

We now expect inflation at 6.2% by year-end 2017

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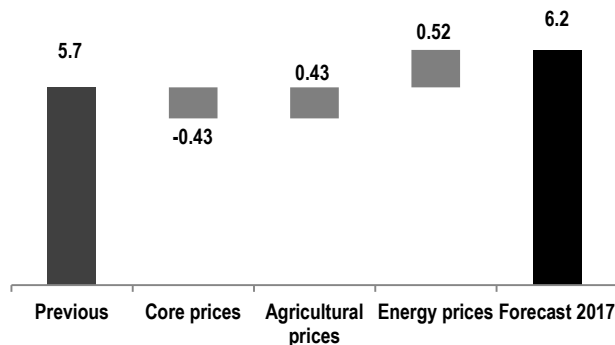
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- **INEGI just published its inflation report for July**
- **With these data, we now expect inflation at 6.2% from previous 5.7% by year-end**
- **For 2018, we revised up our forecast to 3.8% from 3.1% previously**
- **Headline inflation (Jul): 0.38%/m/m (Banorte-Ixe: 0.2%/m/m; consensus: 0.19%/m/m)**
- **Core inflation (Jul): 0.06%/m/m (Banorte-Ixe: 0.14%/m/m; consensus: 0.16%/m/m)**
- **Inflation in July was explained by pressures on prices of fruits & vegetables along with increases in the prices of other services**
- **We recommend long positions in the 3-year Udibono Dec'20 taking advantage of deteriorated inflation dynamics**

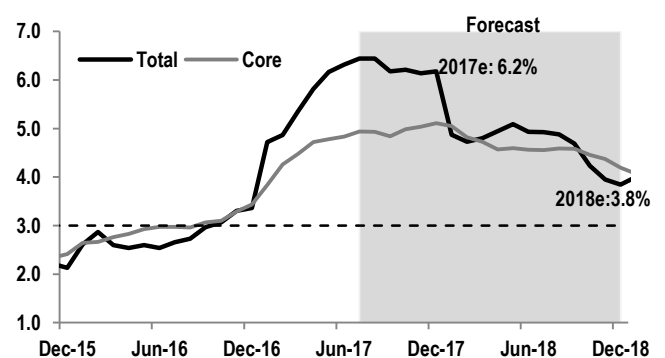
We now expect inflation at 6.2% by year end (vs. our previous 5.7%). The rationale behind this change comes from a downward revision of core inflation in 2017, recognizing a lower pass-through effect from FX to prices amid the appreciation of the Mexican peso since the beginning of the year (~ 17.5%). Nevertheless, this will be offset by pressures on agricultural prices and the fact that energy prices have not been edged down as much as we expected (see chart below). This change is made in the context of the publication of the inflation report in July which showed that, in line with our estimates, annual inflation reached its peak of 6.44% in the year, which we expect it to converge, as of September, towards our new estimate of 6.2%. Additionally, for 2018 we also revised our estimate to 3.8% from 3.1%, as shown in the chart on the right.

Changes in our inflation forecast %



Fuente: Banorte con datos del INEGI

Inflation forecast 2017-2018 % var. anual



Fuente: Banorte con datos del IENGI

Consumer prices increased 0.38% m/m in July, above expectations. Core inflation was 0.06% vs. our 0.14% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (-7.5bps vs. our -5.7bps); (2) an underestimation of merchandise prices (4.1bps vs. our 2.9bps); along with (3) a larger than expected contribution of agricultural prices (23.6bps vs. our 17bps), as shown in the table below

Inflation by components in July

% monthly incidence

	INEGI	Banorte-ixe	Difference
Total	0.38	0.32	0.06
Core	0.20	0.19	0.01
Goods	0.04	0.03	0.01
Processed foods	0.06	0.06	0.01
Other goods	-0.02	-0.03	0.01
Services	0.16	0.16	0.00
Housing	0.03	0.03	0.00
Education	0.01	0.01	0.00
Other services	0.12	0.12	0.00
Non-core	0.18	0.13	0.05
Agriculture	0.24	0.17	0.07
Fruits & vegetables	0.20	0.13	0.07
Meat & eggs	0.03	0.04	-0.01
Energy & government tariffs	-0.06	-0.05	-0.02
Energy	-0.08	-0.06	-0.02
Government tariffs	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

Inflation in July was explained by pressures on prices of fruits & vegetables along with increases in the prices of other services. In the first case, prices of agricultural products increased 2.49% m/m on the back of a 5.7% increase in the prices of fruits and vegetables, with prices of products such as tomatoes, potatoes, and Husk tomatoes up 21.8% m/m, 16% m/m and 18.7% m/m, respectively. These three products added 16.2bp to inflation during the seventh month of the year. Moreover, meat and egg prices increased 0.54% m/m. Meanwhile, also in the non-core index, energy prices edged down 0.78% m/m with domestic LP gas prices down 2.46% while low-grade gasoline prices came down 0.52% m/m.

In the core index, merchandise prices increased 0.12% m/m explained by higher prices of food (0.4%), partially offset by a drop in the prices of non-food goods (-0.12%). In this context, *INEGI* mentioned the price of women's trousers (-1.6%), personal deodorants (-1.15%) and clothing for girls (-1.44%), among products with falling prices. Meanwhile, services prices were up 0.4% m/m, on the back of a 0.19% increase in the cost of housing, a 0.12% increase in education costs and the price of other services up 0.7%.

From our fixed income and FX strategy team

We recommend long positions in the 3-year Udibono Dec'20 taking advantage of deteriorated inflation dynamics. Today's inflation report came in higher than market expectations. It is worth mentioning that market consensus continues underestimating inflation, suggesting additional pressures beyond forecasts in recent polls. In the last 16 fortnightly reports, analysts have overlooked 14 readings. Taking into account current conditions, we recommend long positions in the 3-year Udibono Dec'20 with entry level of 3.05%, target of 2.90% and stop-loss of 3.15%. More details in our research note "*We recommend long positions in the 3-year Udibono Dec'20*" [<pdf>](#), published today.

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