

Inflation in April – A *threesome* of factors result in a negative monthly rate

May 7, 2015

- **INEGI just published its inflation report for April**
- **Headline inflation (Apr): -0.26%/m/m (Banorte-Ixe: -0.17%/m/m; consensus: -0.24%/m/m)**
- **Core inflation (Apr): 0.16%/m/m (Banorte-Ixe: 0.17%/m/m; consensus: 0.15%/m/m)**
- **Deflation in April is explained by three factors: (1) The start of summer discounts on electricity tariffs; (2) lower agricultural prices, especially in the first half of the month; and (3) lower costs of tourism services given the end of the Easter holiday period**
- **With these numbers, annual inflation is at 3.06% vs. 3.14% in previous month**
- **Muted reaction towards CPI report in local markets with investors focusing on global risks**

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes

Senior Economist, Mexico
alejandro.cervantes@banorte.com

Fixed income and FX Strategy

Alejandro Padilla

Head Strategist - Fixed-Income and FX
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA

FX Strategist
juan.alderete.macal@banorte.com

Consumer prices decreased 0.26%/m/m in April, more than expected. Core inflation was 0.16% in line with our forecasts. The main deviation from our forecast comes from: (1) A lower than expected contribution of agricultural prices (2.4bps vs. our 9bps); (2) a lower than expected contribution of merchandise prices (9.6bps vs. our 10.9bps); (3) an overestimation of government tariffs prices (0.4bps vs. our 1.3bps); and (4) a larger than expected contribution of services prices (2.1bps vs. our 1.8bps), as shown in the table below.

April inflation by components

% monthly incidence

	Observed	Banorte-Ixe	Difference
Headline	-0.26	-0.17	-0.085
Core	0.12	0.13	-0.010
Goods	0.10	0.11	-0.014
Processed foods	0.03	0.03	-0.001
Other goods	0.06	0.08	-0.012
Services	0.02	0.02	0.003
Housing	0.035	0.035	-0.001
Education	0.00	0.00	0.000
Other services	-0.02	-0.02	0.004
Non-core	-0.38	-0.31	-0.074
Agricultural	0.02	0.09	-0.066
Fresh fruits and vegetables	-0.01	0.03	-0.044
Meat and egg	0.03	0.06	-0.021
Energy and government regulated	-0.42	-0.41	-0.008
Energy	-0.43	-0.43	0.001
Government regulated	0.00	0.01	-0.009

Source: Banorte-Ixe with data from INEGI and Banco de México.

Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology.

Document for distribution among public

Three factors behind monthly deflation in April. Firstly, during the period in question, summer discounts on electricity tariffs (-14.1%) started applying in some regions of the country, on top of which there were lower low grade gasoline prices, particularly in some cities in the northern border of the country (-0.48%). In addition, the price of “fruits & veggies” fell 0.33%, with *INEGI* mentioning strong declines in products such as *Husk* tomatoes (-9.5%), bananas (-6.3%), potatoes (-3.9%) and zucchini (-7.6%), which more than offset for the increases in other products such as *Serrano* chilies (22.1%), avocados (11.3%), other fresh chilies (13.8%) and *Poblano* chilies (33.8%). Finally, “*other services*” prices came down 0.09% m/m on the back of lower prices of tourism services (air transportation: -9.3%; tourism services: -7.5%), given the end of the Easter holiday season. In contrast, merchandise prices increased 0.28%, due to a 0.21% m/m rate of food inflation coupled with a 0.34% increase in other goods.

With these numbers, annual inflation is at 3.06% vs. 3.14% in previous month. Meanwhile, core inflation is at 2.31% from 2.45% in March. We expect inflation to remain hovering around the 3% target in the coming months.

From our fixed income and FX strategy team

Muted reaction towards CPI report in local markets with investors focusing on global risks. Local rates observed a muted reaction towards today’s CPI report, as the deflationary figure was highly expected (mainly explained by seasonal factors). However, investors have acknowledged that current economic conditions will result in a lower FX pass-through effect, as it has been depicted in the latest releases. This is an important situation to be considered, as now the market is pricing in the beginning of the tightening cycle in Mexico in tandem with the Federal Reserve and not before (as it was the case a month ago), with market implied probabilities pointing towards an initial rate hike by 4Q15. Mexican bonds are trading today with a positive bias (gains of 2-3bps), albeit still under a depreciation trend started at the end of April. Market participants are focusing on global risks, leaving aside momentarily local factors. The local yield curve has been closely correlated in the last days with its U.S. and European peers. Price and rate adjustments in European bonds (following better growth and inflation data in the region) together with concerns on Fed and an increase in oil prices have pushed Mexican rates higher, depicting a strong sell-off. It is our take that investors’ sentiment will remain undermined by the high uncertainty about tomorrow’s BLS labor market report in the U.S. In our view, the yield curve in Mexico (Mbonos) is reaching attractive valuations for long directional strategies, although we recognized that appetite for sovereign debt could be affected by the strong uncertainty regarding Fed future actions and the effect of the hiking cycle on the price of financial assets worldwide.

The 20-year segment of the Mbonos curve continues depicting an attractive valuation vis-à-vis other tenors, however we remain cautious and suggest patience in order to observe better entry levels. In terms of Mexican linkers, valuation is extremely attractive in Udibonos, especially the mid and long ends. Inflation *breakevens* are hovering 3% in every tenor. The most attractive breakeven is the 10-year (2.89%). Risk rewards in this strategy could be around 70bps. However, an important issue to take into consideration is the negative carry of Mexican linkers in the 1H15. In this regard, we consider that by the end of this month the market is likely to swap long strategies from Mbonos to Udibonos.

In FX, the Mexican peso traded broadly unchanged after the report, gaining 0.1% from yesterday's close to 15.34 per dollar. In our view, the report adds to the evidence that pass-through effects have been very moderate, probably owing to a still weak cyclical condition and elevated output gap as commented by Banxico's governor Cartens yesterday. We believe this could bode well for the currency if it results in better economic growth dynamics going forward, particularly private consumption, which could pick up in 2H15 due to contained inflation levels, among other factors. Nevertheless, this assumes a relatively good external environment, although uncertainty about the Fed and Greece remains high. All in all, we maintain a neutral short-term stance on the peso given evidence of recent underperformance in the EM space, technical signs that the weakening trend remains in place (such as the inability to break definitively below the 50D MA, currently at 15.24), lack of positive local drivers and a complicated external environment, eyeing events in coming weeks to analyze the possibility of a better backdrop and performance in 3Q15.

Disclaimer

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Livia Honsel	Economist, Europe	livia.honsel@banorte.com	(55) 1670 - 1883
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5004 - 1275
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 5004 - 1231
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 5004 - 1179
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 5004 - 1227
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 5004 - 1266
Valentín III Mendoza Balderas	Equity Research Analyst	valentin.mendoza@banorte.com	(55) 5268 - 9000 x 1267
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 5004 - 5262

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5004 - 1405
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugo.a.gomez@banorte.com	(55) 5004 - 1340
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 5004 - 1437

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Managing Director – Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Jorge de la Vega Grajales	Managing Director – Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Managing Director – Private Banking	lpietrini@ixe.com.mx	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Managing Director – Asset Management	pimentelr@ixe.com.mx	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Managing Director – International Banking	rvelazquez@ixe.com.mx	(55) 5268 - 9879
Victor Antonio Roldan Ferrer	Managing Director – Transactional Banking	voldan@ixe.com.mx	(55) 5004 - 1454