August inflation – Pressures continue in the non-core

- **Headline inflation (August): 0.55% m/m; Banorte: 0.57%; consensus: 0.53% (range: 0.49% to 0.59%); previous: 0.48%**
- **Core inflation (August): 0.27% m/m; Banorte: 0.32%; consensus: 0.30% (range: 0.28% to 0.34%); previous: 0.39%**
- **As in recent periods, the non-core led at 1.44%. Pressures continued in agricultural items (1.7%), especially fruits and vegetables (4.0%). Energy also rose, noting LP gas (6.2%) after five months to the downside. At the core, seasonality is mostly adverse for services (0.3%) due to the return to classes, impacting tuitions (1.7%)**
- **Annual inflation fell to 4.64% from 4.79% in the previous month, still helped by positive base effects. The core declined by a larger magnitude to 6.08% from 6.64%**
- **We reiterate our call that the first cut to Banxico's reference rate will take place until February 2024**
- **TIIE-IRS payers at the front-end close to profit-taking levels**

Inflation at 0.55% m/m, with pressures extending at the non-core. This was slightly higher than consensus and the five-year average of 0.37%. The non-core once again led at 1.44%. Agricultural items kept climbing (1.7%), with fruits and vegetables as the culprits at 4.0% –noting increases in tomatoes and onions, among others. However, meat and egg added a fourth month to the downside at -0.2%. Energy prices rebounded 1.7%, with LP gas leading the charge (6.2%) given higher international benchmarks –breaking with five months lower–, but with electricity (1.5%) and low-grade gasoline (0.6%) also higher. Turning to the core (0.27%), the expansion centered on services, up 0.3%. Most of the contribution was in education (tuitions) at 1.7% as high school and colleges resumed at the beginning of the month, so it was seen since the 1st fortnight. Part of this seasonality was compensated by tourism items within 'others' (0.1%). In goods (0.2%) processed foods were more contained at 0.2%, with 'other goods' (0.3%) also affected by the return to classes.

August 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
Tomatoes	16.0	31.7
LP gas	8.5	6.2
Onions	6.7	30.5
Low-grade gasoline	3.1	0.6
Dinning away from home	3.1	0.6
Goods and services with the largest negative contribution		
Potatoes	-4.1	-8.6
Air fares	-3.3	-12.8
Squash	-2.2	-21.3
Tourism services	-1.8	-5.2
Oranges	-1.4	-5.0

Source: INEGI

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Winners of the 2023 award for best Mexico economic forecasters, granted by *Focus Economics*

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Annual inflation continues to decline, still helped by base effects. The headline fell to 4.64% from 4.79% in July, with the core descending to 6.08% from 6.64%. This is very relevant as comparison bases for the headline will become more challenging starting next month –and in December for the core–, which we anticipate will add pressures to the annual print. In addition, the recent rebound of the non-core –which left behind negative territory standing at 0.37% (previous: -0.67%)– implies additional upside risks. While these increases have a direct impact on the headline, something that is starting to worry us is the possibility of a speedier pass-through to the core given low economic slack. Considering that the most recent pressures have been concentrated in food and energy, the items with the greatest risks would include 'dining away from home' –in our opinion, already facing challenges from wages–, and processed foods. This is particularly important as the outlook is more complicated with the development of the *El Niño* phenomenon, which we expect to lead to more extreme weather conditions for agricultural items. Other risks are related to demand pressures, such as: (1) Expectations that the US slowdown will materialize until next year, if it happens at all; and (2) stimulus in China could have a positive impact on global economic activity. In this context, we maintain our forecast that inflation will close this year at 4.5%, although the outlook looks more turbulent.

Banxico will stay pat for the remainder of the year. We believe that the central bank's latest communications reaffirmed a more hawkish tone. On prices, concerns about a balance of risks still skewed to the upside and that there is still some time ahead for the convergence to the target will lead to more caution from the central bank. Moreover, the fact that the output gap is in positive territory increases the likelihood of demand pressures on prices, in turn in favor of keeping the rate in more restrictive territory for longer. Considering this, we maintain our expectation that the first cut to the reference rate will take place until February 2024 –estimate that we have held since late April. We must note that analysts' consensus has converged to our view, remembering that the previous banking sector survey –in mid-August– the median suggested the first reduction in December 2023.

From our fixed income and FX strategy team

TIIE-IRS payers at the front-end close to profit-taking levels. Today's CPI report and a more complex outlook for the energy sector will continue to strengthen the market's expectation of a restrictive stance for longer. In this sense, bets for interest rates cuts for the remainder of the year have lost more and more steam. Currently, the curve is pricing-in until December an adjustment of -10bps from -42bps at the beginning of August. As a result, TIIE-IRS payers at the front-end of the curve have been benefited, in line with our expectations as we rule out rate cuts in 2023. The 1-year TIIE-IRS (13x1) is trading at 11.27%, equivalent to an increase of 36bps since the beginning of August. In this sense, we reiterate our preference for these strategies, although we recognize that they are close to realizing their potential with little room for additional gains.

Apart from this, breakevens have increased rapidly in recent weeks caused by nominal rates increasing at a faster pace than real ones. The 3-year reading stands at 4.20%; that is 20bps above the level that we had identified as attractive for long-term positions, from 3.84% a month ago. Despite this adjustment, short-term CPI-linked bonds (Udibonos) still reflect a better valuation in relative terms. The 3-year Udibono is trading very close to all-time highs at 5.74%.

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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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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