June inflation – Food items remain to the upside, pushing annual rates higher

- **Headline inflation (June): 0.84% m/m; Banorte: 0.87%; consensus: 0.84% (range: 0.77% to 0.87%); previous: 0.18%**
- **Core inflation (June): 0.77% m/m; Banorte: 0.83%; consensus: 0.82% (range: 0.50% to 0.84%); previous: 0.59%**
- **Processed foods (1.3% m/m) and agricultural goods (1.8%) extended the increase seen in the first fortnight. At the core, 'other goods' (0.7%) benefitted from discounts in clothing, among others. Services (0.5%) accelerated at the margin. At the non-core, energy was relatively more stable (0.4%), helped by LP gas (-2.1%). Government tariffs (0.8%) were hit by the increase in urban transportation prices in Mexico City**
- **Annual inflation picked up to 7.99% from 7.65% on average in May, not seen since early 2001. The core advanced to 7.49% from 7.28%, steering further away from Banxico's target**
- **Given new inflation highs and the Fed's tightening cycle, we reiterate our view of a 75bps hike in August and that the reference rate will reach 10.00% by the end of this year**
- **The market is fully pricing-in a 75bps hike in August**

Inflation at 0.84% m/m in June. First, we note continuing pressures food items. Processed foods (1.3%) kept resenting higher prices in beverages, among others; in fruits and vegetables (2.0%) and meat and egg (1.6%), we highlight potatoes and oranges the former, as well as chicken in the latter. At the core, 'other goods' (0.7%) were helped by discounts in clothing and lower prices in TVs and computers in the 2nd half. Services (0.5%) had a modest adverse seasonality in airfares and tourism, which may have been exacerbated by the earlier end of the elementary school period in some states. However, the driver remains 'dining away from home', with businesses passing through higher input prices. At the non-core, LP gas (-2.1%) fell, but low-grade gasoline (0.6%) and natural gas (5.8%) were higher. Government tariffs (0.8%) were affected by the MXN$1 increase in the price of urban transportation prices in Mexico City.

June inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.84	0.87	-0.03
Core	0.58	0.62	-0.05
Goods	0.41	0.43	-0.02
Processed foods	0.28	0.28	-0.01
Other goods	0.13	0.14	-0.01
Services	0.17	0.19	-0.02
Housing	0.04	0.05	0.00
Education	0.00	0.00	0.00
Other services	0.12	0.14	-0.02
Non-core	0.27	0.25	0.02
Agriculture	0.20	0.22	-0.02
Fruits & vegetables	0.10	0.12	-0.02
Meat & egg	0.10	0.10	0.00
Energy & government tariffs	0.07	0.03	0.03
Energy	0.04	0.02	0.02
Government tariffs	0.03	0.01	0.02

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

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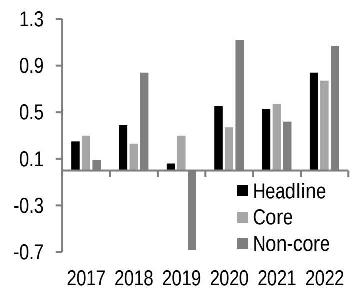
Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Inflation in June
% m/m



Source: INEGI

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June 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
Potatoes	10.0	28.6
Chicken	6.2	3.4
Dining away from home	4.7	1.0
Oranges	4.3	24.9
Electricity	3.7	2.6
Goods and services with the largest negative contribution		
LP Gas	-4.9	-2.1
Lemon	-2.2	-17.0
Serrano chilies	-2.0	-17.2
Onions	-1.1	-4.6
Grapes	-1.0	-14.9

Source: INEGI

New high in annual inflation. The headline stood at 7.99% y/y from 7.65% on average in May, surpassing the most recent high of 7.68% –in monthly frequency– seen in April. Nevertheless, the core was more concerning as it increased to 7.49% from 7.28% in the same period, stringing 19 months on the upside. Focus remains on the latter, especially processed foods (which reached 11.8% y/y) within goods (9.9%). Nevertheless, services (4.8%) are also above Banxico's target. More favorably, we could see some relief given the latest correction in some commodities, in turn impacted by growing fears of a global recession. For example, WTI has dropped 13.7% since the beginning of June, while *Bloomberg*'s industrial metals' subindex has lost around 18%. This could be very relevant as it could limit the impact from accumulated input price hikes, which have had a second-round effect on core inflation. Nevertheless, it could be modest and gradual, due to: (1) Mexican peso losses, dampening the potential price fall that could be experienced in imported goods; (2) the local mechanism that 'smooths out' global adjustments in gasoline prices, with the complementary subsidy falling in tandem with the move in oil; and (3) a high likelihood of tighter business profit margins, so they could pass on changing final prices to recover their profitability, especially if domestic demand stays robust. Considering these and today's results, we maintain our year-end forecast at 8.1%, looking closely at short-term dynamics given the current backdrop.

Banxico will continue in its hiking cycle. We believe the minutes of the decision held on June 23rd, which will be released today, will give us important information on the tightening cycle. We will be watching if there are comments on: (1) The possibility (or not) of increasing the rate by a higher or lower magnitude, as well as advantages and disadvantages of each option; (2) the likely path of upcoming rate increases, especially given changes to the statement and recent actions by the Fed; and (3) the most adequate level for the terminal rate, both in nominal and real terms. In our view, the document will support our call of an additional +75bps in August, followed by three 50bps hikes each in September, November, and December. With this, the reference rate would reach 10.00% by year-end, which coincides with our terminal rate forecast for this cycle.

From our fixed income and FX strategy team

The market is fully pricing-in a 75bps hike in August. High inflation globally remains at the center of central bank discussions. In Mexico, the latest CPI print have supported the market's expectation of a more hawkish stance from Banxico. In this sense, the short-end is fully pricing-in another 75bps hike in August.

Moreover, the curve incorporates accumulated increases of +211bps for the rest of the year, finishing the tightening cycle with a rate around 10.00%, in line with our call. We believe that short-term rates will remain exposed to bouts of volatility as interest rate hikes continue, without ruling out further negative inflation surprises. In real rates, CPI-linked Udibonos traded with a flattening bias, albeit adjusting about +100bps at the short-end and +65bps in the long-end during 1H22. With this, the 3-year breakeven has cheapened slightly, currently at 5.11% from 5.23% in mid-June. Nevertheless, it remains well above Banxico's target and its 12-month average of 4.68%. In this sense, we still do not see enough relative value for new positions in these securities despite implied carry that remains quite attractive.

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, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivos Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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.
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