

Higher energy prices in the first half of August

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- **INEGI just published its inflation report for August**
- **Headline inflation (Aug): 0.31%2s/2s (Banorte-Ixe: 0.47%2s/2s; consensus: 0.34%2s/2s)**
- **Core inflation (Aug): 0.13%2s/2s (Banorte-Ixe: 0.16%2s/2s; consensus: 0.15%2s/2s)**
- **Inflation August was explained by pressures on gasoline prices along with increases in the price of other goods**
- **With these numbers, annual inflation is at 2.80% vs. 2.65% in previous month**
- **Local rates did not react much to the downward inflation surprise as liquidity is low**

Consumer prices increased 0.31%2s/2s in August, below our expectations and consensus. Core inflation was 0.13% vs. our 0.16% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of services prices (0.5bps vs. our 7.6bps); (2) an underestimation in agriculture prices (0.7bps vs. our 5bps); (3) a lower than expected reduction in energy prices (21.8bps vs. our 24.5bps), and (4) an underestimation of merchandise prices as shown in the table below.

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Inflation by components in August

%monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.31	0.47	-0.16
Core	0.10	0.16	-0.06
Goods	0.09	0.09	0.00
Processed foods	0.00	0.02	0.02
Other goods	0.09	0.07	-0.02
Services	0.01	0.07	-0.06
Housing	0.01	0.01	0.00
Education	0.04	0.05	-0.01
Other services	-0.05	0.01	0.04
Non-core	0.21	0.29	-0.08
Agriculture	0.01	0.05	-0.04
Fruits & vegetables	0.01	0.04	-0.04
Meat & eggs	-0.01	0.01	0.01
Energy & government tariffs	0.20	0.24	-0.04
Energy	0.20	0.24	-0.04
Government tariffs	0.00	0.00	0.00

Source: Banorte-Ixe 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 is explained by pressures on the prices of energy and other goods. Energy prices increased 2.25%2w/2w on the back of higher prices of low-grade (3.6%) and high-grade (2.6%) gasoline, along with increases in the prices of natural gas (5.9%). Nevertheless, it is worth noting that this increase was offset by the reduction in LP gas (-0.58%). Meanwhile, although food prices edged down (-0.03%), other merchandise prices were up 0.52%, contributing almost 10bp to total inflation in the first half of August, reflecting pass-through effects from FX depreciation. Meanwhile, services prices show mixed results, with education costs increasing 0.8% amid the back to school season, while prices of other services were up 0.3% on the back of lower prices of air transportation, and other tourism services. Moreover, mobile phone services were down 0.58%2w/2w. Finally, agricultural prices were up 0.9% as a result of higher prices of fruits and vegetables (0.53%), partly offset by a contraction in prices of “meat and eggs” (-0.18%).

With these data, annual inflation is at 2.8% vs. 2.65% in the previous month. Meanwhile, core inflation remained at 2.97%, unchanged vs. last month. In our view, inflation could increase in the coming months, but will converge to our estimate of 2.8% by year-end.

From our fixed income and FX strategy team

Local rates did not react much to the downward inflation surprise as liquidity is low. In local rates, both Mbonos and Udibonos did not show relevant changes after the report. Nominal rates are up by 3-4bps since the beginning of the day, following FX dynamics relatively close and still with some adjustment after yesterday’s S&P announcement about Mexico’s rating outlook. Real rates exhibit very limited liquidity and are trading mostly unchanged relative to yesterday’s closing levels. Even considering that the pickup in the merchandise sub-index could suggest greater pass-through from FX weakness, we believe that this figure could strip some of the greater appetite seen for short-term Udibonos, as evidenced by yesterday’s primary auction of the Jun’19 security. In terms of strategy, the mid-part of the Mbonos and TIE-IRS curves (3- and 5-year tenors) remains as the most attractive and could portray a defensive performance for the rest of the month (expecting further profit taking in the extremes of the yield curve). However, we expect better market conditions ahead in order to start new directional trade strategies. In Udibonos, we believe that the most favorable valuations are in 5- and 10-year instruments given breakeven inflation slightly above 3%, particularly when compared against the 3-year (with higher breakeven) and 30-year securities (lower duration-adjusted premium).

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