

## Inflation in June – Pressures on merchandise and services prices offset by falling agricultural prices

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- **INEGI just published its inflation report for June**
- **Headline inflation (Jun): 0.17%/m/m (Banorte-Ixe: 0.12%/m/m; consensus: 0.2%/m/m)**
- **Core inflation (Jun): 0.21%/m/m (Banorte-Ixe: 0.18%/m/m; consensus: 0.21%/m/m)**
- **Inflation in June was explained by pressures on other services prices along with increases in processed foods prices, but compensated by falling agricultural prices**
- **With these numbers, annual inflation remains at 2.9% in June**
- **Attractive valuation in Mexican linkers despite contained inflation levels**

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**Consumer prices increased 0.17%/m/m in June, below market expectations but above our own forecast.** Core inflation was 0.21% vs. our 0.18% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (2.8bps vs. our 3.1bps); (2) a lower than expected contribution of government tariffs (0.5bps vs. our 0.6bps); (3) an underestimation of services prices (8.5bps vs. our 6.6bps); along with (4) a larger than expected contribution of agricultural prices (-2.3bps vs. our -5.1bps), as shown in the table below

#### June inflation by components

% monthly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.17	0.12	0.043
Core	0.16	0.14	0.019
Goods	0.07	0.07	0.000
Processed foods	0.04	0.05	-0.017
Other goods	0.03	0.02	0.017
Services	0.08	0.07	0.018
Housing	0.03	0.03	0.000
Education	0.00	0.00	0.001
Other services	0.05	0.03	0.017
Non-core	0.01	-0.01	0.023
Agriculture	-0.02	-0.05	0.028
Fruits & vegetables	0.00	-0.01	0.003
Meat & eggs	-0.02	-0.04	0.024
Energy & government tariffs	0.03	0.04	-0.004
Energy	0.03	0.03	-0.003
Government tariffs	0.01	0.01	-0.001

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.

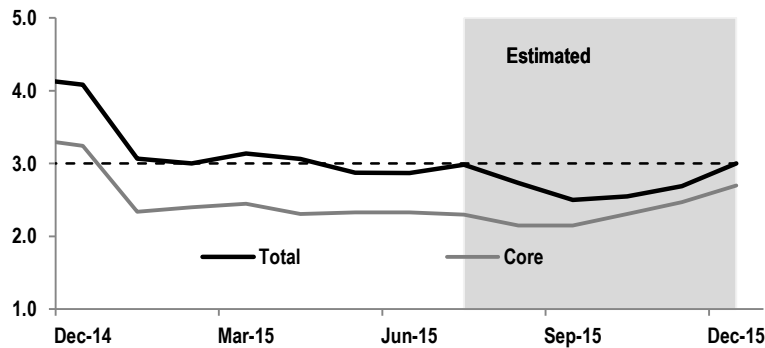
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**Inflation June was explained by pressures on other services prices along with increases in processed foods prices, but compensated by falling agricultural prices.** Services inflation is at 0.21% m/m on the back of 0.17% higher costs of housing, along with an increase of 0.08% in education costs. Meanwhile, other services prices were up 0.29%, particularly as a result of higher tourism services given the start of the summer holiday season (air-transportation: +8.2%; tourism services: 1.8%; restaurants: +0.3%, among others). Merchandise inflation was 0.21% m7m derived from pressures on processed food prices (+0.24%), while other merchandise prices increased only 0.18%, reflecting the start of the summer discounts in some products. In the non-core index, agricultural prices edged down 0.24% m/m on the back of lower prices of fruits and vegetables (-0.09%), while “meat and egg” prices are down 0.32%. In fact, *INEGI* mentions strong reductions in the prices of eggs (-4.75%) and poultry (-1.22%). Finally, energy prices edged up 0.28% on the back of higher gasoline prices in some border cities.

**With these numbers, total inflation remains at 2.9% in the sixth month of the year.** Similarly, core inflation is at 2.33% in June. In our view, inflation will remain below Banxico’s 3% target in the coming months.

**Inflation forecast**

% yoy



Source: Banorte-Ixe with data from INEGI

*From our fixed income and FX strategy team*

**Attractive valuation in Mexican linkers despite contained inflation levels.**

INEGI's CPI report for June showed still moderate inflation and no evidence of strong pass-through effects from Mexican peso weakness. Although below market expectations, this figure confirms the end of the seasonal deflationary period in Mexico, with prices increasing 0.03% 2w/2w during the second half of the month. We believe inflation linkers exhibit a positive valuation, particularly in the 5- and 10-year zones. In this respect and despite correcting higher in recent weeks, inflation breakevens are still below long-term equilibrium levels at 3.27% and 3.16%, in the same order. On the other hand, we maintain our year-end inflation forecast at 3.0%yoy, expecting a moderate rebound by the end of the year and above its current level of 2.87%. The latter implies attractive UDIS's carry when compared to nominal-rate securities with similar duration. In terms of recommendations, we reiterate our expectation of further flattening of the swaps curve with a long TIEE-IRS position in the 10-year maturity (130x1) and short position in the 2-year tenor (26x1), currently at 211bps (entry: 230bps, target: 200bps, stop-loss: 250bps)

**In the FX market, the peso is trading 0.5% stronger at 15.76 per dollar, not reacting meaningfully to the report.** We continue believing that low inflation could be positive for the peso as it supports real income growth and private consumption, which has shown more favorable dynamics. Nevertheless, local data should keep exerting a relatively weak influence in the peso at least for the time being given high external risks. We reiterate our defensive stance on the currency and recommendation to trade with a short bias, not discarding the possibility of further pressures to USD/MXN 16.00 in the short term, particularly if no deal is reached in Greece that could make investors jittery on higher prospects of a potential *Grexit*.

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