

## Inflation in August shows the effect of back to school season

September 9, 2015

- **INEGI just published its inflation report for August**
- **Headline inflation (Aug): 0.21%/m/m (Banorte-Ixe: 0.19%/m/m; consensus: 0.24%/m/m)**
- **Core inflation (Aug): 0.2%/m/m (Banorte-Ixe: 0.15%/m/m; consensus: 0.2%/m/m)**
- **Inflation in August resented the effects of back to school season with higher education costs and merchandise prices**
- **Nevertheless, with these numbers, annual inflation is at 2.59% vs. 2.74% in previous month**
- **Inflation dynamics supporting our positive view in the short-end of the curve**

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**Consumer prices increased 0.21%/m/m in August, in line with our estimations but below market's forecast.** Core inflation was 0.2% vs. our 0.15% estimate. The main deviation from our forecast comes from: (1) An underestimation of merchandise prices (11.8bps vs. our 10.8bps); and (2) a larger than expected contribution of services prices (3.4bps vs. our 2.4bps), as shown in the table below.

#### August inflation by components % monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.21	0.19	0.02
Core	0.15	0.13	0.02
Goods	0.12	0.11	0.01
Processed foods	0.03	0.03	0.00
Other goods	0.09	0.07	0.01
Services	0.03	0.02	0.01
Housing	0.03	0.03	0.00
Education	0.05	0.06	0.00
Other services	-0.05	-0.06	0.01
Non-core	0.06	0.06	0.00
Agriculture	0.02	0.02	0.00
Fruits & vegetables	0.04	0.02	0.01
Meat & eggs	-0.02	0.00	-0.01
Energy & government tariffs	0.04	0.04	0.00
Energy	0.01	0.01	0.00
Government tariffs	0.03	0.03	0.00

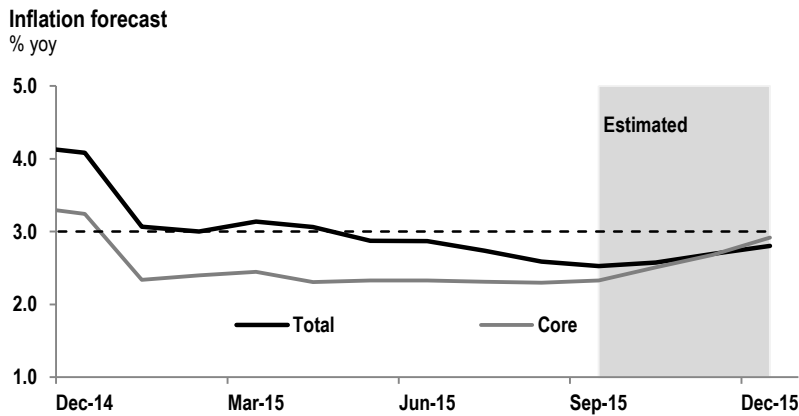
Source: Banorte-Ixe with data from INEGI and Banco de México.

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 August resented the effects of back to school season with higher education costs and merchandise prices.** Merchandise inflation was 0.34% m/m, on the back of a 0.19% increase in food prices, coupled with higher prices of other merchandise, up 0.46%. Meanwhile, services prices increased 0.08% due to higher costs of housing (0.15% m/m) and education (1.03%), given the back to school season. These increases more than offset the fall in the prices of other services (-0.27%), with the report mentioning sharp falls in the tourism services (-9.36%), air transportation (-10.8%) and mobile phone services (-0.62%). Meanwhile, in the non-core index, agricultural prices showed mixed results, with the prices of fruits and vegetables increasing (+1.12%), while prices of *meat and egg* came down 0.24% m/m. Finally, energy prices increased 0.12% m/m, while government rates increased 0.47% m/m, particularly on the back of higher costs of public transport (0.8%).

**Nevertheless, with these numbers, annual inflation is at 2.59% vs. 2.74% in previous month.** Meanwhile, core inflation remained at 2.3% in August. In our view, inflation will remain below the central bank’s 3% target in the coming months, as shown in the following chart.



Source: Banorte-Ixe with data from INEGI

*From our fixed income and FX strategy team*

**Inflation dynamics supporting our positive view in the short-end of the curve.** Mexico portrays once again a historical low annual inflation after today's CPI report, with no clear evidence of FX pass-through effect in the short-term. Low-inflation inertia and an effect of slack in the economy worldwide are factors supporting favorable inflation dynamics, supporting our positive view in the short-end of the curve. In this regard, we hold our trade idea of receiving the 9-month TIE swap (9x1) with entry level of 3.85%, target of 3.65% and stop-loss of 4.00% (currently trading around 3.80%). This position implies an expected return of 11bps per month (carry + roll-down). For more details see: "*Trade Idea: Receive nine-month TIE-IRS (9x1 <[pdf](#)>)*" published on September 3. Nevertheless, mid- and long-term inflation expectations could adjust upwards. Mexican linkers (Udibonos) are trading relatively cheaper (inflation breakevens hovering 3.2% in the mid- and long-ends), especially in terms of carry, and could result in a better demand going forward, especially from local institutional investors. In our view, the most attractive CPI-linked securities are Jun'19 to Jun'22.

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