

1H-June inflation –Upside surprise drives the annual rate slightly above target

- **Headline inflation (1H-Jun): 0.32% 2w/2w; Banorte: 0.20%; consensus: 0.22% (range of estimates: 0.02% to 0.33%); previous: -0.01%**
- **Core inflation (1H-Jun): 0.29% 2w/2w; Banorte: 0.14%; consensus: 0.14% (range of estimates: 0.05% to 0.21%); previous: -0.06%**
- **At the core level, we highlight pressures in other goods (0.9% 2w/2w), in our view influenced by the reversal of discounts seen in the previous fortnight, while processed foods kept moderating (0.0%). Non-core prices were up 0.4%, with a mixed performance within agricultural goods (-0.9%) but with energy still trending higher**
- **Annual inflation increased to 3.17% from 2.84% in May, slightly above Banxico’s target. Core inflation stood at 3.66% from 3.64%. Non-core prices keep normalizing, at 1.63% from 0.35%**
- **We expect Banxico to cut the reference rate by 50bps to 5.00% on Thursday, in line with consensus expectations, likely remaining dovish despite its prudent approach to easing**
- **We suggest waiting for more attractive valuations in long-term Mbonos for new tactical long positions**

Consumer prices up 0.32% 2w/2w in the first half of June. This was higher than consensus at 0.22%, which was close to our 0.20%. Both the core and non-core components were higher relative to the previous fortnight. In the former, we highlight the upside surprise in other goods (see table below), in our view influenced by the reversal of discounts from the *Hot Sale* campaign in the previous fortnight. Processed foods moderated after recent pressures, while tax adjustments in some digital services did not show up very strongly. In the latter, performance was more mixed. Agricultural goods declined 0.9%, with fruits and vegetables lower but meat and egg higher. On the other hand, energy picked up 2.2%, with both LP gas and gasolines higher for three consecutive prints.

1H-June inflation by components

%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.32	0.20	0.11
Core	0.22	0.11	0.12
Goods	0.17	0.07	0.11
Processed foods	0.01	0.06	-0.05
Other goods	0.16	0.01	0.15
Services	0.05	0.04	0.01
Housing	0.00	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.05	0.03	0.02
Non-core	0.09	0.10	-0.01
Agriculture	-0.10	-0.05	-0.05
Fruits & vegetables	-0.12	-0.07	-0.06
Meat & eggs	0.02	0.02	0.00
Energy & government tariffs	0.19	0.15	0.04
Energy	0.19	0.15	0.03
Government tariffs	0.00	-0.01	0.01

Source: INEGI, Banorte.

Note: Contributions might not add due to the number of decimals allowed in the table.

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www.banorte.com
@analisis_fundam

Alejandro Padilla

Executive Director of Economic Research and Financial Market Strategy
alejandropadilla@banorte.com

Juan Carlos Alderete, CFA

Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores

Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Manuel Jiménez

Director of Market Strategy
manuel.jimenez@banorte.com

Santiago Leal Singer

Senior Strategist, Fixed-Income and FX
santiago.leal@banorte.com

Leslie Orozco

Strategist, Fixed Income and FX
leslie.oroazco.velez@banorte.com

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1H-Jun inflation: Goods and services with the largest contributions

% 2w/2w; bi-weekly incidence in basis points

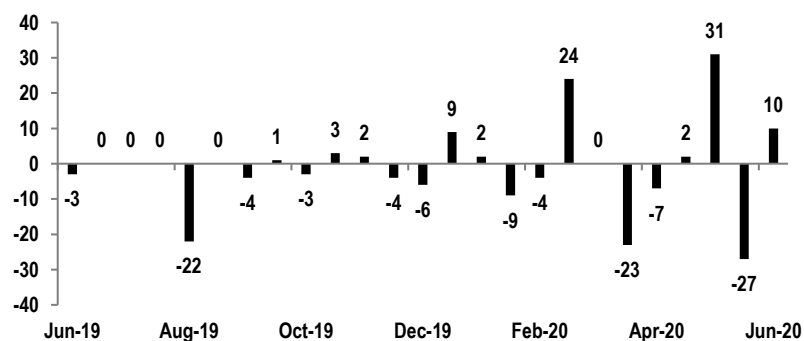
Goods and services with the largest positive contribution	Incidence	% 2w/2w
Low-grade gasoline	13.3	3.0
Chicken	4.6	3.2
LP gas	3.1	1.6
Airfares	2.6	16.4
Oranges	2.1	10.9
Goods and services with the largest negative contribution		
Beer	-4.9	-3.4
Tomatoes	-4.4	-6.3
Eggs	-3.4	-3.6
Serrano chilies	-2.4	-13.7
Onions	-1.7	-8.2

Source: INEGI

Annual inflation an inch above Banxico’s target. With today’s report, headline inflation increased to 3.17% y/y from 2.84% in May, slightly above Banxico’s target after staying below 3% during the previous two months. The uptick in May and the first half of June was faster than we had anticipated, as we stated that headline inflation could reach the latter level until late in the third quarter. Moreover, core inflation increased to 3.66% from 3.64% in the same period, failing to consistently breach the 3.50% psychological level since late 2016. Broadly speaking, short-term price dynamics have been distorted by COVID-19, including higher volatility in recent bi-weekly figures (see chart below). Despite of these caveats, we believe the economic outlook –downgrading further our GDP forecast for this year earlier this week, [to -9.8%](#)– and current inflation still argue in favor of additional central bank easing. In this respect, we expect Banxico to cut the reference rate by 50bps tomorrow, to 5.00%, in line with consensus. As we argued [previously](#), we expect another unanimous decision, although we cannot rule out a dissenter, as: (1) [In the latest minutes](#), we identified two members in favor of more aggressive cuts; and (2) we believe that, at the margin, economic and financial conditions have evolved in a way that could convince some in this regard. Despite of this, most Board members will likely keep following a prudent and cautious approach, seeing the trade-off between cutting at a more accelerated pace to boost activity and risks that this could entail to financial stability as still favoring the current strategy. Going forward and after tomorrow’s decision, we maintain our view of an additional 50bps decrease in the meeting to be held on August 13th, with the reference rate reaching 4.50%, where we expect it to finish this year.

Inflation surprises

Bps, actual less consensus, bi-weekly frequency



Source: INEGI and Bloomberg

From our fixed income and FX strategy team

We suggest waiting for more attractive valuations in long-term Mbonos for new tactical long positions. This morning's higher-than-expected CPI print adds to the high uncertainty backdrop in local price dynamics, ahead of Banxico's decision tomorrow with a market pricing in close to 133bps of accumulated rate cuts for 2020. In our view, this discount is excessive considering our estimate for a terminal rate at 4.50% this year, where we expect two additional 50bps rate cuts; one in tomorrow's decision and the other one in August. In this sense, this positioning will probably moderate during today's session amid a pressured performance in nominal rates, with real-rate bonds outperforming. Under this scene, breakevens between Mbonos and Udibonos have modestly compressed during the month, especially in 5- and 10-year maturities. We prefer to wait for better entry levels for long positions in long-term Mbonos, after the recent profit taking in our trade idea of long positions in Udibono Nov'35.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega 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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GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Markets Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katía Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldivar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Juan Barbier Arizmendi	Analyst	juan.barbier@banorte.com	(55) 1670 - 1746
Corporate Debt			
Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	dela.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebaldos@banorte.com	(55) 5268 - 9996
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Oswaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454