October inflation –Annual rate up due to pressures at the non-core

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- **Headline inflation (October): 0.61% m/m; Banorte: 0.62%; consensus: 0.57% (range of estimates: 0.54% to 0.62%); previous: 0.23%**
- **Core inflation (October): 0.24% m/m; Banorte: 0.27%; consensus: 0.26% (range of estimates: 0.23% to 0.27%); previous: 0.32%**
- **Within the core, we highlight some stability in goods, albeit mixed inside. Services remained low, despite some pressures in tourism associated to the reopening. The non-core was more volatile, with energy strongly to the upside given seasonal patterns and with agricultural goods driven up by fresh fruits & vegetables**
- **Annual inflation picked-up to 4.09% from 4.01% in September, highest since May 2019. In contrast, core inflation stood at 3.98% from 3.99%. We reiterate our call of a 25bps cut in the reference rate on Thursday**
- **We prefer to wait for better entry levels for long positions in Udibonos**

Consumer prices up 0.61% m/m. This figure was above expectations at 0.57%, but practically in line with our forecast (0.62%). Meanwhile, the core stood at 0.24%, slightly better than anticipated. Within the latter, we note the relative stabilization in processed foods at 0.3% m/m, although with other goods higher (+0.3%), likely skewed up in the second half in advance to *El Buen Fin* (Mexico's Black Friday). Services stayed low (0.2%), despite some pressures in 'others', including tourism-related categories such as airfares, possibly impacted by some seasonal patterns and additional effects from the reopening. Non-core inflation rose 1.77%, remembering the impact from the increase in electricity tariffs in the first fortnight. Moreover, LP gas was higher throughout the period (+2.7%), with pressures in the international reference. On the contrary, gasolines were more favorable, with low-grade declining 1.0% in the month, with a positive performance in the second half. Agricultural goods were high, especially fruits and vegetables (+3.5%), only marginally compensated by meat and egg (-0.3%).

October inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.61	0.62	-0.01
Core	0.18	0.21	-0.03
Goods	0.12	0.13	-0.02
Processed foods	0.05	0.07	-0.01
Other goods	0.06	0.07	0.00
Services	0.06	0.07	-0.01
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.05	0.06	-0.01
Non-core	0.43	0.41	0.02
Agriculture	0.16	0.12	0.04
Fruits & vegetables	0.17	0.15	0.03
Meat & egg	-0.02	-0.02	0.01
Energy & government tariffs	0.27	0.29	-0.02
Energy	0.27	0.29	-0.01
Government tariffs	0.00	0.00	0.00

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

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October inflation: Goods and services with the largest contributions
% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	m/m
Electricity	26.9	18.7
Tomatoes	11.1	18.6
Onions	7.4	25.2
LP gas	5.4	2.7
Nopales	2.4	30.1
Goods and services with the largest negative contribution		
Chicken	-5.2	-3.2
Low-grade gasoline	-4.8	-1.0
Oranges	-2.9	-17.4
Lemons	-2.8	-17.8
Avocadoes	-2.4	-10.4

Source: INEGI

We reaffirm our call of an additional 25bps cut from Banxico this Thursday. With today's report, annual inflation reached 4.09% from 4.01% in September, with unfavorable dynamics in the non-core component, increasing to 4.42% from 4.10%. Meanwhile, core inflation stood at 3.98% from 3.99%, marginally better. Despite of this, short-term signals are somewhat favorable, including some normalization in processed foods –which had been skewed up since the pandemic started– and with services remaining low. At the non-core component, our monitoring points to a relevant fall in gasoline prices at the beginning of November. In addition, and despite not expecting an immediate adjustment lower in fruits & vegetables, their historical performance leads us to believe that in coming months we could see a reversion lower. In the medium term, the outlook has also become more favorable, with the rejection of some proposals within the Revenue Law that would have had an adverse effect on prices, such as the implementation of an additional tariff on excise taxes for fuel, along the more modest adjustments on collections from the use of the radio spectrum. Moreover, markets are discounting Joe Biden as the new US President with more clarity. This should benefit risky assets, such as the Mexican peso, currently at USD/MXN 20.17. In this context, we expect Banxico to cut the reference rate by 25bps in its upcoming decision on Thursday to 4.00%. We think the decision could be split, with one or even two Board members voting in favor of maintaining the stance unchanged. Despite of this, we believe that the majority will try to take advantage of the available room after the end of the electoral process in the US, the possibility of a better performance in prices, and the need of additional stimulus for activity, with signs of decelerating in the last few months. After this, we expect the rate at that level by year-end 2020 and throughout 2021, with several factors limiting more downside, including the preference for a low –although still positive–real *ex ante* interest rate, less benefits from a lower rate, and prevailing financial stability risks, among the most relevant.

From our fixed income and FX strategy team

We prefer to wait for better entry levels for long positions in Udibonos. This Monday's CPI print will continue benefiting Udibonos' carry, in line with our view for these securities, which will be an interesting strategy for the months ahead. However, we wait for more attractive entry levels in light of the recent breakeven cheapening which still has space for further compression considering readings still distant from their 12-month average in most maturities. Meanwhile, we suggest receiving the shortest-end of the local yield curve ahead of Banxico's decision on Thursday and we favor a greater steepening with attractive levels in the TIIE-28 IRS 2s10s spread. In this sense, the market currently incorporates implied cuts for the 4Q20 by -8bps and -18bps for the 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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