

1H-Jun inflation – Annual inflation back to the upper bound of Banxico’s variability range

- **INEGI just published its inflation report for the first half of June**
- **Headline inflation (1H-Jun): 0.01% 2w/2w; Banorte: 0.05%; consensus: 0.04% (range of estimates: -0.03% - 0.19%); previous: -0.03%**
- **Core inflation (1H-Jun): 0.16% 2w/2w; Banorte: 0.16%; consensus: 0.13% (range of estimates: 0.10% - 0.23%); previous: 0.17%**
- **Dynamics during the period were helped by lower prices in fresh fruits and vegetables for third print in a row, along with a reduction in energy. In this context, non-core inflation fell from 5.8% to 4.3% yoy**
- **With these figures, annual headline inflation fell to 4.00% from 4.28% at the end of May. Nevertheless, core-inflation increased to 3.87% from 3.77% previously**
- **Local assets acknowledged the dovishness from the Federal Reserve and improvement in CPI dynamics**

Consumer prices advanced 0.01% 2w/2w in 1H-Jun. This number was lower than consensus (0.04%) and our forecast (0.05%). Core inflation rose 0.16%, in line with our forecast. The main deviation came from: (1) A lower than expected contribution in LP gas (-6bps vs. our -2bps); (2) a smaller impact from low-grade gasoline (-2bps vs. our -1bp); and (3) lower pressures in other goods (+1bp vs our +3bps), as shown in the table below:

1H-Jun inflation by components

% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.01	0.05	-0.04
Core	0.12	0.12	0.01
Goods	0.04	0.06	-0.02
Processed foods	0.03	0.03	0.00
Other goods	0.01	0.03	-0.02
Services	0.08	0.06	0.02
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.06	0.04	0.03
Non-core	-0.12	-0.07	-0.04
Agriculture	-0.05	-0.05	0.00
Fruits & vegetables	-0.06	-0.06	0.00
Meat & eggs	0.02	0.02	0.00
Energy & government tariffs	-0.07	-0.03	-0.04
Energy	-0.08	-0.03	-0.04
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.

June 24, 2019

www.banorte.com
@analisis_fundam

Delia Paredes

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

Juan Carlos Alderete, CFA

Senior Economist, Mexico
juan.alderete.magal@banorte.com

Francisco Flores

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

Fixed income and FX Strategy

Alejandro Padilla

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

Santiago Leal Singer

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

Leslie Orozco

Fixed Income and FX Strategist
leslie.orozco.velez@banorte.com

Document for distribution among public

Period dynamics were helped by the fall in fruits and vegetables along energy. The former declined 1.4% 2w/2w, subtracting 6.2bps to the headline. For the whole category of agricultural goods, the contribution was -4.5bps. By product, those with the highest declines included onions (-11.1%), tomatoes (-4.3%), eggs (-1.8%) and lemon (-11.7%). On the contrary, the most pressured included chicken (+2.0%), squash (+34.0%) and avocados (+4.0%), among others. We highlight two things: (1) Tomatoes declined even in a context in which a tariff of 17.5% on this product by the US remains in place; and (2) pork prices advanced 0.8%, with the tenth highest incidence in the period, which is relevant in the context of a market impacted by swine flu in China. Energy subtracted 7.5bps. Specifically, LP gas declined 2.8%, contributing with -5.7bps, while low-grade gasoline fell 0.4% despite the reduction in the Federal Government's fiscal subsidy since mid-May. In our view, the relative strength of the MXN and lower international prices more than compensated for the latter.

Core inflation contributed 12.5bps, higher than expected by the market. Part of this advance is due to other services, which added 6.5bps. Among the categories in this group we noted the start of the seasonal adjustment in airfares (+16.2%) and tourism services (+2.8%). We also highlight that housing contributed with less than 2bps for a second print in a row, category that had been relatively pressured recently and a positive signal going forward.

Annual inflation stands at 4.00% from 4.28% at the end of May. In bi-weekly terms, this is the lowest figure since the second-half of March when it reached the same level, coinciding with the upper bound of Banxico's variability range around the 3% target. Although this is positive, the reduction is mainly due to non-core inflation, which went from 5.8% at the end of May to 4.3%, a new low since the strong upward adjustment in gasoline prices at the start of 2017. In this context, core inflation picked up one-tenth to 3.9%, second highest so far this year. Although some of this increase, particularly since last April, is due to methodological changes in 2018 (base-year change), we believe that the central bank will remain cautious as core inflation is still presenting some resistance to the downside. We will remain focused on: (1) Dynamics in agro, as they have kept falling but historically have been very volatile and with a tendency towards mean reversion; (2) the additional effect that could be in store in pork due to swine flu in China, as observed today; (3) energy prices, particularly low-grade gasoline, given recent tensions in the Strait of Hormuz and between US and Iran; and (4) potential pressures at a more structural level at the core, which seem to be materializing in some categories, although also taking into account the recent moderation in activity.

We expect Banxico to maintain a prudent stance. On Thursday, Banxico's fourth monetary policy decision will take place. We anticipate the central bank to keep the interest rate unchanged at 8.25%. In terms of the tone of the communique, we believe that it will remain relatively hawkish, broadly in line with the latest *Quarterly Report* and minutes. In particular, we expect the institution to remain cautious about the resistance to the downside of core inflation, as observed today, in spite of signs of a significant moderation in economic activity.

Moreover, the central bank is likely to reaffirm its prudent stance on uncertainty about financial stability risks after recent actions by credit rating agencies and trade tensions, even with the Fed showing a more dovish bias. Nevertheless and given our expectation that some of these risks will diminish gradually, among other factors, we maintain our call that Banxico will have room to cut the reference rate by 25bps in its November 14th meeting. For additional details, see: “*Mexico: Ahead of the Curve – Banxico to remain on hold, maintaining a prudent stance*”, <[pdf](#)>, published last Friday.

From our fixed income and FX strategy team

Local assets acknowledged the dovishness from the Federal Reserve and improvement in CPI dynamics. The local market is opening today’s session with 3bps gains, extending last week’s 4bps rally in Mbonos, reacting to a better than expected fortnightly CPI report in combination with a weaker proxy GDP (IGAE) and a stronger demand for fixed-income assets worldwide. Although annual inflation is locating 100bps above Banxico’s target (just in the upper limit of the confidence interval) with a mild downward trend so far this year, investors are acknowledging a less resilient core component and several risks in the global and local landscapes that could result in additional cost pressures in the economy. Some of these concerns could be stressed out by the central banks at its monetary policy committee this Thursday June 27th, most likely depicting a prudent rhetoric despite the strong dovishness from the Federal Reserve last week. Overall, this scenario explains the current valuation of the yield curve, with only -36bps of implied rate cuts priced-in until 2019-end but nearly -125bps by the end of 2020. In terms of strategy, we are favoring liquidity, especially with the attractive short-term rates in Mexico (in comparison with the rest of EM) and waiting for better valuations, after the profit taking in the tactical long strategies in Mbonos Nov’36 and Nov’38 on June 14th.

In the FX market, the Mexican peso registered a slightly negative reaction to the combination of local inflation and economic activity gauges released (IGAE) this morning, coupling to a USD rebound against a number of currencies after the sharp pressures registered last week. Following a rather flat session opening, the peso went from 19.13 per dollar to 19.18 (-0.2%). We believe that the USD/MXN short-term outlook could hold relatively favorable. Although we hold a view on low premiums and valuations becoming more expensive when extending the appreciation below 19.00, the dovish scenario just joined by the Fed is a relevant support, more so when considering the strong implied MXN carry given Banxico’s rate which remains high, primarily when compared with other EM regions. Meanwhile, as latest CPI readings become more favorable, MXN “fair value” should also reflect some improvement derived from the competitive adjustments. However, we hold a vision around limited appreciation space when trading below 19.00. Under this logic, we believe MXN could observe interesting spaces for USD directional longs, were we see as especially attractive the 18.80 region.

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.

Analyst Certification.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Francisco Duarte Alcocer, Jorge Antonio Izquierdo Lobato and Leslie Thalia Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	<i>When the share expected performance is greater than the MEXBOL estimated performance.</i>
HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

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
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
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
Francisco Duarte Alcocer	Analyst, Global Economist	francisco.duarte.alcocer@banorte.com	(55) 1103 - 4000 x 2707
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
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

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
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
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	Manager, 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