

Inflation in the first half of July explained by pressures on other services

- **INEGI just published its inflation report in the first half of July**
- **Headline inflation (1H-Jul): 0.24% 2w/2w; Banorte-Ixe: 0.2% 2w/2w; consensus: 0.19% 2w/2w; (range of estimates: 0.12% to 0.24%); previous: 0.03% 2w/2w**
- **Core inflation (1H-Jul): 0.19%2w/2w; Banorte-Ixe: 0.14% 2w/2w; consensus: 0.16% 2w/2w (range of estimates 0.1% to 0.2%); previous: 0.1% 2w/2w**
- **Inflation in the first half of July was explained by pressures on the prices of other services and fresh fruits and vegetables**
- **With these numbers, annual inflation is at 6.28% vs. 6.33% in previous two weeks**
- **Profit taking in our trade idea of long positions in CPI-linked Udibono Jun'22 vs Mbono with same duration**

Consumer prices increased 0.24%2w/2w in in the first half of July. Core inflation was 0.19% vs. our 0.14% estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of other services prices (10.6bps vs. our 7.5bps); (2) a lower than expected contribution of energy prices (-2.8bps vs. our -0.5bps); (3) an underestimation of processed foods (3.6bps vs. our 1.5bps); (4) an underestimation of fresh fruits and vegetables prices (9.7bps vs. our 8bps); and (5) a lower than expected contribution of housing prices (1.7bps vs. our 2.6bps), as shown in the table below.

1H-Jul inflation by major subcomponent

Bi-weekly incidence, %

	Observed	Banorte-Ixe	Difference
Headline	0.24	0.20	0.04
Core	0.14	0.10	0.03
Goods	0.01	0.00	0.01
Processed foods	0.04	0.02	0.02
Other goods	-0.02	-0.02	-0.01
Services	0.13	0.10	0.02
Housing	0.02	0.03	-0.01
Education	0.00	0.00	0.00
Other services	0.11	0.08	0.03
Non-core	0.10	0.10	0.00
Agricultural	0.12	0.10	0.02
Fresh fruits and vegetables	0.10	0.08	0.02
Meat and egg	0.02	0.02	0.00
Energy and government regulated	-0.02	0.00	-0.02
Energy	-0.03	0.00	-0.02
Government regulated	0.01	0.01	0.00

Source: INEGI, Banorte-Ixe

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 24, 2017

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

Francisco Flores

Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Alejandro Padilla

Head Strategist – Fixed-Income and FX
alejandropadilla@banorte.com

Juan Carlos Alderete, CFA

FX Senior Strategist
juan.alderete.magal@banorte.com

Santiago Leal Singer

Fixed-Income and FX Strategist
santiago.leal@banorte.com

Document for distribution among public

Inflation in the first half of July was explained by pressures on the prices of other services, along with increases in the prices of fresh fruits and vegetables. In the first case, prices increased 0.62% 2w/2w, on the back of higher prices of tourism services (8.45% 2w/2w), airfares (10.38% 2w/2w) and dining away from home items (0.36% 2w/2w). Moreover, merchandise prices increased 0.04% 2w/2w as a result of a 0.22% 2w/2w increase in processed foods offset by the 0.12% 2w/2w decline in other goods. Regarding non-core items, fresh fruits and vegetables prices increased 2.74% 2w/2w, on the back of higher prices of tomatoes (7.54% 2w/2w), potatoes (9.62% 2w/2w) and bananas (5.91% 2w/2w) In addition, energy prices came down 0.29%, as a result of lower prices of LP gas (-1.19% 2w/2w) and low-grade gasoline (-0.09% 2w/2w).

With these numbers, annual inflation comes down to 6.28% vs. 6.31% in June. Nevertheless, we expect annual inflation at 6.36% at the end of the month, near the all-year high (estimated in August at 6.42%). Meanwhile, core inflation edged up to 4.92% from 4.83% last month and we expect it to finish the month at 4.96%.

From our fixed income and FX strategy team

Profit taking in our trade idea of long positions in CPI-linked Udibono Jun'22 vs Mbono with same duration. Today's report is still consistent with the upward trend of annual inflation that started 9 months ago, which will reach its peak according to our forecast in August (6.4%). Market consensus has been consistently underperforming fortnightly readings throughout the year (12 out of 13 reports), posing a significant risk of additional pressures ahead that are not fully priced in by local rates. Under this scenario, we acknowledge an expensive valuation in the short-end, with investors pricing in 19bps in implied rate cuts 12 months ahead, contrary to our view of a stable repo rate for longer. More details in our research note "*Banxico's Minutes – Restricting cycle comes to an end while opening the door to rate cuts in the medium term*" <[pdf](#)>, published July 6th. On the other hand, this CPI report is granting a good exit point for our trade idea opened July 7th. We recommend profit taking of the relative value strategy of long positions in the Udibono Jun'22 and short positions in the Mbono Jun'22, considering an attractive breakeven trading below the lower bound of a 2-standard deviation band and potential carry gains in UDIS (today 5.02% annualized for the remaining 160 days of 2017 when taking into account our forecasts). Since July 7th, the CPI-adjusted Udibono Jun'22 rallied 12bps, while Mbono Jun'22 sold-off 5bps. The Mexican peso did not react strongly to the report and trades 0.1% stronger at 17.64 per dollar, easing pressures during trading hours in Europe that pushed it to 17.77 as its worst intraday level. As USD/MXN reached briefly the 17.70 level suggested for protecting profits in peso longs, we exit the market for now at the current level and ahead of the Fed meeting on Wednesday, albeit still with a positive trading bias on the currency as we believe that local and external conditions remain favorable.

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
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
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