1H-August inflation – Decline in annual terms despite higher pressures in the period

August 24, 2023

- **Headline inflation (1H-Aug): 0.32% 2w/2w; Banorte: 0.31%; consensus: 0.31% (range: 0.18% to 0.41%); previous: 0.21%**
- **Core inflation (1H-Aug): 0.19% 2w/2w; Banorte: 0.19%; consensus: 0.22% (range: 0.14% to 0.27%); previous: 0.09%**
- **The print was high after discounting for seasonal effects in both directions. The core added 15bps. Goods (0.2%) accelerated, mainly 'others' (0.3%). Services also picked up (0.2%), with education (1.4%) climbing strongly due to the back-to-school period, although partly compensated by declines in tourism categories. The non-core went up more strongly (0.72%), highlighting again fruits and vegetables (1.6%), along with LP gas (4.2%) within energy (1.1%)**
- **In bi-weekly terms, annual inflation fell to 4.67% from 4.78%. The core came in at 6.21% from 6.52%, accelerating its decline at the margin**
- **We will watch Banxico's minutes closely later today, especially the assessment about the outlook for the economy and prices and how these could affect the monetary policy path**
- **We reiterate our call that Banxico will start easing until February 2024. Moreover, the market sees fewer cuts this year**

Inflation at 0.32% 2w/2w. This was higher than the 5- and 10-year averages, closer to 0.20%. As in recent fortnights, we noted pressures at the non-core (0.72%). In agricultural goods (0.6%), fruits and vegetables (1.6%) extended their move higher on adverse climatological conditions, highlighting key goods such as tomatoes, onions, and other fruits. To the latter we must add energy (1.1%), influenced by higher international benchmark prices and a weaker peso against the dollar. Low-grade gasoline picked up 0.4%, while LP gas rose by 4.3%, and electricity by 1.5%. At the core (0.19%), several categories adjusted as high schools and colleges returned to classes. To the upside, education (1.4%) and 'other goods' (0.3%), recalling that the latter includes clothing and school supplies, among others. To the downside, airfares (-6.8%) and tourism services (-2.4%). Food-related items were mixed, with processed foods moderating its pace to 0.1%, albeit with 'dining away from home' (0.4%) still to the upside.

1H-August 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
Tomatoes	9.4	18.1
LP gas	5.8	4.2
Onions	3.9	17.4
University tuition	2.7	1.9
Electricity	2.0	1.5
Goods and services with the largest negative contribution		
Potatoes	-2.5	-5.4
Squash	-1.8	-16.3
Airfares	-1.7	-6.8
Avocadoes	-1.1	-3.7
Eggs	-1.0	-1.2

Source: INEGI

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Focus on inflation relative to Banxico's forecasts… In bi-weekly terms, headline inflation fell to 4.67% from 4.78% in the second half of July, while the core dropped to 6.21% from 6.52%. As we have stated before, this reduction is not a surprise because it is driven by favorable base effects. This has already been recognized by the central bank. Hence, for its potential monetary policy implications, we suggest focusing more on: (1) The marginal results, that as we have already mentioned, were above the average of recent years in this fortnight; and (2) consistency relative to the central bank's forecasts. On the latter point, average annual headline and core inflation estimated for 3Q23 is at 4.7% and 6.2%, in the same order. With this report, those metrics stand at 4.7% and 6.5%, respectively. More importantly, our estimates point that those levels are quite achievable by the end of the period. Nevertheless, we are less optimistic that the core will reach the institution's estimate of 5.1% by 4Q23 (Banorte: 5.4%). In our view, this is very important as the market is still discounting with a high probability a 25bps rate cut in December. If our forecasts materialize, we think this is not probable if the central bank keeps adjusting upwards its view about this inflation component, which remains as the Board's main concern.

…as well as Board members' opinions in the minutes. Today, at 11:00am (EST), the minutes of the decision held on August 10th will be released, in which they left the reference rate at 11.25%, in line with expectations. We believe that the information contained will be relevant, especially as we have had few comments from members since the meeting. With this in mind, we will look for: (1) The assessment about economic performance and its potential implications for inflation, especially at the core level; (2) the balance of risks for inflation, which remains to the upside; and (3) the forward guidance and the conditions that would be necessary to consider a reference rate change, which would likely be a cut. For details, see our document, *Ahead of the Curve*.

From our fixed income and FX strategy team

The market sees fewer interest rate cuts this year. Since Banxico's last policy decision, the market has recalibrated its expectations of lower interest rate cuts this year. Now, they see the monetary easing cycle starting in December, with -25bps to 11.00%. This is less dovish than the two cuts of the same magnitude, in November and December (10.75%), priced-in before. As a result, TIIE-IRS payers at the front-end have benefited. We reiterate our preference for these strategies as we reiterate our long-held call that Banxico will keep the benchmark rate unchanged at 11.25% in the remainder of 2023. On the other hand, August has been characterized by risk aversion and strong pressures on long-duration sovereign bonds, led by Treasuries. Long-term Mbonos have accumulated a 45bps sell-off despite yesterday's 11bps rally. We restate that yields of these securities look attractive for long-term portfolios, mainly the May'33 (9.24%), Nov'38 (9.32%) and Nov'42 (9.33%) maturities. However, high volatility and the closeness of Powell's speech at Jackson (on Friday) inserts upside risks for rates, in turn maintaining us with a more cautious stance. In real rates, short-term Udibonos with breakevens below 4.00% look attractive for new positions.

Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Juan Carlos Mercado Garduño, Daniel Sebastián Sosa Aguilar, Jazmin Daniela Cuautencos Mora and Andrea Muñoz Sánchez, 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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