1H November inflation explained by the end of summer discounts in electricity tariffs

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- ***INEGI* just published its inflation report for the first half of November**
- **Headline inflation (1H-November): 0.77% 2w/2w (Banorte-Ixe: 0.73%2w/2w; consensus: 0.67%2w/2w)**
- **Core inflation (1H-November): 0.23% 2w/2w; (Banorte-Ixe: 0.11% 2w/2w; consensus: 0.13% 2w/2w)**
- **Inflation in the first half of November was explained by pressures on electricity tariffs, given the end of summer discounts**
- **Moreover, *INEGI*'s report highlights the increases in "other services" prices, as a result of a higher costs of air fares and tourism services**
- **With these numbers, annual inflation is at 3.29% vs. 3.04% in October**
- **Market biased towards positions in Udibonos as inflation dynamics are deteriorating**

Consumer prices increased 0.77% 2w/2w in the first half of November. In addition, core inflation was 0.23% vs. our 0.11% estimate. The main deviation from our forecast comes from: The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (56.8bps vs. our 63.2bps); (2) an underestimation of the prices of goods (7.4bps vs. our 3.9bps); (3) an underestimation of the prices of services (10.1bps vs. our 4.6bps); and (4) a larger than expected contribution of agricultural prices (6.3bps vs. our 0bps); as shown in the table below.

Nov-1H CPI inflation by major subcomponent
Bi-weekly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.77	0.73	0.04
Core	0.17	0.08	0.09
Goods	0.07	0.04	0.03
Processed foods	0.03	0.03	0.00
Other goods	0.04	0.01	0.03
Services	0.10	0.05	0.06
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.03	0.06
Non-core	0.61	0.64	-0.03
Agricultural	0.06	0.00	0.06
Fresh fruits and vegetables	0.04	0.00	0.04
Meat and egg	0.02	0.00	0.02
Energy and government regulated	0.56	0.64	-0.08
Energy	0.57	0.63	-0.06
Electricity tariffs	0.66	0.63	0.03
Government regulated	0.00	0.01	-0.01

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

Inflation in the first half of November was explained by pressures on electricity tariffs, as well as the increase in the price of "other services". According to *INEGI*, electricity tariffs increased 25.61% 2w/2w, given the end of summer discounts in some regions of the country. In addition, we observed some pressures on the prices of services, given the increases seen in the prices of air fares (+11.85% 2w/2w) and tourism services (5.85% 2w/2w), as a result of the holiday taking place on November 20th.

Moreover, merchandise inflation was up 0.21% 2w/2w, with higher prices of both "processed food" (+0.2% 2w/2w) and "other goods" (+0.22% 2w/2w). In this context, we believe that the upward trend in the latter is explained by the significant depreciation of the Mexican currency, which has induced a higher pass-through effect to prices. Within the non-core index, agricultural prices rose as a result of the 1.26% increase in the "fresh fruits" sub-index.

12-month inflation maintains an upward trend. With today's figures, 12-month inflation is at 3.29% vs. 3.04%, in October. In addition, core inflation is at 3.33. Looking ahead, we expect a slight deflation in the second half of November, particularly within the "processed food" and "other goods" sub-indices as a result of "The Good Weekend". However, we consider that the ascending trend of the price level will be determined by a higher pass-through effect to prices.

From our fixed income and FX strategy team

Market biased towards positions in Udibonos as inflation dynamics are deteriorating. *INEGI* released the CPI report for the first half of November, with a print which came in above market expectations, clearly depicting some inflationary pressures coming from the peso depreciation throughout 2016. Passthrough effects remain contained in the core goods component, however starting to weigh on market expectations regarding headline CPI dynamics. Recent polls have depicted important forecast adjustments for 2017 to levels close to 4.0%yoy from a previous 3.2%-3.4% range. Even Banxico has increased its expected inflation for the next year inside the Quarterly Inflation Report published yesterday. The market is pricing inflation breakevens hovering around 3.8% in every tenor from 3.3% a month ago. Taking into consideration current conditions, we suggest reducing exposure in Mbonos and increasing their positions in CPI-linked Udibonos, as a defensive relative value strategy. The Udibonos with the most attractive pricing are the ones maturing on Jun'19, Dec'20 and Jun'22.

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