

# 1H-October inflation – Another upward surprise, especially at the core

- **Headline inflation (1H-Oct): 0.54% 2w/2w; Banorte: 0.52%; consensus: 0.52% (range: 0.38% to 0.60%); previous: 0.21%**
- **Core inflation (1H-Oct): 0.33% 2w/2w; Banorte: 0.20%; consensus: 0.20% (range: 0.14% to 0.25%); previous: 0.13%**
- **We highlight energy prices, up 3.8% (contribution: 37bps). Electricity (18.8%) was affected by an adverse seasonality, while LP gas surged again (4.4%). Gasolines were more stable. At the core, both processed foods (0.3%), and ‘others’ (0.4%) picked up their pace at the margin. In services (0.3%), we note that tourism-related categories adjusted higher despite online discounts**
- **Annual inflation increased to 6.12% from 6.00% on average in September, a trend that we expect to prevail through the end of the year. The core reached 5.12% from 4.92% in the same period**
- **We expect Banxico to extend the hiking cycle into year-end and early 2022 as inflation pressures remain elevated**
- **The market holds an aggressive pricing for Banxico**

**Inflation at 0.54% 2w/2w in 1H-October, with an adverse seasonality.** This was slightly above consensus and our call, which coincided at 0.52%. The core stood at 0.33%. Energy prices were up 3.8%, recalling an adverse seasonality on the start of the rollback of discounts in electricity tariffs (18.8%). Moreover, LP gas (4.4%) remained highly pressured, while gasolines were more stable. Also, at the non-core, agricultural goods (-0.7%) were favorable. Going to the core, goods (0.4%) remain above services (0.3%). In the former, processed foods (0.3%) are still a cause of concern. More surprisingly, tourism-related categories in the latter, such as airfares (11.4%) and tourism services (4.9%), adjusted meaningfully higher despite the *Hot Travel* campaign of online discounts. Moreover, we also note autos (0.7%) and professional services (7.4%), possibly affected by higher costs and maybe also better COVID-19 dynamics.

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

	INEGI	Banorte	Difference
Total	0.54	0.52	0.02
Core	0.25	0.15	0.10
Goods	0.15	0.13	0.02
Processed foods	0.06	0.10	-0.04
Other goods	0.08	0.03	0.05
Services	0.10	0.02	0.08
Housing	0.02	0.01	0.01
Education	0.00	0.00	0.00
Other services	0.08	0.01	0.07
Non-core	0.29	0.38	-0.08
Agriculture	-0.07	-0.01	-0.07
Fruits & vegetables	-0.08	0.02	-0.10
Meat & egg	0.00	-0.03	0.03
Energy & government tariffs	0.37	0.38	-0.01
Energy	0.37	0.38	-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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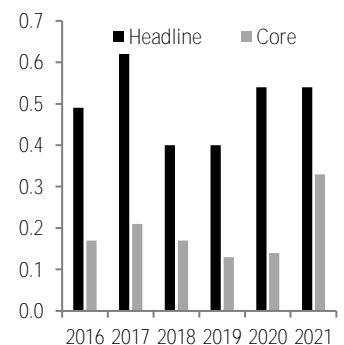
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Headline and core inflation in 1H-Oct  
% 2w/2w



Source: INEGI

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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	26.8	18.8
LP gas	10.4	4.4
Onions	2.7	9.7
Air fares	2.1	11.4
Eggs	1.6	2.0
Goods and services with the largest negative contribution		
Tomatoes	-9.0	-11.8
Chicken	-2.4	-1.4
Oranges	-1.7	-10.1
Avocados	-1.5	-5.5
Lemons	-0.9	-6.8

Source: INEGI

**Annual inflation will keep moving higher.** The headline stood at 6.12% from 6.00% on average in September, while the core moved to 5.12% from 4.92% in the same period. In our view, the renewed rise in energy commodities and their second-round effects, including at the core level, will keep pushing inflation at least in the short term. In both cases, the base effect going into December will be increasingly difficult, also limiting potential declines. Nevertheless, we remain more concerned about the trend at the core –particularly in goods–, as it has kept moving up since the beginning of the year and has stayed above 4% since March. In addition, strong global demand and the persistence of supply bottlenecks, the possibility of a stronger dollar as the Fed begins tapering, and the upcoming winter season in the northern hemisphere (possibly having an additional impact on energy prices) suggest that risks remain firmly skewed to the upside.

**Banxico to extend the hiking cycle this year and into early 2022.** In our view, the [central bank’s most recent information](#) shows heightened concerns among the Board’s majority about the inflation path and its potential impact on expectations. Moreover, we believe there is more consensus about the need to extend the hiking cycle despite maintaining a high data dependency approach. The backdrop is even more complicated when considering price dynamics globally. This has resulted in a less accommodative stance by other central banks, mostly in emerging markets, in turn reducing the room to maneuver for Banxico. Specifically, we expect two more 25bps hikes this year, to 5.25%. For 2022, we estimate two more increases at the beginning of the year and one more of the same magnitude by the end, with the reference rate closing the period at 6.00%.

*From our fixed income and FX strategy team*

**The market holds an aggressive pricing for Banxico.** Inflation prints will continue offering validation to the market for a more aggressive pricing for the central bank’s action, where the yield curve discounts +91bps by year-end from +59bps two weeks ago, and +214bps for the 1H22. Both expectations are higher than our estimates. Under a backdrop of inflationary pressures, during October, Mexican inflation linkers have shown a slight positive performance averaging gain of 3bps, contrarily to nominal rates’ price action. In line with the adjustments in global bonds, Mbonos have experienced pressures of 28bps, on average, extending the dynamics seen in September, with greater adjustments focused on short- and mid-term tenors.

Consequently, inflation breakevens have widened in 3- and 5-year readings, with the latter reaching its highest since 2008 at 5.09% yesterday. In terms of strategy, we hold a view of greater relative value in mid-term Udibonos and given the current conditions we opt to wait for better levels to take long positions in long-term Mbonos, although we acknowledge the recent adjustments suggest a notable cheapening.

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We, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo 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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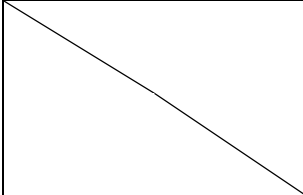
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