

Inflation in the first half of August explained by pressures on education and energy prices

- **INEGI just published its inflation report in the first half of August**
- **Headline inflation (1H-Aug): 0.31% 2w/2w; Banorte-Ixe: 0.25% 2w/2w; consensus: 0.22% 2w/2w; (range of estimates: 0.07% to 0.22%); previous: 0.25% 2w/2w**
- **Core inflation (1H-Aug): 0.20% 2w/2w; Banorte-Ixe: 0.19% 2w/2w; consensus: 0.15% 2w/2w (range of estimates 0.12% to 0.24%); previous: 0.06% 2w/2w**
- **Inflation in the first half of August was explained by pressures on the prices of other services and fresh fruits and vegetables**
- **With these numbers, annual inflation is at 6.59% vs. 6.44% in the previous month**
- **Upside surprises in inflation support our recommendation of long positions in Udibono Dec'20 and the attractiveness of MXN carry**

Consumer prices increased 0.31% 2w/2w in in the first half of August. Core inflation was 0.20% vs. our 0.19% estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of other goods prices (10.1bps vs. our 0bps); (2) a lower than expected contribution of other services prices (-6.5bps vs. our 3.8bps); and (3) an underestimation of energy prices (5.9bps vs. our 1.7bps), as shown in the table below.

1H-Aug inflation by major subcomponent

Bi-weekly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.31	0.25	0.06
Core	0.15	0.14	0.01
Goods	0.14	0.04	0.11
Processed foods	0.04	0.04	0.01
Other goods	0.10	0.00	0.10
Services	0.01	0.11	-0.10
Housing	0.02	0.02	0.00
Education	0.05	0.05	0.00
Other services	-0.07	0.04	-0.10
Non-core	0.16	0.11	0.05
Agricultural	0.08	0.08	0.00
Fresh fruits and vegetables	0.06	0.07	0.00
Meat and egg	0.02	0.02	0.01
Energy and government regulated	0.07	0.03	0.05
Energy	0.06	0.02	0.04
Government regulated	0.01	0.01	0.00

Source: INEGI, Banorte-Ixe

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 education and energy. In the first case, prices increased 1.03% 2w/2w, on the back of higher prices university (1.69% 2w/2w) and high school (2.03% 2w/2w). Moreover, processed foods increased 0.26% 2w/2w, while other goods rose 0.53% 2w/2w. Additionally, the prices of other services decreased 0.38% 2w/2w, on the back of declines in tourism services (-7.77% 2w/2w) and air fares (-13.7% 2w/2w).

Regarding non-core items, energy prices grew by 1.64% 2w/2w driven by an increase in the price of LP Gas (2.18% 2s/2s) and low-grade gasoline (0.41% 2s/2s), despite the 0.20% 2w/2w in the prices of electricity. Moreover, fresh fruits and vegetables prices increased 1.64% 2w/2w, on the back of higher prices of tomatoes (4.53% 2w/2w), onions (16.99% 2w/2w) and *husk* tomatoes (5.91% 2w/2w). However, these were mitigated by decreases in the prices of squash (-16.7% 2w/2w), bananas (-3.17% 2s/2s), avocados (-2.91% 2s/2s) and peppers (-5.14% 2s/2s).

With these numbers, annual inflation edges up to 6.59% vs. 6.44% in July. Moreover, core inflation climbed to 5.02% (vs. 4.94% in July). We consider that inflation will reach its maximum level in the second half of August, starting to converge towards our 6.2% forecast for the end of the year.

From our fixed income and FX strategy team

Upside surprises in inflation support our recommendation of long positions in Udibono Dec'20 and the attractiveness of MXN carry. Inflation keeps surprising the market to the upside, maintaining relatively negative dynamics. It is worth noting that analysts have consistently underestimated inflation, suggesting the possibility of upward adjustments in market forecasts in the near future. Moreover, the 3-year breakeven is at 3.52%, below the 12-month average of 3.69%, and -0.3σ of its 3-month MA, suggesting an attractive valuation. Based on our inflation forecasts, 12m carry in UDIS is at 4.80%, significantly higher than consensus, one-year forward inflation of 3.92% (median) according to Banxico's latest survey. All in all, these conditions are favorable and support our trade recommendation in Udibono Dec'20, recently opened with entry of 3.05%, target of 2.90% and stop-loss of 3.15%, currently at 3.07%. For details, refer to: "*We recommend long positions in the 3-year Udibono Dec'20*", [pdf](#), published on August 9, 2017.

In FX, the peso is gaining 0.3% today to 17.64 per dollar in a more positive context for risky assets and EM currencies, picking up slightly after the report. In our view this is because consistently higher inflation prints suggest the need for Banxico to at least maintain its reference rate unchanged for longer, particularly against market expectations of possible rate cuts ahead. This could be helpful in terms of carry, which still looks attractive in absolute terms and relative to EM, particularly if adjusted for volatility. We maintain a neutral directional stance but a positive bias for trading purposes, buying MXN on dips and with a strong support at 17.50, which we see adequate for profit taking in speculative positions.

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