

Inflation 1H-July surprises on the back of higher agricultural prices

July 24, 2018

www.banorte.com
@ analisis_fundam

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

Francisco Flores
Economist, Mexico
francisco.flores.serano@banorte.com

- **INEGI just published its inflation report for in the first half of July**
- **Headline inflation (1H-Jul): 0.32%2w/2w (Banorte: 0.23%2w/2w; consensus: 0.26%2w/2w)**
- **Core inflation (1H-Jul): 0.19%2w/2w (Banorte: 0.12%2w/2w; consensus: 0.15%2w/2w)**
- **Inflation in the first half of July was explained by pressures on fruits & vegetables prices along with increases in other services prices**
- **With these numbers, annual inflation is at 4.85% vs. 4.65% in the previous month**
- **Sell-off in Mbonos following a higher than expected inflation print**
- **The dynamics in consumer prices are helping our short-term tactical trade idea of long positions in floating-rate Bondes D**

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.maca@banorte.com

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

Consumer prices increased 0.32%2w/2w in in the first half of July, above expectations. Core inflation was 0.19% vs. our 0.12% estimate. The main deviation from our forecast comes from: (1) An underestimation of agricultural prices (10.2bps vs. our 8.5bps); (2) an underestimation of energy prices (7.3bps vs. our 5.4bps); and (3) a larger than expected contribution of goods prices (6.5bps vs. our 1bps), as shown in the table below.

Inflation by components in the first half of July
% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.32	0.23	0.09
Core	0.14	0.09	0.05
Goods	0.07	0.01	0.06
Processed foods	0.05	0.02	0.03
Other goods	0.02	-0.01	0.03
Services	0.08	0.08	0.00
Housing	0.01	0.02	-0.01
Education	0.00	0.00	0.00
Other services	0.06	0.06	0.00
Non-core	0.18	0.14	0.04
Agriculture	0.10	0.09	0.02
Fruits & vegetables	0.13	0.07	0.06
Meat & eggs	-0.03	0.02	-0.05
Energy & government tariffs	0.08	0.06	0.02
Energy	0.07	0.05	0.02
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

Inflation in the first half of July was explained by pressures on fruits & vegetables prices along with increases in other services prices. Agricultural prices increased 1.11% 2w/2w on the back of a 3.32% increase in fruit and vegetable prices, which was partially offset by a drop in “meat & egg” prices (-0.54%). *INEGI*'s report mentioned *husk* tomatoes (42.1%), tomatoes (5.7%), potatoes (4.35%) and onions (6.73%), among the products with higher prices.

Document for distribution among public

Altogether, these five elements added 8.4bps to the total inflation during the period in question. Nevertheless, among the products with falling prices, the report highlighted the prices of poultry (-2.25% 2w/2w) and eggs (-1.96%), subtracting as much as 4.6bp to total index variation. Meanwhile, energy prices increased 0.69% 2w/2w on the back of a 0.9% increase in low-grade gasoline prices.

In the core index, other services prices climbed 0.34% 2w/2w on the back of pressures on tourism services (3.42%) and dining away from home items (0.29%). On top of this, living and education costs edged-up 0.08%, respectively. Moreover, merchandise prices were up 0.19% 2w/2w derived from 0.29% and 0.1% 2w/2w increases in the prices of processed food and of other merchandise prices, respectively.

With these figures, annual inflation is at 4.85% vs. 4.65% in the previous month. Core inflation edged up marginally to 3.64% from 3.62% in June. In our view, 12-month inflation will remain above 4.6% during the coming months, to converge toward the end of the year to our year-end forecast of 4.3% y/y. Note that in the first half of August, *INEGI* will apply the methodology and base year changes to Mexico's CPI.

From our fixed income and FX strategy team

Sell-off in Mbonos following a higher than expected inflation print. Today's fortnightly CPI reading came above market expectations, increasing the inflationary premium embedded in local rates. Mbonos are extending yesterday's losses, trading 4bps higher this morning. A similar performance is observed in the TIEE-IRS curve. This is consistent with our view about an expensive valuation in Mbonos and the risks associated to a short-term correction. For more information please refer to our "*Fixed-Income and FX Weekly*" [<pdf>](#), published yesterday. In contrast, inflation-linked Udibonos are rallying 2-3bps, mainly in short-term securities, despite valuations that have turned expensive in recent weeks (especially in terms of inflation breakevens). The dynamics in consumer prices are helping our short-term tactical trade idea of long positions in floating-rate Bondes D, as market participants are likely to increase their odds of a rate hike from Banxico this year (currently pricing in +9bps). With a short-term perspective, we expect this CPI inflation report to have a relevant influence in today's ordinary auctions, with investors likely to increase their appetite for the 3-year Udibono and reduce exposure in the 3-year Mbonos despite a higher breakeven at 4.18%. More details in our publication "*3Y Mbono and Udibono auction preview*" [<pdf>](#), released today.

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
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional	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.rolan.ferrer@banorte.com	(55) 5004 - 1454