October 24, 2024

Inflation 1H-October – Seasonal factors and new shocks in fruits drive non-core prices higher

- **Headline inflation (1H-October): 0.43% 2w/2w; Banorte: 0.55%; consensus: 0.40% (range: 0.19% to 0.55%); previous: -0.02%**
- **Core inflation (1H-September): 0.23% 2w/2w; Banorte: 0.18%; consensus: 0.18% (range: 0.13% to 0.24%); previous: 0.05%**
- **The period is characterized by the end of the first tranche of summer discounts on electricity (+18.1%). Nevertheless, this time around we also highlight the reversion higher in fruits and vegetables (+1.9%) after five fortnights of declines. The skew for the rest of items was to the downside, noting meat and egg (-0.2%), LP gas (-1.9%), and government tariffs (-0.1%). With this, non-core inflation came in at 1.08%. In the core, services (0.2%) were impacted by adverse seasonal effects in 'others' (0.4%). In goods (0.2%), increases were similar in both categories**
- **In bi-weekly terms, annual inflation accelerated to 4.69% from 4.50% in the second half of September. However, the core moderated further, now at 3.87% (previous: 3.88%)**
- **Despite the rebound in the headline, we believe that continuing improvements at the core –on top of other factors– will keep driving Banxico's easing cycle**

Inflation at 0.43% 2w/2w in the 1st half of October. The period is characterized by the end of the first tranche of summer discounts on electricity, resulting in a 18.1% expansion –remembering that next month's adjustment is larger. However, another highlight was the 1.9% pickup in fruits and vegetables, reversing higher after five fortnights of declines –driven by tomatoes, husk tomatoes and squashes, although with relevant setbacks in lemons, bananas, and oranges. We noted several declines in the rest of items, including meat and egg (-0.2%) –dragged by chicken–, LP gas (-1.9%), and government tariffs (-0.1%) –with the latter apparently leaving behind the string of notable increases after the election. On the contrary, low-grade gasoline grew 0.1%, explained by higher international references. With all this, non-core inflation rose 1.08%. Turning to the core (0.23%), seasonal effects also hit services (0.2%), especially 'others' (0.4%). Specifically, we note the rebound in professional services (5.7%), in addition to tourism items (*e.g.* air fares at 10.3%). Housing advanced 0.1%. In goods (0.2%), moves were more modest, with processed foods (0.2%) and 'other goods' showing rather similar changes at 0.2%

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 tariffs	20.5	18.1
Air fares	2.4	10.3
Tomatoes	2.3	4.0
Husk tomatoes	2.1	14.8
Squash	1.8	15.6
Goods and services with the largest negative contribution		
LP gas	-2.7	-1.9
Lemons	-2.1	-15.0
Bananas	-1.4	-6.6
Chicken	-1.1	-0.7
Oranges	-1.1	-8.5

Source: INEGI


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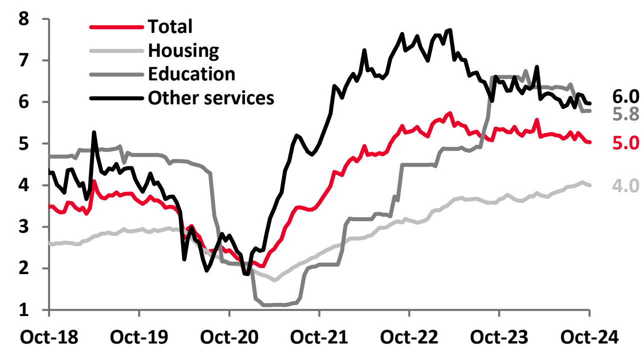
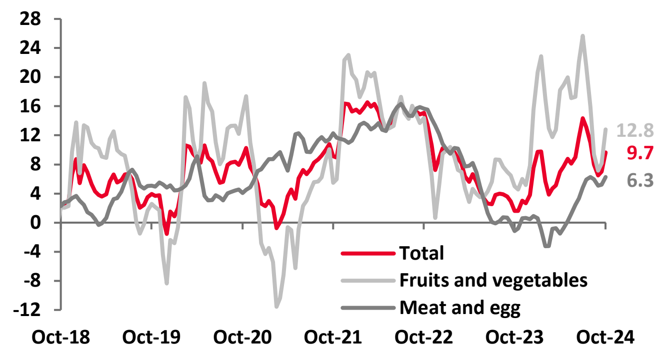
Headline inflation accelerates once again, although the core continues to decline. The former came in at 4.69% y/y from 4.50% in the second half of September, breaking with five fortnights lower. The increase was explained by the non-core at 7.17% (previous: 6.28%), specifically in fruits and vegetables, which returned to double digit variations at 12.8%, (see chart below, right). Once again, the shock came from tomatoes, this time in response to the loss of crops in Florida due to Hurricane Milton. Thus, the event corroborates the sector's fragility due to weather conditions, which will probably remain under pressure on expectations of additional storms in the remainder of the year, as well as the arrival of the *La Niña* phenomenon. On energy, escalating tensions in the Middle East have introduced greater volatility to reference prices, partially offset by signs of economic weakness in certain latitudes. Thus, we believe that the sector is unlikely to contribute to a substantial moderation in the short-term. For its part, the core came in at 3.87% (previous: 3.88%), its lowest level since the 2nd half of August 2021. As has been the case for quite some time now, goods moderated further, reaching 2.9% –its lowest since 2016. So far, evidence of an exchange rate pass-through effect to prices is scarce, although we remain very vigilant to corroborate whether this materializes. Also positive, services added a third fortnight to the downside, reaching 5.0%, not seen since mid-2022 (see chart below, left). Nonetheless, we remain on the lookout to its performance inside, with housing just starting to show signs of stabilization.

Core CPI: Services
% y/y, bi-weekly frequency



Source: Banorte with data from INEGI

Non-core CPI: Agricultural items
% y/y, bi-weekly frequency



Source: Banorte with data from INEGI

Despite the rebound in headline inflation, Banxico will continue easing in coming meetings. After a quarter of favorable figures and in line with the institution's estimates, we believe that the new shock in fruits and vegetables will not be enough reason to delay additional cuts. Several Board members, especially those from the dovish wing, have stressed that these are transitory and that their effect on remaining prices may be quite limited if they are reversed quickly. Moreover, we see as a more compelling argument that the path of the core is still to the downside, which will likely be enough to drive further moves. However, other factors that should support reductions include: (1) Expectations that the Fed and other central banks will continue with their easing cycles; and (2) forecasts of lower economic growth in coming months. Thus, we continue to anticipate two 25bps rate cuts in the remainder of the year, taking the rate to 10.00% by YE24. Further ahead, we expect a year-end 2025 level of 8.00%.

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