

# 1h-April Inflation below expectations due to lower energy and agricultural prices

April 24, 2018

www.banorte.com  
@analisis\_fundam

**Delia Paredes**  
Executive Director of Economic Analysis  
delia.paredes@banorte.com

**Francisco Flores**  
Economist, Mexico  
francisco.flores.serrano@banorte.com

- **INEGI** just published its inflation report for the first half of April
- **Headline inflation (1H-Apr): -0.35% 2w/2w; Banorte: -0.30% 2w/2w; consensus: -0.27% 2w/2w; (range of estimates: -0.36% to -0.04%); previous: 0.01% 2w/2w**
- **Core inflation (1H-Apr): 0.07% 2w/2w; Banorte: 0.06% 2w/2w; consensus: 0.08% 2w/2w (range of estimates 0.02% to 0.18%); previous: 0.05% 2w/2w**
- **Deflation in the first half of April was greater than expected given lower prices in the energy and agricultural sub-indices**
- **With these results annual inflation edged down to 4.69%, below the 5.04% seen in March**
- **Rally in Mbonos and sell-off in CPI-linked Udibonos, in line with our expectations, in the aftermath of current inflation dynamics**

## Fixed income and FX Strategy

**Alejandro Padilla**  
Head Strategist – Fixed-Income and FX  
alejandro.padilla@banorte.com

**Juan Carlos Alderete, CFA**  
FX Senior Strategist  
juan.alderete.macal@banorte.com

**Santiago Leal Singer**  
Fixed-Income and FX Strategist  
santiago.leal@banorte.com

Consumer prices decreased 0.35% 2w/2w in the first half of April, below both our -0.30% 2w/2w forecast (consensus: -0.27% 2w/2w). Core inflation was up 0.07% 2w/2w, marginally above our 0.06% 2w/2w estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution from other services (-6bps vs. our -2bps); (2) a greater impact from other goods prices (7bps vs. our 4bps); (3) a lower contribution from agricultural prices (-4bps vs. our -1bps); and (4) a slightly lower than expected contribution from energy (-36bps vs. our -34bps), as shown in the table below.

### 1H-April inflation by major subcomponent

Bi-weekly incidence, %

	Observed	Banorte forecast	Difference
Headline	-0.35	-0.30	-0.05
Core	0.05	0.04	0.01
Goods	0.09	0.05	0.05
Processed foods	0.02	0.01	0.01
Other goods	0.07	0.04	0.04
Services	-0.04	0.00	-0.04
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	-0.06	-0.02	-0.04
Non-core	-0.40	-0.34	-0.06
Agricultural	-0.04	-0.01	-0.04
Fresh fruits and vegetables	-0.03	-0.02	-0.02
Meat and egg	-0.01	0.01	-0.02
Energy and government regulated	-0.36	-0.33	-0.02
Energy	-0.36	-0.34	-0.02
Government regulated	0.01	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

**Deflation in the first half of April was explained by the start of the summer discounts in electricity tariffs, as well as a fall in agricultural prices. In**

Document for distribution among public

particular, energy prices decreased 3.26% 2w/2w on the back of lower prices of electricity (-13.86% 2w/2w) and LP gas (-2.36% 2w/2w), while low-grade gasoline costs increased 0.29% 2w/2w. Moreover, prices of fruits and vegetables edged-down 0.93% 2w/2w, driven by lower prices of tomatoes (-9.15% 2w/2w) and bananas (-4.04% 2w/2w), among others. However, these were partially offset by the increase in the price of lemons (4.09% 2w/2w) and potatoes (2.56% 2w/2w). In addition, prices of eggs decreased 3.47% 2w/2w, driving down the meat and egg component 0.17% 2w/2w.

Regarding the core index, the cost of other services decreased 0.36% 2w/2w on the back of lower prices of tourism services (-9.66% 2w/2w) and air fares (12.78% 2w/2w), despite the 0.19% 2w/2w increase in dining away from home items. Additionally, other goods prices increased 0.38% 2w/2w given the growth in the prices of toothpaste (2.21% 2w/2w) and detergent (1.27% 2w/2w). Moreover, prices of processed foods edged up 0.15% 2w/2w while housing costs increased 0.1% 2w/2w on the back of a similar increase in home ownership costs.

**With these figures, annual inflation continued edging down to 4.69% vs. 5.04% in March.** Additionally, core inflation came down to 3.70% from 4.02% in the previous month. We continue expecting inflation to show a downward trend to finish 2018 at 4.3%. In the coming months, we will focus on the evolution of energy prices, considering the possible increase in the international reference price –given the start of the US driving season–, as well as the behavior of agricultural prices, and the impact they might have in Mexico’s CPI.

*From our fixed income and FX strategy team*

**Rally in Mbonos and sell-off in CPI-linked Udibonos, in line with our expectations, in the aftermath of current inflation dynamics.** Inflation continues depicting favorable news throughout 2018 after several headwinds faced in 2017. Today's deflationary print, although highly anticipated by market participants given the seasonal reduction in electricity tariffs, came in below consensus, suggesting that price dynamics in Mexico have improved considerably in the first four months of 2018. Local bonds reacted with a 2-3bps rally in Mbonos, while CPI-linked Udibonos sold off, especially in the front end, by 12bps (*e.g.* Jun'19). The current inflation backdrop is a relevant driver for the short-end of the yield curve, as market participants expect a less hawkish rhetoric from *Banco de México* ahead, pricing in only 5bps of implied rate hikes for the next two quarters and 11bps of cuts by year-end. This assessment could be supported on Thursday with the release of the minutes of the last policy meeting. In terms of strategy, we hold a constructive view in terms of the Mbonos curve, especially for foreign investors, as the embedded carry remains highly attractive *vis-à-vis* other EM with similar credit profile. However, we suggest waiting for better entry points, especially in the mid-end. In contrast, Mexican linkers will remain impaired by current breakeven levels trading at fair value when compared to mid- and long-term inflation expectations in several surveys (*e.g.* Banxico) combined by a negative UDI-related carry in the next two months. We expect a further correction, especially in the short-end of the Udibonos curve. Taking into account our inflation forecasts, the expected UDI carry will be only 0.39% in the next 91 days (1.56% on an ACT/360 basis), 0.59% in 182 days (1.18% annualized) and 4.55% in a 365-day frame. This suggests that local investors will continue demanding other type of securities with positive carry, especially floating-rate bonds (*e.g.* Bondes D).

**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
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@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 Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist 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) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

**Corporate Debt**

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

**Wholesale Banking**

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454