Inflation in the first half of September explained by pressures on education and energy prices

- ***INEGI*** **just published its inflation report in the first half of September**
- **Headline inflation (1H-Sep): 0.34% 2w/2w; Banorte-Ixe: 0.32% 2w/2w; consensus: 0.4% 2w/2w; (range of estimates: 0.28% to 0.52%); previous: 0.12% 2w/2w**
- **Core inflation (1H-Sep): 0.28% 2w/2w; Banorte-Ixe: 0.29% 2w/2w; consensus: 0.30% 2w/2w (range of estimates 0.2% to 0.38%); previous: 0.05% 2w/2w**
- **Inflation in the first half of September was explained by pressures on education and energy prices**
- **With these numbers, annual inflation is at 6.53% vs. 6.66% in the previous month**
- **The start of seasonal high inflation prints is a positive condition for our trade idea in Udibonos**

Consumer prices increased 0.34% 2w/2w in in the first half of September. Core inflation was 0.28% vs. our 0.29% estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of energy prices (10.2bps vs. our 5.8bps); (2) a higher than expected contribution of other goods (6.8bps vs. our 4bps); (3) a lower than expected impact of other services (-0.8bps vs. our 1bps); and (4) an underestimation of agricultural (2.7bps vs. our 4.1bps), as shown in the table below.

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

	Observed	Banorte-Ixe forecast	Difference
Headline	0.34	0.32	0.02
Core	0.21	0.22	-0.01
Goods	0.09	0.07	0.02
Processed foods	0.02	0.03	-0.01
Other goods	0.07	0.04	0.03
Services	0.12	0.15	-0.02
Housing	0.01	0.02	-0.01
Education	0.12	0.12	0.00
Other services	-0.01	0.01	-0.02
Non-core	0.13	0.10	0.03
Agricultural	0.03	0.04	-0.01
Fresh fruits and vegetables	0.01	0.01	0.00
Meat and egg	0.02	0.03	-0.01
Energy and government regulated	0.11	0.06	0.04
Energy	0.10	0.06	0.04
Government regulated	0.00	0.01	0.00

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 the first half of September was explained by pressures on the prices of education and energy. In the first case, prices increased 2.21% 2w/2w, on the back of higher prices of elementary (4.35% 2w/2w), middle school (4.35% 2w/2w) and kindergarten tuitions (4.46% 2w/2w). Moreover, processed foods increased 0.12% 2w/2w, while other goods rose 0.36% 2w/2w due to higher automobile prices (0.83% 2w/2w). Additionally, the prices of other services decreased 0.05% 2w/2w, on the back of a 11.76% 2w/2w decline in professional services.

Regarding non-core items, energy prices grew by 1.07% 2w/2w driven by an increase in the price of low-grade gasoline (1.15% 2w/2w) and LP Gas (2.16% 2w/2w), despite the 0.25% 2w/2w decline in the price of electricity. Moreover, fresh fruits and vegetables prices increased 0.29% 2w/2w, on the back of higher prices of onions (20.47% 2w/2w), potatoes (9.61% 2w/2w) and squash (14.23% 2w/2w). However, these were mitigated by decreases in the prices of tomatoes (-11.94% 2w/2w), husk tomatoes (-11.21% 2w/2w), bananas (-4.94% 2s/2s), avocados (-3.01% 2s/2s) and oranges (-5.66% 2s/2s).

With these numbers, annual inflation edges down to 6.53% vs. 6.66% in August. Moreover, core inflation decreased to 4.9% (vs. 5% in August). We consider that inflation reached its maximum level in the second half of August, and will now start to converge towards our 6.4% forecast for the end of the year.

From our fixed income and FX strategy team

The start of seasonal high inflation prints is a positive condition for our trade idea in Udibonos. Today's CPI report for the first half of September in Mexico was the kickoff for the seasonal high inflation prints, with a 0.34% increase, lower than market consensus of 0.40% but very close to our 0.32% forecast. However, it was the highest figure observed since the first half of March. Annual inflation located at 6.53% from 6.74% on the previous biweekly reading, suggesting that we have reached an inflection point. Nevertheless, looking ahead, convergence towards significant lower levels will be difficult given current dynamics with several components (*e.g.* commodities). Under these circumstances we hold our trade recommendation of long positions in the 3-year Udibono Dec'20 with entry level of 3.05%, target of 2.90%, stop-loss of 3.15%, and current level of 2.97%. More details in our research note "*We recommend long positions in the 3-year Udibono Dec'20*" <pdf>, published on August 9th, 2017. We expect carry gains to be supportive for this strategy. The 12-month expected carry gains based on our inflation forecasts is 4.67%, which compares significantly higher to the 3.87% of market consensus inside Banxico's monthly survey published on September 1st. Moreover, from a technical point of view, the 3-year inflation breakeven trading at 3.56% is considerably lower than the 12-month mean of 3.72% and 15pb lower from the upper bound of a 2σ rolling band, suggesting an attractive relative valuation.

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