1H-July inflation – Core pressures are still lingering around

- **Headline inflation (1H-Jul): 0.43% 2w/2w; Banorte: 0.38%; consensus: 0.39% (range: 0.36% to 0.46%); previous: 0.39%**
- **Core inflation (1H-Jul): 0.34% 2w/2w; Banorte: 0.29%; consensus: 0.33% (range: 0.27% to 0.39%); previous: 0.26%**
- **Inflation was slightly above its 5-year average. At the core, food remains pressured, with processed foods up 0.5%. Other goods were more modest (0.3%), in our view helped by seasonality and some discount campaigns. Services (0.3%) were a little high, with tourism accelerating at the margin. The non-core remains driven mostly by agricultural goods (1.2%), albeit with energy also higher (0.3%)**
- **In bi-weekly frequency, annual inflation picked up 7bps to 8.16% highest since January 2001. The core was algo higher, at 7.56% from 7.52% in the previous fortnight**
- **In our view, recent developments have reinforced the view that Banxico will likely hike by 75bps on August 11th. We reiterate our call that the reference rate will reach 10.00% by year-end, with balanced risks**
- **Markets expect another 75bps hike in the next central bank decision**

Inflation at 0.43% 2w/2w in 1H-July, with additional pressures at the core. The headline was slightly above consensus and from its 5-year average (0.31%). Food items remain in focus. At the core, processed foods jumped 0.5%, highlighting upward moves in sodas (0.7%). 'Other goods' (0.3%) were relatively modest, in our view partially helped by seasonal factors and discount campaigns (*e.g.,* supermarkets, *Prime Day*, etc.). Services (0.3%) were a little high. Airfares (6.0%) and tourism services (4.4%) accelerated, consistent with the holiday period. At the non-core, we also flag agricultural goods (1.2%), with items such as egg among the most pressured, but also positive for fruits and vegetables, highlighting potatoes and onions. In energy (0.3%), electricity remained high (1.4%), with more modest changes in LP gas (0.1%) and low-grade gasoline (0.1%).

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

	INEGI	Banorte	Difference
Total	0.43	0.38	0.05
Core	0.26	0.22	0.04
Goods	0.15	0.14	0.01
Processed foods	0.11	0.11	0.00
Other goods	0.05	0.03	0.02
Services	0.10	0.08	0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.06	0.03
Non-core	0.17	0.16	0.01
Agriculture	0.14	0.14	0.00
Fruits & vegetables	0.10	0.08	0.01
Meat & egg	0.05	0.06	-0.01
Energy & government tariffs	0.03	0.02	0.02
Energy	0.03	0.01	0.02
Government tariffs	0.01	0.01	0.00

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

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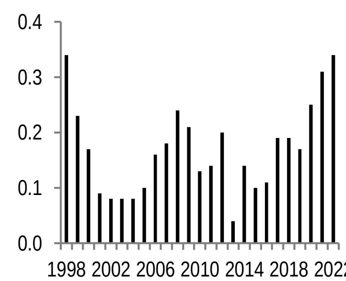
Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Core inflation 1H-July
% 2w/2w



Source: INEGI

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
Eggs	5.9	6.3
Potatoes	3.1	6.8
Dining away from home	2.1	0.4
Electricity	2.0	1.4
Tourism services	1.5	4.4
Goods and services with the largest negative contribution		
Chicken	-2.6	-1.4
Avocadoes	-1.6	-3.6
Grapes	-0.6	-11.2
Female children clothing	-0.3	-1.3
Poblano chilies	-0.3	-5.5

Source: INEGI|

Annual inflation could keep rising. In bi-weekly frequency, annual inflation went from 8.09% to 8.16%, also standing above the previous month average at 7.99%. The core was more stable, from 7.52% to 7.56%. We remain cautious as we estimate that both will keep climbing in the short term, with concerns mostly centered at the core. In this sense, we have had news that Grupo Bimbo hiked bread prices last Monday –except for white bread, as part of the commitments made in the *Plan Against Inflation*. We do not rule out additional effects on close substitutes (such as bread sold at supermarkets), restaurants, and dining away from home. On a more favorable note, the NY Fed's *Global Supply Chain Pressure Index* fell to +2.4σ in June, lowest since March 2021. Nevertheless, new COVID-19 cases in China have accelerated, risking strict lockdowns. In addition, recession fears have induced some declines in commodity prices, but the demand-supply balance is still tight. The domestic price of low-grade gasoline may not fall as much as subsidies are only cut gradually. Lastly, we are looking for news about the possible minimum wage increase for 2023. Negotiations are poised to be difficult as workers will likely demand a significant raise because of inflation and its impact on real wages; companies may argue that other cost pressures limit their capacity without impacting employment. Broadly speaking, the outlook still looks challenging despite some favorable developments in recent weeks.

Banxico will extend the restrictive cycle. We reaffirm our call of a 75bps hike by the central bank on August 11th, following the Fed as we expect the latter to do the same on July 27th. Speculation that the FOMC could even hike by 100bps rose after the release of June's inflation, albeit moderating afterwards. We think this puts a "floor" for the possible move in Mexico as the central bank aims to preserve the rate spread at +600bps, at least for now. Moreover, we still see 3 hikes of 50bps each in September, November, and December. Therefore, the reference rate would reach 10.00% by year-end. This is above consensus, but given high inflation, we think risks to our forecast are currently balanced.

From our fixed income and FX strategy team

Markets expect another 75bps hike in the next central bank decision. Unprecedent inflation levels have forced central banks to accelerate their pace of interest rate hikes, with Mexico included. Locally, market expectations remain anchored to a 75bps hike in Banxico's upcoming decision, in line with our call. In this way, the reference rate would reach historical highs of 8.50%, above the terminal rate of the previous tightening cycle of 8.25%. During the month, short-term sovereign bonds have recorded greater adjustments compared to other maturities, assimilating central banks' more hawkish stance.

For example, Treasuries have lost 30bps, while Mbonos 35bps, on average. On the other hand, short-term CPI-linked bonds (Udibonos) have traded more defensive. As a result of these adjustments, breakevens have increased. In particular, the 3-year tenor moved to 5.18% from 4.97% at the beginning of July, registering the largest spread (+48bps) relative to other maturities vs its 12-month average. Furthermore, this breakeven remains well above Banxico's inflation target. In this backdrop, we do not favor positions in Udibonos given its expensive valuation and lower relative value. Additionally, the attractiveness in short-term Mbonos has increased considering the last adjustments, currently trading at stressed levels; however, we also recognize that this segment of the curve will remain exposed to high volatility as the normalization process continues, without ruling out further negative inflation surprises.

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, David Alejandro Arenas Sánchez, 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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	Reference
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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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