

# Inflation in 1h-June below expectations despite pressures on energy prices

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- **INEGI just published its inflation report for in the first half of June**
- **Headline inflation (Jun): 0.13%2w/2w (Banorte: 0.16%2w/2w; consensus: 0.16%2w/2w)**
- **Core inflation (Jun): 0.08%2w/2w (Banorte: 0.13%2w/2w; consensus: 0.16%2w/2w)**
- **Inflation in the first half of June was explained by pressures on energy prices**
- **With these numbers, 12-month inflation remained at levels around 4.5%**
- **Local rates are extending the recent rally following today better-than-expected inflation print**

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**Consumer prices increased 0.13%2w/2w in in the first half of June, below expectations.** Core inflation was 0.08% vs. our 0.13% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of agricultural prices (-6.6bps vs. our -1.5bps); (2) a lower than expected contribution of merchandise prices (-0.2bps vs. our 4.5bps); (3) an underestimation of the contribution of services prices (6.1bps vs. our 5.3bps); and (4) a larger than expected contribution of energy prices (13.7bps vs. our 7.6bps), as shown in the table below.

### 1H-June inflation by components

% bi-weekly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.13	0.16	-0.02
Core	0.06	0.10	-0.04
Goods	0.00	0.05	-0.05
Processed foods	0.01	0.03	-0.02
Other goods	-0.01	0.02	-0.03
Services	0.06	0.05	0.01
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.04	0.03	0.01
Non-core	0.07	0.06	0.01
Agriculture	-0.07	-0.02	-0.05
Fruits & v egetables	-0.03	-0.03	-0.01
Meat & eggs	-0.03	0.01	-0.04
Energy & government tariffs	0.14	0.08	0.06
Energy	0.14	0.08	0.06
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

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**Inflation in the first half of June was explained by pressures on energy prices.** Together, the variation in the price of domestic gas (3.2%), low-grade gasoline (0.75%) and electricity tariffs (1.5%) explained practically the total variation of CPI during the period in question. Nevertheless, this increase was partially offset by the 0.7% 2w/2w decline in agricultural prices on the back of a 2.3% reduction in the prices of fruit and vegetables. *INEGI* highlighted lower prices of bananas (-6.4% 2w/2w), lemons (-10.6% 2w/2w), grapes (-8.8%), papaya (-8.9%) and tomatoes (-1.75%). Meanwhile, in the core index, merchandise prices remained flat as a result of a 0.08% increase in food prices offset by drop of a similar magnitude in the prices of other goods with *INEGI* highlighting the reductions in the prices of cars (-0.3%) and men's pants (-1%) and shirts (-1.2%). Moreover, services inflation was up 0.15% during the first half of the month, on the back of higher housing (0.1%) and education costs (0.02%), along with an increase of 0.25% in other services prices.

**With these data, 12-month inflation remains at around 4.5%.** 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 estimate of 4.3% for year-end.

*From our fixed income and FX strategy team*

**Local rates are extending the recent rally following today better-than-expected inflation print.** Mexican bonds are trading on the bullish side this morning (-4bps), extending the gains observed this week. Despite the hawkish hike from Banxico delivered yesterday, investors are acknowledging a favorable valuation in mid- and long-term Mbonos, especially with *breakevens* hovering around 4% in all tenors that suggest an inflationary premium with a potential downside risk. In terms of relative valuation, the Mar'26 and Nov'47 securities are the cheapest tenors. In terms of strategy, we hold our trade idea of long positions on floating-rate Bondes D. In addition, we have changed our assessment about the Mbonos and TIE-IRS curves, having a more optimistic view in the long-end as we acknowledge the strong likelihood of an additional flattening bias.

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