

Inflation in the first half of June in line with our forecast

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- **INEGI just published its inflation report for in the first half of June**
- **Headline inflation (1H-June): 0.02% 2w/2w; Banorte-Ixe: 0.02% 2w/2w; consensus: 0.1%2w/2w**
- **Core inflation (1H-June): 0.16% 2w/2w; Banorte-Ixe: 0.09% 2w/2w; consensus: 0.14% 2w/2w**
- **Inflation in the first half of June was explained by pressures on other goods prices along with increases in processed foods prices**
- **With these numbers, annual inflation is at 2.55% vs. 2.6% in previous month**

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Consumer prices decreased 0.45%*m/m* in May, in line with forecasts. Core inflation was 0.21% also similar to our estimates. The main deviation from our forecast comes from: (1) A larger than expected reduction in agricultural prices (-7.4bps vs. our -6.5bps); along with (2) a larger than expected contribution of services prices (7.2bps vs. our 6.7bps), as shown in the table below.

Consumer prices increased 0.02%*2w/2w* in in the first half of June, in line with our forecast (consensus: 0.1%). Core inflation was 0.16% vs. our 0.09% estimate. The main deviation from our forecast comes from: (1) A lower than expected contribution of agriculture prices (-14.3bps vs. our -8.5bps); (2) an underestimation of energy prices (4.4bps vs. our 3.5bps); (3) an underestimation of services prices (5.1bps vs. our 3.2bps); and (4) a larger than expected contribution of goods prices (7.2bps vs. our 4bps), as shown in the table below

Inflation by components in the first half of June
% bi-weekly incidence

	INEGI	Banorte-Ixe	Difference
Total	0.02	0.02	0.00
Core	0.12	0.07	0.05
Goods	0.07	0.04	0.03
Processed foods	0.04	0.02	0.01
Other goods	0.04	0.02	0.02
Services	0.05	0.03	0.02
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.01	0.02
Non-core	-0.10	-0.05	-0.06
Agriculture	-0.14	-0.09	-0.06
Fruits & vegetables	-0.10	-0.07	-0.03
Meat & eggs	-0.05	-0.02	-0.03
Energy & government tariffs	0.05	0.04	0.01
Energy	0.04	0.03	0.01
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 June was explained by pressures on merchandise prices offset by lower agricultural prices. Merchandise prices increased 0.2% 2w/2w on the back of increases in the prices processed foods (0.22%), and of other goods (0.19%). Meanwhile, services inflation increased 0.13% 2w/2w, as a result of housing costs up 0.12% -in particular, in homeownership costs-, coupled with a 0.04% increase in education costs and a 0.117% increase in other services prices. The *INEGI*'s report mentions the costs of restaurants (0.2%), airfares (8%), and of tourism services (1.5%), among the products with rising prices.

Within the non-core index, energy prices were up 0.3% 2w/2w amid the higher prices of low-grade gasoline. However, agricultural prices edged down -1.5% 2w/2w with products such as red tomatoes (-2.9%), eggs (-5.4%), lemons (-37%), onions (-6.4%), poultry (-1%), and *Husk* tomatoes (-17.4%), among others.

With these numbers, annual inflation is at 2.55% vs. 2.6% in previous month. Meanwhile, core inflation is at 2.98% from 2.93% in May. The downward trend in agricultural goods prices have offset the pressures observed in the core index, where we can see a moderate pass-through from exchange rate to prices. We highlight that merchandise inflation passed from 2.8% at the end of last year to 3.6% in the first half of June, while services prices have increased from 2% to 2.46%. Looking ahead, we expect inflation to continue rising to levels around 2.8% in the coming months.

From our fixed income and FX strategy team

Figures confirm well-behaved inflation dynamics, while markets could show greater appetite for Udibonos in 2H16. The CPI report surprised to the downside with a +0.02% 2w/2w growth rate, 8bps below market consensus although matching our economists' forecast. In contrast, core prices were up by 0.16%, higher than expectations and the previous bi-weekly print at 0.11%. Considering today's report and yesterday's close, inflation breakevens stood at 3.11%, 3.19%, 3.08%, and 2.98% in 3-, 5-, 10-, and 30-year tenors, respectively, confirming the market's positive assessment regarding inflation dynamics. Nevertheless, we should recognize that UDIS's carry could improve substantially as seasonally higher inflation levels are coming in 2H16, potentially resulting in greater appetite for Udibonos during the summer. Local rates have conveyed the market's global hush taking into account recent polls in the United Kingdom where *Bremain* gained momentum over *Brexit*, in tandem with the relief rally observed following the dovish tilt in the Fed's latest communiqué released last week and Yellen's recent comments. In terms of strategy, we hold a cautious stance despite acknowledging an attractive valuation in the Mbonos market, especially in the 20-year segment. However, we prefer waiting for the resolution on *Brexit* and better and more stable market conditions for long directional positions in the 20-year tenor.

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