

Inflation in September – 12-month rate starts to ease to 6.35% from 6.66%

October 9, 2017

- **INEGI just published its inflation report for September**
- **Headline inflation (Sep): 0.31% m/m; Banorte-Ixe: 0.38% m/m; consensus: 0.43% m/m; (range of estimates: 0.38% to 0.46%); previous: 0.49% m/m**
- **Core inflation (Sep): 0.28% m/m; Banorte-Ixe: 0.32% m/m; consensus: 0.36% m/m (range of estimates 0.32% to 0.37%); previous: 0.25% m/m**
- **Inflation in September was explained by pressures on energy and education prices, particularly during the first half of the month**
- **However, these pressures were mitigated by the decline in the price of telephone services and transportation tariffs, as a result of the September 19th earthquake**
- **With these numbers, annual inflation is at 6.35% vs. 6.66% in previous month**
- **Relief rally in local rates in the aftermath of today's CPI inflation report**

www.banorte.com
www.ixc.com.mx
@analisis_fundam

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

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Alejandro Padilla
Head Strategist – Fixed-Income and FX
alejandro.padilla@banorte.com

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

Santiago Leal Singer
Fixed-Income and FX Strategist
santiago.leal@banorte.com

Consumer prices increased 0.31% m/m in in September. Core inflation was 0.28% m/m vs. our 0.32% m/m estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of government tariffs (-6.2bps vs. our -0.8bps); (2) a lower than expected contribution of other services (-5.9bps vs. our -2.7bps); (3) a higher than expected impact of energy prices (16.5bps vs. our 14.3bps); and (4) an overestimation of agricultural (-0.6bps vs. our 0.3bps), as shown in the table below.

September inflation by major subcomponent

Monthly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.31	0.38	-0.07
Core	0.21	0.24	-0.03
Goods	0.12	0.11	0.00
Processed foods	0.03	0.03	-0.01
Other goods	0.09	0.08	0.01
Services	0.10	0.13	-0.03
Housing	0.03	0.03	0.00
Education	0.13	0.13	0.00
Other services	-0.06	-0.03	-0.03
Non-core	0.10	0.14	-0.04
Agricultural	-0.006	0.003	-0.009
Fresh fruits and vegetables	-0.02	0.00	-0.01
Meat and egg	0.01	0.01	0.00
Energy and government regulated	0.11	0.14	-0.03
Energy	0.16	0.14	0.02
Government regulated	-0.06	-0.01	-0.05

Source: INEGI, Banorte-Ixe

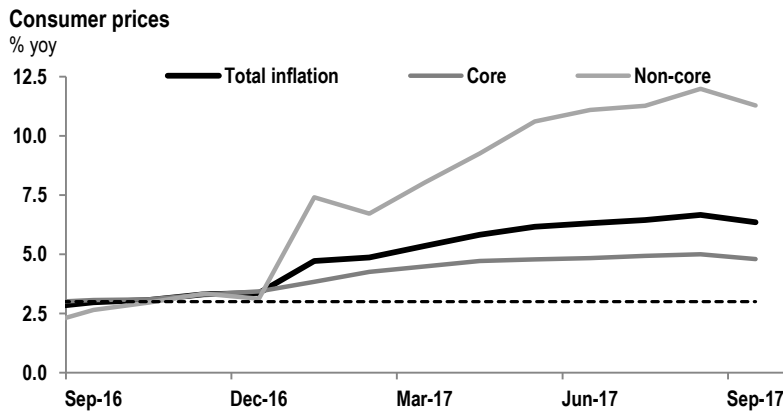
Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

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Inflation in September was explained by pressures on the prices of energy and education, which were mitigated the fall in other services and government tariffs. In the first case, prices grew by 1.73% m/m driven by an increase in the price of LP Gas (4.61% m/m) and low-grade gasoline (1.46% m/m). Moreover, we highlight the 1.12% m/m fall in government tariffs, given the suspension of highway tolls and public transportation after the September 19 earthquake. It is worth noting that subway prices came down 23.49% m/m also due to this effect. In addition, fresh fruits and vegetables prices decreased 0.41% m/m, given the fall in the prices of tomatoes (-20.18% m/m), husk tomatoes (-17.17% m/m), bananas (-10.8% m/m), and avocados (-7.2% m/m). However, these were mitigated by increases in the prices of onions (44.89% m/m) and potatoes (16.71% m/m).

Regarding the core index, education prices rose 2.37% on the back of higher prices of elementary (4.42% m/m), middle school (4.15% m/m) kindergarten (4.55% m/m) and college tuitions (0.87% m/m). Additionally, other services decreased 0.35% m/m on the back of the 3.72% reduction in mobile phone services, since most of them were offered free of charge in the days after the earthquake. Moreover, there were declines in the prices of professional services (-11.93% m/m), tourism services (-3.29% m/m) and air fares (-6.97% m/m).

With these numbers, annual inflation edges down to 6.35% vs. 6.66% in August. Moreover, core inflation decreased to 4.8% (vs. 5% in August). Given that the decline in government services and tariffs was due to a suspension in its collection, we expect to see a rebound in the prices of these services in the next inflation print. Considering this, we maintain our inflation year-end forecast of 6.4%



Source: INEGI

From our fixed income and FX strategy team

Relief rally in local rates in the aftermath of today's CPI inflation report.

Today's CPI inflation report confirmed our view that inflection point for the annual metric was reached last month. The local fixed-income market is depicting a positive reaction as September's print came in below market expectations, partially explained by short-term transitory factors (e.g. lower government tariffs in the aftermath of last month's earthquake in Mexico City). The yield curve is rallying 3-5bps, mainly in the entire Mbonos curve, following this release, after a significant sell-off observed in the last two weeks. In our view, market's debate will now center on the rate of convergence of annual inflation towards lower levels by year-end and in 2018. In terms of strategy, last week we recommended to close the long Udibono Dec'20 strategy to minimize the recent market correction. More details in "*Stop-loss in the CPI-linked Udibono Dec'20 strategy despite an attractive valuation*" [<pdf>](#), published October 6th, 2017. In our view, volatility ahead of the 4th round of NAFTA negotiations, minutes from the Federal Reserve and Banxico, consumer data in the U.S., geopolitical news worldwide and earnings results could result in higher risk and term premiums that could grant better opportunities for long directional trades. Market participants have increase the implied probability for a rate hike from the Federal Reserve in December to 80.2% from 26.9% observed a month ago. This change of paradigm in tandem with the uncertainty surrounding President Trump's fiscal plan makes us believe that relative value tactical strategies are more convenient, especially targeting steepeners in the TIE-IRS curve such as 2s5s (currently at -11bps) and 2s10s (+22bps).

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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
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
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 Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist 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	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@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	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@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
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454