

# 1H-October inflation – The end of summer discounts on electricity tariffs

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- **INEGI** just published its inflation report for the first half of October
- **Headline inflation (1H-October): 0.49% 2w/2w; Banorte-Ixe: 0.43%; consensus: 0.50% (range of estimates: 0.42% to 0.58%); previous: 0.17**
- **Core inflation (1H-October): 0.17% 2w/2w; Banorte-Ixe: 0.12%; consensus: 0.18% (range of estimates: 0.12% to 0.26%); previous: 0.15%**
- **Inflation in the first half of October was explained by pressures on electricity tariffs, given the end of summer discounts, along with increases in “other goods” prices**
- **With these numbers, annual inflation is at 3.09% vs. 2.97% in September**
- **Stronger demand for CPI-linked securities following today’s inflation report**

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**Consumer prices increased 0.49% 2w/2w in the first half of October.** In addition, core inflation was 0.17% vs. our 0.12% estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of electricity prices (43.7bps vs. our 30.2bps); (2) an underestimation of “other goods” prices (3.3bps vs. our 1.5bps); and (3) an underestimation of housing prices (1.6bps vs. our 0.8bps), as shown in the table below.

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### Inflation by components in the first half of October

% bi-weekly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.49	0.43	0.06
Core	0.12	0.09	0.03
Goods	0.07	0.05	0.02
Processed foods	0.04	0.04	0.00
Other goods	0.03	0.02	0.02
Services	0.05	0.04	0.01
Housing	0.02	0.01	0.01
Education	0.00	0.00	0.00
Other services	0.04	0.03	0.01
Non-core	0.38	0.34	0.04
Agriculture	-0.01	0.01	-0.02
Fruits & vegetables	-0.01	0.01	-0.02
Meat & eggs	0.00	-0.01	0.00
Energy & government tariffs	0.40	0.33	0.07
Energy	0.40	0.33	0.07
Government tariffs	0.00	0.00	0.00

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 October was explained by pressures on electricity tariffs.** According to *INEGI*, electricity tariffs increased 20.3%, given the end of summer discounts in some regions of the country. In addition, there were some pressures in the prices of other services. In particular, the report mentions professional services (+8.6% 2w/2w) and air transportation (+2.9%), among the items with increasing prices.

In addition, merchandise inflation was up 0.2% 2w/2w, with higher prices of both processed food (+0.24% 2w/2w) and “other goods” prices (+0.17%). 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 fell as a result of the 0.35% contraction in the prices of fruits and vegetables.

**12-month inflation continues to edge up.** With today’s figures, 12-month inflation is at 3.09% vs. 2.97%, in September. Moreover, core inflation is at 3.1% from 3.07% in the previous month. Looking ahead, we expect inflation will hover around this level and will stand at our 3.1% forecast for year-end.

*From our fixed income and FX strategy team*

**Stronger demand for CPI-linked securities following today’s inflation report.** Limited market reaction after the CPI report was released this morning, with investors depicting a stronger preference for inflation-adjusted securities (e.g. Udibonos), taking into account a more attractive relative value for the remainder of the year. In terms of strategy, we suggest waiting for better market conditions in order to implement long directional strategies in the belly of the Mbonos curve, especially the 5- to 10-year area. On the other hand, today’s 1H-Oct inflation print has started the kickoff of the high seasonal inflation figures of the 4Q16. In our view, current inflation dynamics could provide better conditions for long positions in mid-term Udibonos, with a short-term investment horizon. Inflation breakevens are hovering 3.2% in every tenor, but with a more interesting valuation in the Dec’20 and Jun’22 securities. Taking into account our CPI forecasts, the inflation for the remaining 68 days of the year could be 1.39% (7.36% annualized), implying an attractive carry in the UDIS component of this type of bonds. For the coming 6 months, our forecast depicts and inflation of 2.56% for the period (5.06% annualized). However, expected inflation for the 12-month ahead is 3.19%. This situation suggests that Udibonos could be an interesting trading opportunity during 4Q16, but their appeal will be fading away with a long-term horizon.

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