

1H-October inflation – Above 4% on pressures at the non-core

- **Headline inflation (1H-Oct): 0.54% 2w/2w; Banorte: 0.45%; consensus: 0.46% (range of estimates: 0.38% to 0.58%); previous: -0.03%**
- **Core inflation (1H-Oct): 0.14% 2w/2w; Banorte: 0.15%; consensus: 0.15% (range of estimates: 0.11% to 0.19%); previous: 0.12%**
- **We recall that the reversal of summer discounts in electricity tariffs starts in this period, up 18.7% 2w/2w, adding 27bps to the headline. We also highlight the 2.8% advance in fresh fruits and vegetables, likely affected by adverse weather conditions. At the core, goods increased 0.1% and services 0.2%, with the latter mainly due to seasonal effects**
- **Annual inflation picked up at the margin, reaching 4.09% from 4.01% in September. Core inflation was more stable, at 4.00% from 3.99%. Non-core prices increased to 4.34% from 4.10%, although with this component probably moving lower in coming months**
- **In our view, Banxico will stay cautious and maintain the reference rate unchanged at the current level of 4.25%, waiting for additional information on short-term inflation dynamics**
- **Carry gains for Udibonos are still attractive but valuation is expensive**

Consumer prices up 0.54% 2w/2w in the first half of October. This was above our 0.45% forecast, which was very close to consensus. The core stood at 0.14% (Banorte: 0.15%). The advance is mostly due to seasonal effects, highlighting that the reversal of summer discounts to electricity tariffs starts in this period, up 18.7% 2w/2w, adding 27bps to the headline. Nevertheless, we also note the 2.8% increase in fresh fruits and vegetables, in our view affected by adverse weather conditions. The latter may also have impacted LP gas, up by the same magnitude. On the other hand, goods (0.1%) keep showing signs of normalizing after pressures that started since the pandemic begun. In services (0.2%) we observed hikes in airfares (12.0%) and tourism services (3.5%), influenced to a great extent by typical seasonal patterns in this fortnight

1H-October inflation by components
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.54	0.45	0.10
Core	0.11	0.11	0.00
Goods	0.05	0.06	-0.01
Processed foods	0.04	0.03	0.01
Other goods	0.01	0.04	-0.02
Services	0.06	0.05	0.01
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.05	0.04	0.02
Non-core	0.44	0.34	0.10
Agriculture	0.10	0.05	0.05
Fruits & vegetables	0.14	0.06	0.08
Meat & egg	-0.04	-0.02	-0.03
Energy & government tariffs	0.34	0.29	0.05
Energy	0.34	0.28	0.06
Government tariffs	0.00	0.01	-0.01

Source: INEGI, Banorte.

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

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Winners of the award for best economic forecasters for Mexico in 2019, granted by Refinitiv



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1H-October inflation: Goods and services with the largest contributions
 % 2w/2w; bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
Electricity	26.9	18.7
Tomatoes	8.4	14.4
LP Gas	5.6	2.8
Onions	3.7	11.8
Airfares	2.1	12.0
Goods and services with the largest negative contribution		
Chicken	-5.0	-3.1
Lemons	-1.8	-11.9
Oranges	-1.5	-9.4
Avocadoes	-1.1	-5.0
Bananas	-0.7	-3.0

Source: INEGI

Annual inflation picked up at the margin. With today’s print, the annual rate reached 4.09% from 4.01% in September. Core inflation was more stable, at 4.00% from 3.99%. In this respect, these metrics keep hovering near the upper bound of the central bank’s variability range. Non-core prices increased to 4.34% from 4.10%. We reiterate our year-end forecast at 3.7%, below consensus (3.9% in the last Banxico survey), albeit recognizing some risks to the upside. Specifically, we believe non-core prices will probably move lower in coming months, in turn influenced also by some reversion to the mean in agricultural goods and a more benign base effect in energy prices –both LP gas and low-grade gasoline–. Lastly, signals of a slowdown in goods, along muted pressures in services at the core level, should also be favorable in the short-term.

We expect Banxico to maintain the reference rate unchanged. We reiterate our view that the central bank will be cautious, maintaining the reference rate unchanged at 4.25% in its next decision, on November 12th. Our call rests mainly on short-term inflation, with today’s results showing annual inflation slightly surpassing the 4% upper bound, along our expectation that volatility could pick up as we get closer to [election day in the US](#) (November 3rd). Nevertheless, we highlight the ample debate [in the latest minutes](#) about the “available room to maneuver” for further easing. We identified two members in favor of more cuts, two against, and one uncertain. This reflects the possibility of a close decision, which will ultimately depend on price dynamics and financial developments until then –and to a lesser extent the outlook for growth, which remains very challenging–, stressing the importance of data dependency for the central bank. On the other hand, we do not rule out completely that additional cuts may be in the cards next year. Nevertheless, we think most members will prefer to wait for more information on the balance of risks –including those of idiosyncratic nature– to judge if more reductions are appropriate. We see additional challenges ahead, so our base-case scenario remains that the easing cycle has ended, and the rate will be maintained at 4.25% in 2021. Lastly, we also highlight that the Board’s bias will likely change, as the term of Deputy Governor Javier Guzman –which we identify as hawkish– will end this December.

From our fixed income and FX strategy team

Carry gains for Udibonos are still attractive but valuation is expensive. Today's report will support already attractive carry gains in Mexican linkers that [we expect to extend in the following months](#), although we prefer to wait for better entry levels given an elevated valuation for these securities. In particular, the 3- and 5-year breakevens trade at 3.67% and 3.48%, respectively, both at their highest since August and with a distance of 63bps and 29bps relative to their 12-month mean. Meanwhile, these readings could limit the recent strengthening of the market's pricing regarding Banxico's future movements, with the yield curve discounting implied cuts of -10bps for the 4Q20 and -16bps by 2Q21.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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