

Inflation picks up to 4.65% in June

- **INEGI just published its inflation report for June**
- **Headline inflation (Jun): 0.39%/m/m (Banorte: 0.48%/m/m; consensus: 0.33%/m/m)**
- **Core inflation (Jun): 0.23%/m/m (Banorte: 0.23%/m/m; consensus: 0.2%/m/m)**
- **Inflation in June was explained by pressures on domestic gas prices along with increases in low-grade gasoline prices**
- **With these numbers, annual inflation is at 4.65% vs. 4.51% in previous month**
- **Higher than expected inflation print resulting in a selloff in Mbonos and rally in CPI-linked Udibonos**

Consumer prices increased 0.39%/m/m in June, above consensus. Core inflation was 0.23% in line with our estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of agricultural prices (-3bps vs. our 6bps); (2) a lower than expected contribution of merchandise prices (4.5bps vs. our 6bps); (3) an overestimation of energy prices (23.7bps vs. our 25bps); and (4) A larger than expected contribution of services prices (12.8bps vs. our 11bps), as shown in the table below.

Inflation by components in June
%monthly incidence

	INEGI	Banorte	Difference
Total	0.39	0.48	-0.10
Core	0.17	0.17	0.00
Goods	0.04	0.06	-0.02
Processed foods	0.04	0.05	-0.02
Other goods	0.01	0.01	0.00
Services	0.13	0.11	0.02
Housing	0.04	0.04	0.00
Education	0.00	0.00	0.00
Other services	0.08	0.07	0.01
Non-core	0.21	0.31	-0.10
Agriculture	-0.03	0.05	-0.08
Fruits & vegetables	0.01	0.06	-0.06
Meat & eggs	-0.04	-0.01	-0.03
Energy & government tariffs	0.24	0.26	-0.01
Energy	0.24	0.25	-0.01
Government tariffs	0.00	0.00	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

July 9, 2018

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Inflation in June was explained by pressures on domestic gas prices along with increases in low-grade gasoline prices. Inflation in LP domestic gas (5.9% m/m), low-grade gasoline (1.5%) and electricity rates (1.5%) added 0.23%-pts to inflation during the period in question. However, this increase was partially offset by a reduction of 0.32% m/m in agricultural prices derived from a 0.6% fall in “meat and egg” prices, in particularly eggs prices, down 10.2% m/m, while that the prices of fruits and vegetables increased 0.17% in June.

Meanwhile, in the core index, merchandise prices had increased 0.13% on the back of higher processed food prices (0.24% m/m), along with a small increase in the prices of other merchandise (0.04%). *INEGI* highlighted reductions in car prices (-0.23%), among goods with downward prices. Moreover, services prices increased 0.32% m/m, with housing and education costs up 0.24% and 0.05%, respectively. Finally, other services prices increased 0.49% in the month.

With these data, 12-month inflation is now at around 4.65% from 4.5% in previous month, in line with our expectations. Meanwhile, core inflation edged down to 3.6% from 3.7% in May. Looking ahead, we believe that inflation will continue to be pressured by energy prices, offset by down-trending agricultural prices. In addition, we expect temporary pressures on core items as a result of FX the volatility, which could maintain the 12-month rate around current levels. Nevertheless, we expect inflation to converge in 2H18 to our forecast of 4.3% for year-end.

From our fixed income and FX strategy team

Higher than expected inflation print resulting in a selloff in Mbonos and rally in CPI-linked Udibonos. Today’s CPI report in Mexico came in above market consensus, with a monthly increase of 0.39% vs our 0.48% forecast and 0.33% mean according to the Bloomberg’s survey. This resulted in an annual print moving from 4.51% to 4.65%. In our view, the annual inflation should observe two peaks during the remainder of 2018 before heading towards our year-end forecast of 4.3%. The first spike is expected during summer given the new seasonality coming from gasoline prices in addition to the likely pressure in agricultural prices (to be observed in July to almost 4.8%). The second hump is forecasted in September due to a base effect (lower prices last year due to the S19 earthquake), which could result in a move towards 4.8% again. This has significant implications from a monetary policy stand point and for the embedded carry in CPI-defensive strategies as the convergence towards Banxico’s target of 3% could take longer (end of 2019 or even early 2020) as stressed out by a board member during the latest minutes. This backdrop is positive for our recommendation last week to take profit on Mbonos Mar’26 and Nov’47 and argues in favor of holding the defensive strategy of long positions on floating-rate securities (*e.g.* Bondes D). In the aftermath of today’s report the Mbonos curve is selling off nearly 4bps while CPI-linked Udibonos are rallying 7bps mainly in short-term instruments.

Disclaimer

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