

## July inflation an inch above consensus on higher agricultural and energy prices

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- *INEGI* just published its inflation report for July
- **Headline inflation (July): 0.54% m/m; Banorte: 0.56% m/m; consensus: 0.53% m/m; previous: 0.39% m/m**
- **Core inflation (July): 0.29% m/m; Banorte: 0.32% m/m; consensus: 0.30% m/m; previous: 0.23% m/m**
- **Inflation during the month was explained by pressures in fruits & vegetables, coupled with a pickup in energy prices along with other services**
- **With these numbers, annual inflation is at 4.81% vs. 4.65% in the previous month**
- **Mild profit taking in Mbonos and TIEE-IRS amid today's CPI report**

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**Consumer prices increased 0.54% m/m in July, marginally above market expectations.** Core inflation was 0.29% vs. our 0.32% estimate. The main deviation from our forecast comes from: (1) An overestimation of other services in the core component (9.4bps vs. our 10.9bps) coming from airfares and tourism; (2) a lower-than-expected contribution of agricultural prices (17.6bps vs. our 18.6bps); and (3) an underestimation of energy prices (13.7bps vs. our 12.6bps), in particular from low-grade gasoline, as shown in the table below.

#### Inflation by components in July % monthly incidence

	INEGI	Banorte	Difference
Total	0.54	0.56	-0.02
Core	0.21	0.24	-0.02
Goods	0.08	0.08	0.00
Processed foods	0.07	0.07	0.00
Other goods	0.01	0.02	-0.01
Services	0.14	0.15	-0.02
Housing	0.04	0.04	0.00
Education	0.01	0.01	0.00
Other services	0.09	0.11	-0.02
Non-core	0.32	0.32	0.00
Agriculture	0.18	0.19	-0.01
Fruits & vegetables	0.21	0.22	-0.01
Meat & eggs	-0.04	-0.04	-0.01
Energy & government tariffs	0.14	0.13	0.01
Energy	0.14	0.13	0.01
Government tariffs	0.00	0.01	0.00

Source: INEGI, Banorte

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

**Inflation was mostly explained by pressures in some non-core goods (energy, fruits & vegetables) but also with some increases in other services.** Agricultural prices increased 1.91% m/m, driven by a 6.48% pickup in fruit and vegetable prices, partially offset by a drop in “meat & egg” prices (-0.72%). *INEGI*'s report mentions *husk* tomatoes (49.69%), tomatoes (10.68%), oranges (19.63%) and onions (11.30%) as those with double-digit increases during the month, with 6 out of 10 generics with the highest incidence to the upside being agricultural products. Altogether, these added 16.7bps to total inflation in the period in question. Moreover, low-grade gasoline increased 1.8% m/m, adding an additional 10.8bps to this month's print.

On the contrary, among the products with falling prices, the report highlights poultry (-3.27% m/m) and eggs (-3.19%), subtracting 6.9bps to the headline figure. It is worth noting that of the generics listed by *INEGI* with the highest downward effect on the index, none corresponds to services.

Going to the core index, the services sub-index picked up 0.34% m/m, mostly because of other services climbing 0.55%. The latter was influenced by tourism (4.59%), with a monthly incidence of 2.6bps, and dining away from home items (0.64%), adding 2.8bps. Living costs remain in a trend-like pattern, increasing 0.21%, while education edged-up by 0.10%. Merchandise prices were up 0.22%, highlighting an increase of 0.42% in processed foods.

**With these figures, annual inflation is at 4.81% vs. 4.65% in the previous month.** Core inflation stands at 3.63% from 3.62% in June. We reiterate our view that 12-month inflation will remain above 4.6% in coming months but converge towards our year-end forecast of 4.3% y/y by year end.

**New CPI methodology in the next bi-weekly print.** We find useful to stress that in the next release (for the first half of August, to be published on the 23<sup>rd</sup> of August), *INEGI* will apply the methodology and base-year changes to Mexico's CPI. Some of the most relevant changes include: (1) A wider geographical scope; (2) a greater number of goods and services in the index; (3) the new base-year will be the 2<sup>nd</sup> half of July 2018 instead of the 2<sup>nd</sup> half of December 2010; and (4) it is highly likely that the weight of the non-core sub-index will increase relative to the core component, which could result in higher volatility for the headline figure.

*From our fixed income and FX strategy team*

**Mild profit taking in Mbonos and TIE-IRS amid today's CPI report.** Today's inflation report came in above consensus, stressing out some of Banxico's concerns inside its policy communiqué last week. Analysts have underestimated the CPI fortnightly reading in 5 out of the last 6 readings, suggesting the possibility of upward adjustment in market expectations at least for the remainder of the year (*i.e.* higher inflation premium). Despite this reading, we expect investors to price in a stable repo rate for the rest of 2018, as the effect of slack in the economy in recent months and a stronger peso are likely to offset any concerns about current inflation dynamics. In the aftermath of today's CPI print, local rates are observing a modest 2bps profit taking, after a 5-day rally in the Mbonos and TIE-IRS curves (mainly in the short-end). Overall, this data was positive for our short-term idea of long positions in mid-term real-rate Udibonos. Despite expensive breakevens hovering around 4%, the carry gains in UDI-related securities continue to be appealing.

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