1H-April Inflation – Summer discounts on electricity prices start to apply

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- ***INEGI* just published its inflation report for the first half of April**
- **Headline inflation (1H-Apr): -0.15% 2w/2w; Banorte-Ixe: -0.25% 2w/2w; consensus: -0.19% 2w/2w (range of estimates: -0.29% to -0.13%); previous: 0.28% 2w/2w**
- **Core inflation (March): 0.26% 2w/2w; Banorte-Ixe: 0.20% 2w/2w; consensus: 0.12% 2w/2w (range of estimates: 0.05% to 0.20%), previous: 0.29% 2w/2w**
- **The slight deflation in the first half of April was explained by the start of the summer discounts in electricity prices**
- **With these numbers, annual inflation stands at 5.62%, above the 5.42% seen in the previous period**
- **We continue to expect year-end inflation at 5.7%**
- **Local rates moderate gains after higher-than-expected inflation and some reversal of MXN appreciation.**

Consumer prices decreased 0.15% 2w/2w in the first half of April (Banorte-Ixe: -0.25% 2w/2w). In addition, core inflation was 0.26% vs. our 0.20% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of energy prices (-41bps vs our -35bps); (2) an underestimation of fruits and vegetables prices (1bps vs our -6bps); and (3) a higher contribution of meat and eggs (4bps vs. our -1bps), as shown in the table below.

1H-April inflation by major subcomponent
Bi-weekly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	-0.15	-0.25	0.10
Core	0.20	0.15	0.05
Goods	0.12	0.06	0.05
Processed foods	0.06	0.03	0.03
Other goods	0.05	0.03	0.02
Services	0.08	0.09	-0.01
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.07	0.07	0.00
Non-core	-0.35	-0.40	0.06
Agricultural	0.05	-0.07	0.12
Fresh fruits and vegetables	0.01	-0.06	0.07
Meat and egg	0.04	-0.01	0.05
Energy and government regulated	-0.40	-0.33	-0.07
Energy	-0.41	-0.34	-0.07
Government regulated	0.02	0.01	0.01

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 April is explained by lower energy prices. In particular, electricity tariffs came down 13.36% 2w/2w, as summer discounts started applying. Along with this, prices of gas and low grade gasoline prices decreased 3.41% 2w/2w and 0.12% 2w/2w, respectively. Together, these four categories subtracted 41.5bp to inflation during the period in question. Such declines were offset by the pressures in agricultural prices, with prices of meat and egg up 0.64% 2w/2w, particularly driven by higher prices of poultry (2.25% 2w/2w). Moreover, processed foods prices were up 0.4% 2w/2w, on the back of increases in the price of dairy products in particular. Finally, services inflation was 0.2% 2w/2w, explained by higher housing (0.09% 2w/2w) and other services prices (0.39% 2w/2w). Within this last category, we highlight pressures on the price of dining away from home items (0.54% 2w/2w) and tourism services (3.62% 2w/2w).

With these numbers, annual inflation stands at 5.62%, 20bp above the previous figure. Moreover, core inflation in the first half of April increased from 4.63% to 4.76%. Looking ahead, we consider that inflation will be impacted by: (1) The increase and liberalization of gasoline prices; and (2) second round effects stemming from the higher pass-through effect of the depreciation of the Mexican peso and higher energy costs to prices. We continue to expect the headline index to close 2017 at 5.7% yoy.

From our fixed income and FX strategy team

Local rates moderate gains after higher-than-expected inflation and some reversal of MXN appreciation. Rates moderated gains after the inflation report, driven by the global risk-on mood after the results of France’s Presidential Election (First Round) on Sunday that resulted in lower political risk premium. Local fixed-income securities registered a 5bps rally at the beginning of today’s session. Nevertheless, Mbonos Dec’24 and Mar’26 are currently only 1pb stronger at 7.09% and 7.14%, respectively. In the meantime, real-rate securities hold a marginally positive bias, also appreciating 1bp on average, and pairing a stronger rally earlier today. In a similar fashion, the MXN is up by 1% on the day to 18.62 per dollar, reverting some of the move that pushed it towards 18.47, virtually its YTD high. We highlight that markets are again pricing-in potential rate hikes by Banxico during the rest of the year of about +43bps, broadly stable and very near our own expectation of +50bps, after shifting lower at the beginning of last week near +30bps following a batch of lower-than-expected data in the US and a more dovish bias by Banco de Mexico. Moreover, the reversal of some currency gains help explain the moderation in rates, with some concerns over pass-through effects on inflation still in place among market participants, confirmed by the higher-than-expected core reading.

In terms of strategy, last Friday we recommended taking profits in long positions on the belly of the Mbonos curve (Jun’22, Dec’23, and Dec’24), waiting for better entry levels in a context of heightened geopolitical uncertainty and future actions by central banks. In spite of the market-friendly result in France, we believe current valuations are expensive after the rally observed in 1Q17, as seen in the strong flattening of the curve and risk premium contraction. Regarding CPI-linked bonds, we still believe they have already incorporated negative news about inflation dynamics in 2017 that will hardly extend in coming years. In FX, we also wait for better entry levels to evaluate new positions in favor of MXN, which we see as attractive above 19.00 per dollar. We locate a strong support still validated at the 18.46-18.50 zone that so far has not been able to breach despite the positive risk environment in global markets.

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