% to 0.65%); previous: 0.28% m/m**
- **Core inflation (September): 0.48% m/m; Banorte-Ixe: 0.45%; consensus: 0.46% (range of estimates: 0.43% to 0.48%); previous: 0.19% m/m**
- **Inflation in September was explained by pressures on the prices of processed foods given the higher pass-through effect of the depreciation of the Mexican currency to prices**
- **With these numbers, annual inflation is at 2.97 % vs. 2.73% in August**

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

Alejandro Cervantes
Senior Economist, Mexico
alejandro.cervantes@banorte.com

Consumer prices increased 0.61% m/m in September, in line with our forecast. In addition, core inflation was 0.48% m/m. The main deviation from our forecast comes from: (1) A lower-than-expected contribution of agricultural goods prices (21bps vs. our 22bps); and (2) a larger than expected contribution of processed foods prices (11bps vs. our 9bps), as shown in the table below.

Fixed income and FX Strategy

Alejandro Padilla
Director de Estrategia
Renta Fija y Tipo de Cambio
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
FX Strategist
juan.alderete.macal@banorte.com

Inflation by components in September

%monthly incidence

	Observed	Banorte-Ixe forecast	Difference
Headline	0.61	0.60	0.01
Core	0.36	0.34	0.02
Goods	0.23	0.21	0.02
Processed foods	0.11	0.09	0.02
Other goods	0.12	0.12	0.00
Services	0.13	0.13	0.00
Housing	0.03	0.02	0.00
Education	0.12	0.12	0.00
Other services	-0.02	-0.01	0.00
Non-core	0.25	0.26	-0.01
Agricultural	0.28	0.30	-0.01
Fresh fruits and vegetables	0.21	0.22	-0.01
Meat and egg	0.08	0.08	-0.01
Energy and government regulated	-0.04	-0.05	0.01
Energy	-0.05	-0.05	0.00
Government regulated	0.01	0.00	0.00

Santiago Leal
Analyst Fixed Income and FX
santiago.leal@banorte.com

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

Document for distribution among public

Higher pass-through effect explained the upward trend in merchandise prices. Merchandise prices edged-up 0.65% m/m on the back of a 0.66% increase in the prices of “processed food”, along with a 0.64% growth in the prices of “other merchandises”. In this context, we believe that the significant depreciation of the Mexican currency has induced a higher pass-through effect to prices.

Regarding services inflation, education costs were up 2.27% m/m given the start of the new school year, while housing costs rose 0.15%. By contrast, other services came down by 0.09% m/m.

Within the non-core sub-index, agricultural prices increased 3.1% m/m on the back of significant increases in fruit and vegetables (6.2%) combined with higher “meat & egg” prices (+1.3%). Within these two sub-indices we highlight the hike in the prices of tomatoes (38.5% m/m), onions (19.5%), egg (7.1%) and chicken meat (2.1%), which account for 39% of September’s inflation.

We now expect inflation to end the year around 3.1% (previous: 2.8%). With these figures, annual inflation is at 2.97% vs. 2.73% in the previous month. In addition, core inflation stands at 3.07% yoy. We continue to see pressures on core inflation, particularly within merchandise prices, on the back of the higher contagion coming from the depreciation of the Mexican peso. Similarly, the recent spike in agricultural goods prices has also induced a higher inflation.

Looking ahead, we continue to expect that inflation will continue to reflect the depreciation of the Mexican peso. In this regard, our previous forecast was projected at the beginning of the year, and incorporated a much lower depreciation (the previous FX forecast from our strategy team incorporated a relatively lower depreciation than the 12% observed year-to-date). In this context, our new 3.1% estimate is in line with our VAR model in which a 10% depreciation adds around 25bps to annual inflation in the next six months.

From our fixed income and FX strategy team

Local yield curve pricing in a different scenario for inflation. Today's inflation report came in line with our expectations, portraying evidence of FX passthrough contagion into the core component. As a result, market has priced in additional rate hikes for the remainder of the year (28bps) in addition to the 150bps increase delivered by Banxico throughout 2016. Moving forward, several risk factors in the month could result in a weaker peso (e.g. high beta of MXN with US Elections polls). Breakevens remain fairly stable slightly above 3.00%, but with a strong likelihood of trending higher by year-end towards 3.50% (2016 max). As a result, we assess a more attractive valuation in the belly of the Mexican yield curve vis-à-vis the short-end. On the other hand, the belly of the yield curve could outperform long-term tenors during this month, ahead of US Elections. In this regard, we hold our trade idea of a 5y10y steepener in the TIE-IRS curve, with entry of 35bps, target of 50bps, stop-loss of 25bp, currently trading at 40bps. For further details, please refer to: "*Mexico – Trade Idea: 5y10y steepener*" published on October 5, 2016, <[pdf](#)>. In FX, we remain defensive, waiting for better entry levels for long USD/MXN positions as we expect persistent or even higher volatility as we approach Election Day, without discarding gradual pressures towards de 20.00 psychological level if polls in favor of the Republican candidate improve. Although recent Banxico rate hikes and higher short-term rates should help alleviate some of the peso's recent and strong underperformance, the currency remains as one of the preferred and cheapest vehicles to hedge external risks and for betting on the possible outcome of the election, which we believe will limit appetite for long positions in the short term.

Disclaimer

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

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
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
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
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates / Financials/ Mining / Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food / Beverages / Specialized Commerce	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Eugenia Ivonne Arias Medina	Analyst	eugenia.arias.medina@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	Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@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
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454