

June's Inflation – Considerable increase in the price of tomatoes

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- **INEGI just published its inflation report for June**
- **Headline inflation (June): 0.25% m/m; Banorte-Ixe: 0.28% m/m; consensus: 0.27% m/m (range of estimates: 0.20% to 0.29%); previous: -0.12% m/m**
- **Core inflation (June): 0.30% m/m; Banorte-Ixe: 0.32% m/m; consensus: 0.31% m/m (range of estimates: 0.29% to 0.36%), previous: 0.28% m/m**
- **Inflation in June was explained by pressures on the prices of agricultural and goods prices**
- **With these numbers, annual inflation stands at 6.31%, above the 6.16% seen in May**
- **We continue to expect year-end inflation at 5.7%**
- **Inflation premia embedded in Mexican bonds are pricing better inflation dynamics in the 2H17**

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Consumer prices increased 0.25% m/m in June (Banorte-Ixe: 0.28% m/m). In addition, core inflation grew 0.30% m/m, marginally below our estimate (0.32% m/m). The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (-2bps vs our 0bps); and (2) a lower than expected contribution of other goods (4bps vs our 5bps), as shown in the table below.

June inflation by major subcomponent

Monthly incidence, %

| | Observed | Banorte-Ixe forecast | Difference |
|---------------------------------|----------|----------------------|------------|
| Headline | 0.03 | 0.03 | 0.00 |
| Core | 0.08 | 0.08 | 0.00 |
| Goods | 0.03 | 0.03 | 0.00 |
| Processed foods | 0.03 | 0.03 | 0.00 |
| Other goods | 0.00 | 0.00 | 0.00 |
| Services | 0.05 | 0.05 | 0.00 |
| Housing | 0.02 | 0.02 | 0.00 |
| Education | 0.00 | 0.00 | 0.00 |
| Other services | 0.03 | 0.03 | 0.00 |
| Non-core | -0.04 | -0.04 | 0.00 |
| Agricultural | 0.04 | 0.04 | 0.00 |
| Fresh fruits and vegetables | 0.02 | 0.02 | 0.00 |
| Meat and egg | 0.01 | 0.01 | 0.00 |
| Energy and government regulated | -0.08 | -0.08 | 0.00 |
| Energy | -0.08 | -0.08 | 0.00 |
| 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

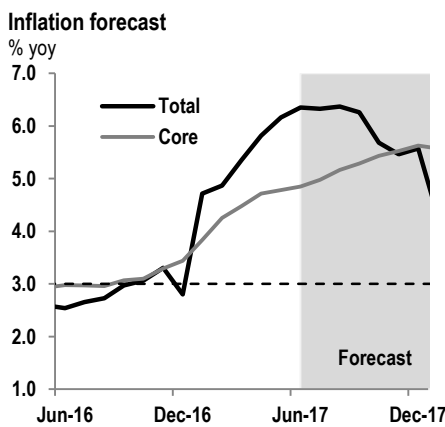
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Inflation in June was explained by pressures on the prices of agricultural and goods prices. Particularly, fresh fruits and vegetables increased 0.42% m/m given the 16.59% m/m in the price of tomatoes and 6.74% m/m of potatoes, despite the fall in the prices of lemons (-22.93% m/m) and husk tomatoes (-10.86% m/m) among others. Moreover, meat and egg prices rose 0.25% m/m mainly due to the 0.77% in beef and 0.99% in chicken.

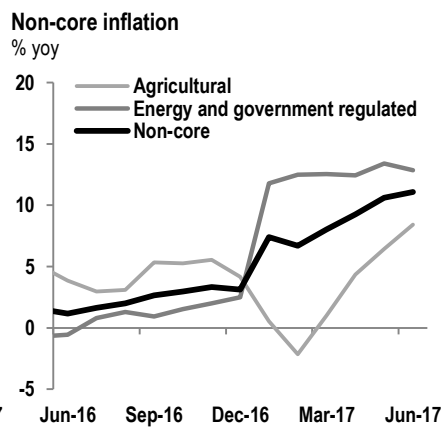
Looking at the prices of goods, they rose 0.32% m/m, driven by the 0.47% in the price of processed foods and 0.19% in other goods. Additionally, services prices rose 0.29% given the increase in housing (0.18% m/m), restaurants (0.47% m/m), dining away from home items (0.37% m/m) and tourism (2.65% m/m).

Finally, energy prices fell 0.12% m/m due to the 0.63% m/m fall in low grade gasoline prices.

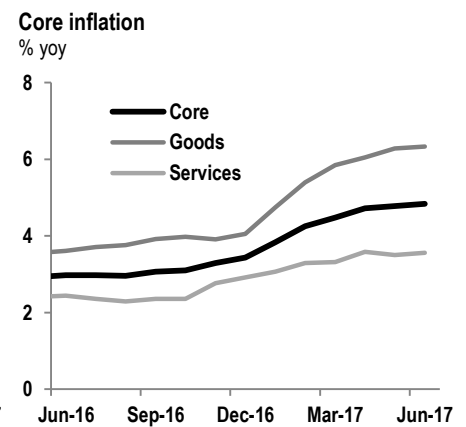
With these data, annual inflation reached 6.31%, from 6.16% in May. Meanwhile, core inflation edged up to 4.83% (previous: 4.78%). In our view, inflation is close to reaching a 12-month high (6.35% in August, according to our estimates) to then converge towards our year-end estimate of 5.7%, as shown in the graph down left. The surge in inflation during 2017 is particularly explained by the upward trend in non-core inflation, on the back of higher energy prices at the beginning of the year, coupled with the recently observed pressures on agricultural prices, as shown in the center chart. In the core index, merchandise inflation edged up from 4.4% in January to 6.9% at the end of the first half of the year, explained by pressures on processed food prices. Services inflation increased from 2.9% in December to 3.56% in June, mainly due to pressures on the prices of other services.



Source: Banorte-Ixe with data from INEGI



Source: Banorte-Ixe with data from INEGI



Source: Banorte-Ixe with data from INEGI

From our fixed income and FX strategy team

Inflation premia embedded in Mexican bonds are pricing better inflation dynamics in the 2H17. Annual inflation continues trending higher, however Mexican bonds are trading on the positive side today (3bps rally) on the back of two factors: (1) Inflationary pressures are likely to start fading away during summer with the expectation of a turning point of the YoY figure by August (6.4% vs current 6.3%) before heading towards our 5.7% year-end forecast, and (2) first time that the released data came in below market expectations after 11 consecutive fortnightly reports of market consensus undershooting observed inflation. Going forward we expect more benign inflation dynamics suggesting a stable reference rate at 7.00% for longer, especially after Banxico's minutes released yesterday. 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 yesterday. In terms of market valuation, breakevens are trading around 3.4% in 3- and 5-year tenors and hovering 3.5% in longer securities, near to lower bounds of 2-standard deviation rolling bands. In addition, potential carry gains for the remainder of the year are depicting a 4.44% annualized in UDIS for the remaining 177 days of 2017 according to our forecasts. These suggest that in relative terms, the pricing of the 5-year CPI-adjusted Udibono is more attractive *vis-à-vis* Mbono, that could result in a good opportunity for a short-term tactical relative value strategy. On the other hand, we suggest waiting for better market conditions for long directional trades after we recommend profit taking on the strategy of long positions in Mbonos Jun'20 and Jun'22 on Wednesday previous to the release of the minutes from the Federal Reserve.

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