

Inflation 1H-August explained by pressures on agricultural and energy prices

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- **INEGI just published its inflation report for the first half of August**
- **Headline inflation (1H-Aug): 0.34% 2w/2w (Banorte: 0.39% 2w/2w; consensus: 0.3%2w/2w)**
- **Core inflation (1H-Aug): 0.19% 2w/2w (Banorte: 0.15% 2w/2w; consensus: 0.15% 2w/2w)**
- **Inflation in the first half of August was explained by pressures on the prices of fruits & vegetables along with increases in low-grade gasoline**
- **With these numbers, annual inflation remained at 4.81%**
- **Local bonds react to bi-weekly CPI with real-rates rallying**

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Consumer prices increased 0.34% 2w/2w in in the first half of August. This number was higher than consensus -but slightly lower than our forecast-, with an unusually high range of estimates due to the changes in the methodology. Meanwhile, core inflation was 0.19% vs. our 0.15% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of agriculture prices (9.1bps vs. our 15bps); (2) a lower than expected contribution of services prices (1.5bps vs. our 4bps); and (3) a higher than expected contribution of goods prices (11.7bps vs. our 7bps), as shown in the table below.

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1H-August inflation by components
% bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.34	0.39	-0.05
Core	0.13	0.11	0.02
Goods	0.12	0.07	0.05
Processed foods	0.05	0.03	0.02
Other goods	0.06	0.04	0.02
Services	0.02	0.04	-0.03
Housing	0.01	0.01	0.00
Education	0.05	0.04	0.01
Other services	-0.04	-0.01	-0.03
Non-core	0.21	0.28	-0.07
Agriculture	0.09	0.15	-0.06
Fruits & vegetables	0.13	0.15	-0.02
Meat & eggs	-0.04	0.01	-0.05
Energy & government tariffs	0.12	0.13	-0.01
Energy	0.11	0.12	-0.01
Government tariffs	0.01	0.00	0.00

Source: Banorte with data from INEGI and Banco de México.

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 the first half of August was explained by pressures on the prices of fruits & vegetables along with increases in low-grade gasoline.

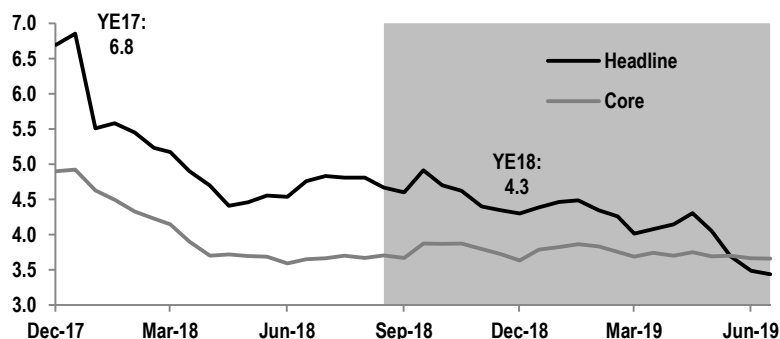
Agricultural prices increased 0.89% 2w/2w on the back of higher prices of fruits and vegetables (+2.8% 2w/2w), which more than offset for the marginal fall in the prices of meat & eggs (-0.7%). INEGI mentions the price of tomatoes (+12.8% 2w/2w), onions (27.8%), lemons (17.6%) and avocados (3.3%), among products with rising prices. In fact, these four products contributed 14.1bps to inflation in the period. Moreover, low-grade gasoline prices rose 1.7% adding another 9.2 bps to the variation of CPI. In this regard, energy prices rose 1.1% 2w/2w.

In the core index, merchandise prices increased 0.3% 2w/2w, on the back of similar expansions in both processed foods and other merchandise prices. In the services index, we highlight the rise in education costs, up 1.4%, given the start of the new school year. This was compensated by the reduction in the prices of other services, down 0.24% 2w/2w, on the back of lower prices in airfares (-16.2%) and tourism services (-7.8%) as the summer holiday season came to an end.

With these figures, annual inflation remains at 4.81%. Similarly, core inflation was 3.6%, marginally below the 3.63% seen in July. We believe inflation will continue to be pressured energy and agricultural prices in the next few bi-weekly prints. Nevertheless, we still believe these are temporary pressures and that inflation will converge at the end of the year to our 4.3% yoy estimate.

Inflation forecast

% yoy, bi-weekly trajectory



Source: INEGI, Banorte

First published data with the new methodology. As already anticipated (see note: "CPI changes methodology as of the 1st half of August" <PDF>), INEGI updated the methodology for calculating the CPI in this report. The new methodology involves a base year change from the second half of December 2010 to the second half of July 2018, among other improvements. Moreover, it officially published the weights for each of the CPI components, as shown in the following graph.

Significant changes in the weights of some specific goods and services. As it was already announced, among the items with a greater upward change in weight are: (1) Low-grade gasoline (+157bps, 2018: 5.36%); (2) soft drinks (+97bps, 2018: 2.06%); (3) dining away from home items (+70bps, 2018: 4.58%); (4) LP gas (+69bps, 2018: 2.17%); and (5) car maintenance (+47bps, 2018: 0.66%). By contrast, the five categories with the most revisions to the downside are: (1) Housing and accommodation –for purchase–, (-214bps, 2018: 12.01%); (2) electricity tariffs (-132bps, 2018: 1.49%); (3) housing and accommodation –rentals–, (-121bps, 2018: 2.17%); (4) automobiles (-100bps, 2018: 1.9%); and (5) cellphone services (-83bps, 2018: 1.28%).

CPI weights

	2018	2010	Difference
Total	100.0	100.0	--
Core	75.6	77.4	-1.9
Goods	39.2	34.4	4.8
Processed foods	20.1	14.7	5.4
Other goods	19.2	19.7	-0.5
Services	36.3	43.1	-6.7
Housing	15.5	19.5	-4.0
Education	3.6	5.1	-1.5
Other services	17.2	18.5	-1.2
Non-core	24.4	22.6	1.9
Agriculture	10.2	8.4	1.8
Fruits & vegetables	4.6	3.6	1.0
Meat & eggs	5.6	4.9	0.8
Energy & government tariffs	14.2	14.1	0.1
Energy	10.0	8.8	1.2
Government tariffs	4.3	5.4	-1.1

Source: INEGI

From our fixed income and FX strategy team

Local bonds react to bi-weekly CPI with real-rates rallying. August’s bi-weekly inflation report came higher than consensus, with analysts having underestimated the CPI fortnightly reading in 6 out of the last 7 readings. As a consequence, the possibility of additional upward adjustments in inflation expectations remains, at least for the remainder of this year. In this sense, inflation breakevens have reacted and are more expensive, printing above 4% in each of the 3-, 5-, 10-, and 30-year tenors, with all of them above their 12-month moving average that hovers around 3.75% to 3.80%. Based on our inflation forecasts, UDIS’s carry for the remaining 130 days of 2018 is still attractive at 2.29% (6.35% annualized rate). It is worth noting that in spite of a complex inflation backdrop, the Mexican peso’s performance in the aftermath of the local electoral process and some signals of a slowdown in economic activity could influence Banxico’s Board to hold their reference rate unchanged for the rest of the year. In this respect, the Mexican yield curve is pricing-in 14bps of implicit accumulated rate hikes for the remainder of 2018, with the market following closely Banxico’s Quarterly Report to be delivered on August 29th, in particular the update on the bank’s inflation point forecasts (likely up) and the estimated range for GDP (slightly down). Considering this latter scenario, it is our take that current CPI conditions and dynamics are still supportive and favorable for our investment idea of long positions in the real-rate security Udibono Jun’22.

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