

Inflation in April continued to edge down to 4.55% from 5.04% in previous month

May 9, 2018

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- **INEGI just published its inflation report for April**
- **Headline inflation (Apr): -0.34%/m/m (Banorte: -0.3%/m/m; consensus: -0.31%/m/m)**
- **Core inflation (Apr): 0.1%/m/m (Banorte: 0.16%/m/m; consensus: 0.15%/m/m)**
- **Inflation in April was explained by lower energy and agricultural prices**
- **With these numbers, annual inflation is at 4.55% vs. 5.04% in previous month**
- **Positive inflation news partially mitigate expectations of a more hawkish Banxico due to current dynamics in the exchange rate and gasoline prices; nevertheless, we maintain defensive strategies in floating-rate securities**

Consumer prices decreased 0.34%/m/m in April, slightly below expectations. Core inflation was 0.1% vs. our 0.16% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (-40.8bps vs. our -38.7bps); and (2) a lower than expected contribution of services prices (-0.6bps vs. our 0.4bps), as shown in the table below.

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Inflation by components in April %/monthly incidence

	INEGI	Banorte-lxe	Difference
Total	-0.34	-0.30	-0.04
Core	0.11	0.12	-0.01
Goods	0.11	0.12	0.00
Processed foods	0.03	0.03	0.00
Other goods	0.08	0.08	0.00
Services	-0.01	0.00	-0.01
Housing	0.04	0.04	0.00
Education	0.00	0.00	0.00
Other services	-0.04	-0.04	-0.01
Non-core	-0.45	-0.42	-0.02
Agriculture	-0.05	-0.04	0.00
Fruits & vegetables	-0.03	-0.03	0.00
Meat & eggs	-0.01	-0.01	0.00
Energy & government tariffs	-0.40	-0.38	-0.02
Energy	-0.41	-0.39	-0.02
Government tariffs	0.01	0.01	0.00

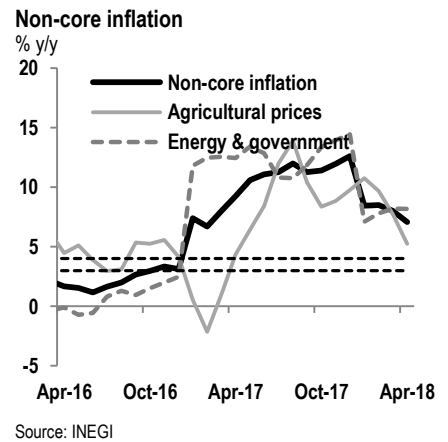
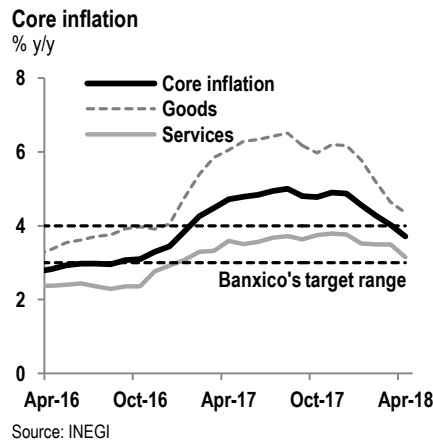
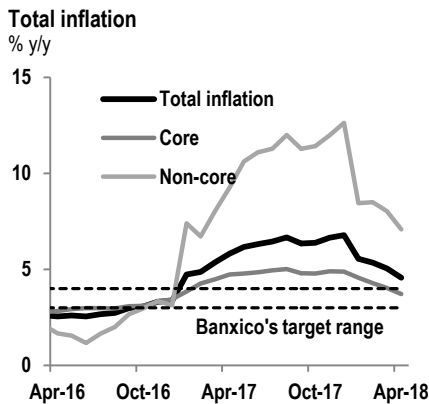
Source: INEGI, Banorte

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

Inflation in April is explained by lower energy and agricultural prices. In the first case, energy prices decreased 3.7% m/m as summer discounts on electricity tariffs (-13.9% m/m) started applying in the first half of the month, while LP gas prices came down 5.8% m/m, more than offsetting the 0.55% increase in low-grade gasoline prices. In terms of agricultural prices, down 0.49% m/m, the result was explained by lower prices of both fruits and vegetables as well as of meat and egg with mixed results within these to indexes. Government tariffs increased 0.22% m/m as a result of higher urban bus fees, up 0.75% m/m.

In the core index, merchandise prices increased 0.33% m/m as a result of a 0.21% m/m increase in the price of processed foods while other merchandise prices edged up 0.44% m/m. Meanwhile, services prices observed mixed results with housing costs up 0.22% m/m, adding as much as 3.2bps to CPI variation and educations costs also marginally higher (+0.01%). Nevertheless, other services prices decreased 0.26% m/m on the back of lower prices of tourism services (-8.9%) and airfares (-14.1%), both subtracting 8.3bp to total inflation in April, as we left behind the Easter holiday season.

With these numbers, annual inflation is at 4.55% vs. 5.04% in previous month. Meanwhile, core inflation is at 3.71% from 4.02% in March. Inflation has been surprising on the downside –in 6 of the last 8 fortnights-, mainly as a result of lower energy and agricultural prices, although basically we can observe a downward trend in annual terms in all of CPI components. In particular, we highlight that core inflation is now within Banxico’s target range. We expect 12-month inflation to remain at these levels in the coming months to converge to our 4.3% y/y year-end forecast.



From our fixed income and FX strategy team

Positive inflation news partially mitigates expectations of a more hawkish Banxico due to current dynamics in the exchange rate and gasoline prices; nevertheless, we maintain defensive strategies in floating-rate securities.

April inflation released today surprised the market positively, fueling today's modest gains in local rates after losing 8bps on average yesterday within the important adjustment process seen since mid-April. Six out of eight bi-weekly inflation prints so far in 2018 have surprised favorably (the market has overestimated the data). The latter has resulted in much more positive news so far, helping inflation to converge faster than expected (annual inflation from 6.77% by year-end 2017 to 4.55% currently, or -222bps). This is important ahead of Banxico's meeting on May 17th, with the market discounting a 25bps rate hike with an implied probability of 49%. In spite of a less adverse inflation backdrop when compared to last year, at least two factors could remain in the Board's careful analysis that could lean their communications towards the hawkish side going forward. These are the FX rate and energy prices, two variables that could exhibit a relatively rapid pass-through effect to consumer prices.

The market's changing stance about Banxico's stance for the rest of the quarter has been motivated by the 9.1% fall of the Mexican peso since the 17.94 per dollar level on April 17th, just a few cents short to erase the gains observed during the first three and a half months of the year. Moreover, energy prices in international markets have surged, mainly oil and gasoline. WTI has gained 17.1% YTD, trading around 70 US\$/bbl for the first time since 2014. Consistent with this, retail gasoline prices were stable up to mid-March, averaging around 2.54 US\$/gal. Nevertheless, prices have increased 12% since then to around 2.83 US\$/gal, also not seen since 2014. The latter has already impacted inflation components related to gasoline prices. With today's report, low-grade gasoline is up by 12.5% in annual terms, while high-grade has increased by 9.4%.

In general, these factors support our investment strategy. On one hand, we reiterate our long recommendation of defensive positions in floating-rate securities (*e.g.* Bondes D), which have been showing high demand as observed in yesterday's offering of the 5-year maturity, and as we wait for better entry levels and market conditions in Mbonos. On the other, since last Monday we recommended long positions in Udibono Jun'19 as a tactical, short-term idea with a one-week investment horizon, taking into account the recent increase in energy prices and pressures in the FX rate. For details, see: "*Fixed-Income and FX Weekly*", [pdf](#), May 7th, 2018.

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