

## Inflation in July – Annual rate at yet another historical low at 2.74%yoy

August 7, 2015

- **INEGI just published its inflation report for July**
- **Headline inflation (Jul): 0.15%/m/m (Banorte-Ixe: 0.17%/m/m; consensus: 0.17%/m/m)**
- **Core inflation (Jul): 0.17%/m/m (Banorte-Ixe: 0.16%/m/m; consensus: 0.16%/m/m)**
- **Inflation in July was explained by pressures on the price of services along with increases in the prices of fruits & vegetables**
- **With these numbers, annual inflation is at 2.74% vs. 2.87% in previous month**
- **Local bonds assimilating no evidence of inflationary pressures coming from FX depreciation... for now**

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### Consumer prices increased 0.15%/m/m in July, below expectations.

Meanwhile, core inflation was 0.17%, in line with our estimation. The main deviation from our forecast comes from: (1) A lower than expected contribution of agricultural prices (0.9bps vs. our 3.7bps); (2) a lower than expected contribution of energy prices (0.7bps vs. our 0.9bps); (3) an underestimation of the price of services (14.8bps vs. our 14.4bps); along with (4) a larger than expected contribution of merchandise prices (-1.9bps vs. our -2.7bps), as shown in the table below.

#### July inflation by components

% monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.15	0.17	-0.02
Core	0.13	0.12	0.01
Goods	-0.02	-0.03	0.01
Processed foods	0.02	0.01	0.00
Other goods	-0.04	-0.04	0.00
Services	0.15	0.14	0.00
Housing	0.026	0.025	0.00
Education	0.01	0.01	0.00
Other services	0.12	0.11	0.00
Non-core	0.02	0.05	-0.03
Agriculture	0.01	0.04	-0.03
Fruits & vegetables	0.07	0.07	0.00
Meat & eggs	-0.06	-0.03	-0.03
Energy & government tariffs	0.01	0.01	0.00
Energy	0.01	0.01	0.00
Government tariffs	0.00	0.00	0.00

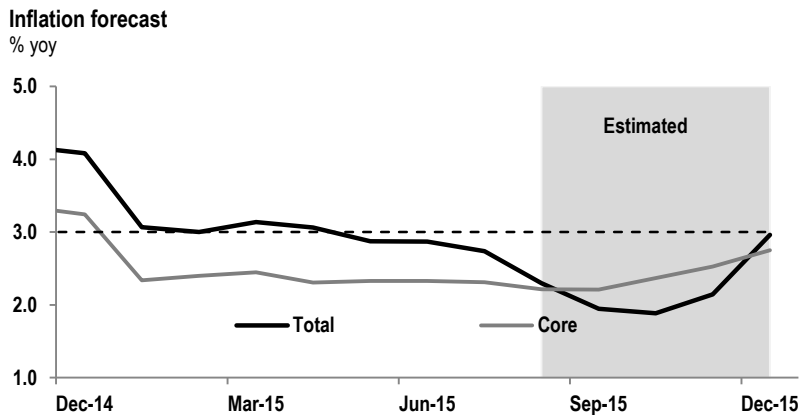
Source: Banorte-Ixe with data from INEGI and Banco de México.

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.

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**Inflation in July was explained by pressures on the price of services along with increases in the prices of fruits & vegetables.** Services inflation was at 0.36% m/m, on the back of a 0.14% m/m rate of inflation both in housing and in education costs. In addition, other services prices increased 0.67% m/m as a result of higher prices tourism services (+10.3%), air transportation (12.4%), as well as dining away from home items (+ 0.47%) and restaurants (0.28%). These increases are probably explained by the summer vacation season. Meanwhile, “fruit & vegetables” prices were up 2.15%, with *INEGI* mentioning sharp increases in products such as tomatoes (11.9%), onions (21%), oranges (32.2%) and other fruits (7.4%). These four elements added 10.2pbs to total inflation during the seventh month of the year, and more than offset the decline in the price of eggs (-7.3%) and poultry (-0.74%). In addition, merchandise prices came down 0.06% m/m, on the back of a reduction of “other merchandise” prices, down 0.2% m/m, probably reflecting the sales season in some retailers. Finally, food prices increased 0.11% m/m.

**With these numbers, annual inflation edges down to 2.74% vs. 2.87% in previous month.** Meanwhile, core inflation remained at 2.3% in July. In our view, inflation will remain below the central bank’s 3% target in the coming months, as shown in the chart below.



Source: Banorte-Ixe with data from INEGI

*From our fixed income and FX strategy team*

**Local bonds assimilating no evidence of inflationary pressures coming from FX depreciation... for now.** Mexican bonds are trading today in tandem with its U.S. peers following the employment report, with no significant reaction after today's CPI data. However, today's print confirmed once again the lack of evidence of pass-through effects, despite the strong MXN depreciation in the last 12 months ( $\approx 22\%$ ) or YTD ( $\approx 10\%$ ). Lower commodities prices and current economic dynamics have been an important counterweight to the FX depreciation in terms of inflation. In our view this will continue, most likely, for the remainder of the year, being supportive for local rates. This situation also portrays a solid argument in favor of Banxico hiking in tandem with the Federal Reserve, and not before. Nevertheless, it is important to take into consideration that market 12-month-ahead inflation expectation is well above current annual reading (3.74% in the last Banamex survey released this week vs actual 2.74%), which makes us believe that Mexican linkers Udibonos are trading relatively cheaper (inflation *breakevens* hovering 3.2% in almost every tenor), especially in terms of carry, and could be an appealing investment alternative in the 2H15. On the other hand, current dynamics support our view that the yield curve will continue flattening in coming weeks.

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