

Inflation in September slightly above consensus as core surprises to the upside

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- **INEGI just published its inflation report for September**
- **Headline inflation (September): 0.42% m/m; Banorte: 0.39%; consensus: 0.41% (range of estimates: 0.33%-0.48%); previous: 0.58%**
- **Core inflation (September): 0.32% m/m; Banorte: 0.26%; consensus: 0.27% (range of estimates: 0.20%-0.33%); previous: 0.25%**
- **Inflation in the ninth month of the year was explained by pressures on energy prices, as well as in merchandise prices and education costs**
- **With these figures, annual inflation stood at 5.02%, the highest print observed since last March**
- **Nevertheless, it is worth noting that a negative base effect was present due to last year's September 19th earthquake**
- **Core inflation picked up to 3.67% from 3.63%, also reflecting, at least in part, a base effect because of the same event**
- **Current inflation backdrop remains supportive for our Udibono Jun'22 trade recommendation**

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Consumer prices increased 0.42% m/m in September. This number was slightly higher than both the consensus (0.41%) and our forecast (0.39%). Meanwhile, core inflation edged-up 0.32% vs. our 0.26% estimate.

The main deviation from our forecast came from: (1) A lower than expected contribution of fresh fruit and vegetables (-5bps vs. our -2bps); (2) a higher than expected impact of other services (-1bps vs. our -4bps); and (3) a higher than expected contribution of processed foods (8bps vs. our 6bps), as shown in the table below.

September inflation by components
% monthly incidence

	INEGI	Banorte	Difference
Total	0.42	0.39	0.03
Core	0.24	0.20	0.05
Goods	0.15	0.13	0.02
Processed foods	0.08	0.06	0.02
Other goods	0.07	0.07	0.00
Services	0.09	0.07	0.03
Housing	0.03	0.03	0.00
Education	0.07	0.07	0.00
Other services	-0.01	-0.04	0.03
Non-core	0.18	0.19	-0.01
Agriculture	-0.02	0.01	-0.03
Fruits & vegetables	-0.05	-0.02	-0.04
Meat & eggs	0.03	0.03	0.00
Energy & government tariffs	0.20	0.18	0.02
Energy	0.19	0.18	0.01
Government tariffs	0.01	0.00	0.01

Source: INEGI, Banorte.

Note: Contributions might not add due to the number of decimals allowed in the table.

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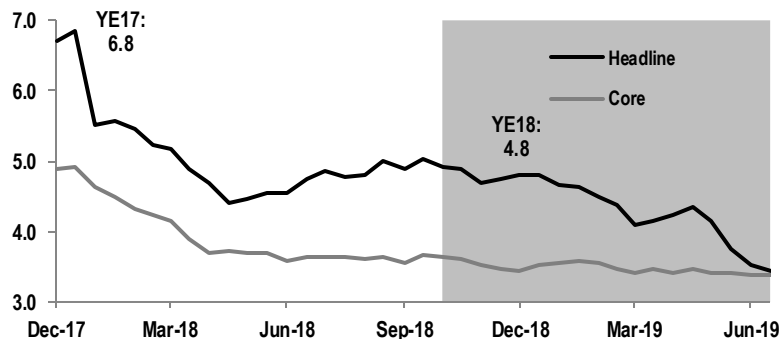
Inflation in September was explained by pressures on the prices of energy, merchandise and education. In the first case, prices increased 1.9% m/m on the back of higher LP gas (+5.3%) and low-grade gasoline prices (+1.5%), offset by the 0.7% reduction in electricity tariffs. Meanwhile, agricultural prices declined 0.2% as prices of fresh fruits and vegetables edged down 1.1% m/m. This is the first monthly decline after three consecutive months edging up about 3.9% m/m on average. In particular, *INEGI* highlights lower prices of potatoes (-11.9%), oranges (-23.2%), and bananas (-4.1%), among others. By contrast, the price of “meat and egg” increased 0.6%, with the price of eggs up 4.0% but compensated somewhat by lower poultry prices (-0.5%).

Core inflation was at 0.32% m/m on the back of seasonally higher –start of the new school year-, education costs (2.1%), particularly elementary school tuitions (+4.2%). This was partially offset by the 0.1% contraction in other services, given the reduction in costs of professional services (-17.1), airfares (-4.9%) and tourism services (-1.3%). It is worth noting that core inflation seems pressured for the second consecutive month, after showing a downward trend since April, which could be suggesting a slightly higher pass-through from the non-core component, as flagged by Banxico as an upside risk for inflation.

In annual terms, inflation picked up to 5.02% from 4.90%, the highest since March and impacted by an adverse base effect. This figure is heavily influenced by an adverse base effect due to last year’s September 19th earthquake. For example, government-regulated prices increased 5.4% yoy in September 2018 while mobile telecom services rose 6.9%. In same month last year, public transportation in Mexico City and several telecom companies suspended all charges to help emergency efforts after the earthquake. In this respect, the impact in today’s print should fade away as early as in the 1st half of October. In spite of this, we see a modest deceleration by year-end, only towards our 4.8% year-end estimate, which is above the consensus at 4.5%.

Inflation forecast

% y.o.y., bi-weekly trajectory



Source: INEGI, Banorte

Banxico will remain vigilant to core inflation dynamics. In our view, Banxico will pay particular attention to core inflation dynamics, as the monthly pace of inflation in this component has ticked up in the two most recent prints. Nevertheless, the signal is less clear in the year-over-year figures, as it is skewed upwards due to the base effect previously described. In this respect, it will be very important to see if the yearly comparison normalizes in October. Specifically, if the downward trend observed all year long reasserts itself. Against this backdrop, we believe that the balance of risks to inflation continue to be skewed to the upside, which is one of the main reasons behind our call for another 25bps rate hike before year-end to leave the reference rate at 8% by year-end. For details, please see: “*Banxico’s decision – On hold but a hike still looms for 2018*”, published on October 4, 2018, <[pdf](#)>.

From our fixed income and FX strategy team

Current inflation backdrop remains supportive for our Udibono Jun’22 trade recommendation. September’s CPI came in above market consensus, with the annual print moving from 4.90% to 5.02%. Inflation dynamics remain challenging for the rest of the year, confirming Banxico’s concerns and hawkish tilt within its monetary policy communiqué from last Thursday. In the aftermath of today’s report, the Mexican yield curve is selling off 2-4bps, with market participants pricing in 11bps of implied rate hikes in 4Q18. In our view, the current landscape will be conducive for a risk off mode among investors, especially in EM, suggesting the need for defensive strategies. In this regard, we hold our trade idea of long positions in the CPI-linked Udibono Jun’22. We acknowledge that inflation breakevens are trading nearly 15bps above their 12-month trailing average. However, the embedded UDI-carry remains highly attractive given the kickoff of the seasonally high-inflation period in the last quarter of the year.

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