

Economic Research

Mexico

1H-July inflation – Core prices remain high, so Banxico will likely keep hiking

- **Headline inflation (1H-Jul): 0.37% 2w/2w; Banorte: 0.30%; consensus: 0.26% (range: 0.14% to 0.43%); previous: 0.20%**
- **Core inflation (1H-Jul): 0.31% 2w/2w; Banorte: 0.23%; consensus: 0.23% (range: 0.16% to 0.36%); previous: 0.21%**
- **We saw pressures at the core again, contributing 23bps to the total. Processed foods (0.5%) are still leading among goods (0.4%), with a renewed increase in corn tortillas (1.5%). ‘Others’ were more modest, at 0.2%. Services (0.2%) keep showing tentative signs of accelerating. At the non-core, the more modest uptick in agricultural (0.3%) is positive, albeit with energy prices quite high (1.0%) especially in LP gas (4.0%)**
- **Annual inflation fell to 5.75% from 5.88% on average in June. The core remains on the upside, at 4.64% from 4.58%, with the non-core to 9.24% from 10.00%, in the same order**
- **We expect Banxico to hike the reference rate by 25bps in its August 12th decision, to 4.50%. Moreover, we still see three more hikes of the same magnitude this year, ending 2021 at 5.25%**
- **The market will reprice Banxico’s hikes**

Inflation at 0.37% 2w/2w in 1H-July. The print was above consensus at 0.26%, and to our 0.30%. We saw pressures at the core again as it stood at 0.31%, contributing with 23bps of the total. Specifically, processed foods (0.5%) exhibited renewed increases in corn tortillas (1.5%) as well as soda (0.6%). ‘Other goods’ were more modest, at 0.2%. We believe these are still influenced by summer discounts, albeit with autos higher (0.7%). Services (0.2%) keep showing tentative signs of accelerating, consistent with higher mobility despite more COVID-19 cases. We keep thinking these remain affected by passthrough from higher costs. At the non-core, agricultural goods were up 0.3%, which may be responding to better conditions regarding the drought. Energy was high (1.0%), highlighting lingering concerns about higher LP gas prices (4.0%).

1H-July inflation by components
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.37	0.30	0.07
Core	0.23	0.18	0.05
Goods	0.15	0.08	0.07
Processed foods	0.10	0.06	0.04
Other goods	0.04	0.02	0.02
Services	0.08	0.10	-0.01
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.07	0.08	-0.01
Non-core	0.14	0.12	0.01
Agriculture	0.04	0.04	0.00
Fruits & vegetables	0.01	0.01	0.00
Meat & egg	0.02	0.03	0.00
Energy & government tariffs	0.10	0.09	0.01
Energy	0.10	0.08	0.02
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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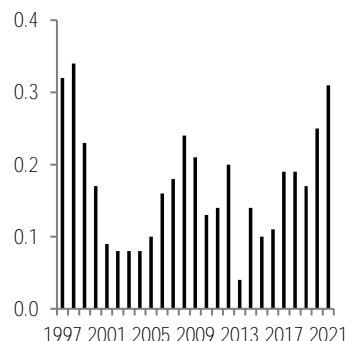
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Core inflation in 1H-Jul
% 2w/2w



Source: INEGI

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1H-July 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
LP Gas	10.0	4.0
Corn tortillas	3.1	1.5
Dining away from home	2.3	0.5
Onions	2.0	12.3
Beef	1.6	0.7
Goods and services with the largest negative contribution		
Eggs	-1.4	-1.7
Husk tomatoes	-0.8	-6.5
Grapes	-0.7	-11.5
Cantaloupe	-0.6	-9.5
Women's blouses and T-shirts	-0.5	-2.0

Source: INEGI

Core inflation remains on the upside. The headline fell to 5.75% from 5.88% y/y on average in June, driven by the non-core, which stood at 9.24% from 10.00% in the same period. The core increased again, up 6bps to 4.64% despite a less challenging base-effect less which is expected to keep improving at least until late 3Q21. In this respect, goods are still running at an uncomfortably high pace of 5.7% y/y while services picked above 3% since early June. More favorably, agricultural goods –especially fresh fruits and vegetables– seem to be stabilizing since the previous fortnight. In contrast, energy remains affected by higher global reference prices, particularly LP gas as it accumulates a whopping 25.6% year-to-date adjustment.

Banxico to keep hiking in coming months. In our view, inflation will remain front and center in the evaluation about the best policy stance. Specifically, we think it is key that core inflation remains above the upper limit around the target. Based on our forecasts, this will linger until 3Q22, providing arguments to the hawks to keep increasing the rate to avoid affecting inflation expectations. Nevertheless, we see a divided and data-dependent Board, so new information is also very important. Apart from inflation data, we will look carefully at: (1) The Fed decision next week, as CPI inflation in the US reached highs since 2008 and investors are looking for signs of an upcoming tapering; (2) Banxico's decision on August 12th; and (3) the 2Q21 *Quarterly Report* on August 31st, especially new (and higher) inflation forecasts. Given this backdrop, we expect Banxico hike the reference rate by 25bps in its August 12th, to 4.50%. Moreover, we still see three more hikes of the same magnitude this year, ending 2021 at 5.25%.

From our fixed income and FX strategy team

The market will reprice Banxico's hikes. Amid the global backdrop with rates compressing recently, the local market partially moderated its pricing for Banxico, currently integrating implied hikes for 86bps by December and a 45% probability for a 25bps rate hike for August's decision. Pressures in today's CPI report will likely result in an expectation in the short end of the yield curve converging again towards our estimate of 25bps rate hikes in all the remainder meetings this year. Moreover, this report will likely result in greater interest for real-rate Udibonos, widening current breakeven levels which have already picked-up recently. In this sense, the 3-year breakeven stands at 4.41% with year-to-date highs at 4.95% reached at the end of last month. We hold a view favoring [further flattening of the nominal yield curve and given the complex outlook for inflation, we believe there is greater relative value in mid-term Udibonos.](#)

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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, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalia 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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