

Economic Analysis

Inflation is on a clear downward trend as expected

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Headline inflation increased 0.61% FoF in the first fortnight of November, with a slightly higher-than-anticipated 0.19% FoF rise in core inflation. Annual headline inflation came in at 4.56%, sharply down from 4.87% in the previous fortnight. Annual core inflation declined 0.1pp to 3.63%, from 3.72% in the previous fortnight. The decline in annual headline inflation was largely driven by weaker energy inflation. The positive headline inflation surprise was driven by a sharp drop in LP gas prices which took (-)0.08 pp off headline inflation. The lower print was also partially driven by a slightly lower-than-expected increase in electricity prices. If it was not for a larger-than-anticipated increase in fruit and vegetable prices, inflation would have surprised more significantly to the downside.

Looking ahead, we expect headline inflation to fall further. Our preliminary monthly forecast for November (0.68%) would bring down inflation to 4.5% and biases our year-end 4.5% slightly to the downside (to 4.4%). In contrast, our preliminary 0.23% MoM core inflation forecast biases our year-end 3.4% slightly to the upside (to 3.47%). The recent drop in international energy prices will continue to feed in inflation numbers in the short-term. This drop in energy prices will continue to push down fuel inflation the rest of the year, turbocharging the already large and positive base effect following last year's significant increases at this time of the year. This positive new development implies that headline inflation is now again likely to drop below the 4.0% threshold around the Summer of next year. This would depend on the budget. If taxes are cut at the border, a drop should be expected in January. Yet, we should also wait to see how the upcoming government is going to proceed with gasoline prices next year.

In any case, inflation is unlikely to be on the spotlight at the time of Banxico's next policy decision. In spite of today's favorable print and the clear downward trend, the budget (and the MXN) still holds the key for December's call. An additional hike is still likely but is still not our base scenario. We will wait on the budget to make our final call.

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