

August CPI getting closer to the central bank's 3% target

- **INEGI** just published its inflation report for August
- **Headline inflation (Aug): -0.02% m/m; Banorte: 0.02%; consensus: -0.02% (range of estimates: -0.04% to 0.05%); previous: 0.38%**
- **Core inflation (Aug): 0.20% m/m; Banorte: 0.20%; consensus: 0.19% (range of estimates: 0.17% to 0.22%); previous: 0.26%**
- **Once again, inflation during the period was benefitted by low pressures at the non-core component, declining 0.7% m/m and resulting in a negative contribution of 17bps**
- **With these figures, annual headline inflation fell strongly, to 3.16% from 3.78% in July, lowest since October 2016. Core-inflation also declined although at a much slower pace, to 3.78% from 3.82%**
- **We reiterate our year-end forecast for inflation of 3.3%, with today's report supporting our view that Banxico will cut the reference rate two more times this year, each by 25bps, in September and December**
- **The inflation backdrop is supporting the idea of a lower reference rate in Mexico in coming months and positive for our trade ideas in Mbonos Nov'38 and Nov'42**

Consumer prices fell 0.02% m/m in August. This number was in line with consensus and slightly lower than our forecast (+0.02%). Core inflation stood at 0.20%, lower than the previous month at 0.26%. The main deviations within the main components came from: (1) A lower than expected contribution from agricultural goods (-16bps vs. our -12bps), driven by both fresh fruits and vegetables (-6bps vs. our -5bps) and meat and egg (-10bps vs. our -7bps); (2) a slightly lower impact in services (3bps vs. our 4bps); and (3) a slightly stronger contribution from government-regulated prices (2bps vs. our 1bp), as shown in the table below:

August inflation by components

% monthly incidence

	INEGI	Banorte	Difference
Total	-0.02	0.02	-0.03
Core	0.15	0.15	0.00
Goods	0.12	0.11	0.01
Processed foods	0.04	0.03	0.00
Other goods	0.08	0.08	0.01
Services	0.03	0.04	-0.01
Housing	0.03	0.04	-0.01
Education	0.04	0.04	0.00
Other services	-0.04	-0.04	-0.01
Non-core	-0.17	-0.13	-0.04
Agriculture	-0.16	-0.12	-0.03
Fruits & vegetables	-0.06	-0.05	-0.01
Meat & egg	-0.10	-0.07	-0.03
Energy & government tariffs	-0.01	-0.01	0.00
Energy	-0.04	-0.04	0.00
Government tariffs	0.02	0.01	0.02

Source: INEGI, Banorte.

Note: Contributions might not add due to the number of decimals allowed in the table.

September 9, 2019

www.banorte.com

@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

Juan Carlos Alderete, CFA

Senior Economist, Mexico
juan.alderete.macal@banorte.com

Francisco Flores

Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Alejandro Padilla

Head Strategist – Fixed-Income and FX
alejandro.padilla@banorte.com

Santiago Leal Singer

Fixed-Income and FX Strategist
santiago.leal@banorte.com

Leslie Orozco

Fixed Income and FX Strategist
leslie.orozco.velez@banorte.com

Document for distribution among public

Inflation increased 0.05% 2w/2w in the second fortnight, albeit with agricultural goods prices still declining. Specifically, this last component contracted 0.15% 2w/2w, subtracting 2bps during the second half of the month. As a result, in the monthly comparison they fell 1.50%, contributing with -16bps. Among the products in this category with the largest price declines, the report included: poultry (-8.2%), onions (-18.6%), avocados (-13.7%), and tomatoes (-2.0%). It should be noted that the latter good, which fell 2.6% in the first half, maintained this trend despite the deal reached by the US and Mexico on August 21st to end the anti-dumping investigation, that had resulted in a tariff of 17.5% to our country's exports since May. In contrast, some pressures were registered in eggs (5.5%), lemons (31.2%) and oranges (19.4%). In addition, energy prices subtracted 3.6bps. We highlight that low-grade gasoline decreased 0.4%, m/m despite of exchange rate pressures and lower excise tax subsidies during the month. On the contrary, electricity increased 0.7% even though the *Energy Regulatory Commission* (CRE) announced a 0.8% monthly reduction in the base tariff, starting in August.

Meanwhile, core inflation added 15bps to the headline. As expected, education was among the most pressured given the seasonal increase in high school (2.2%) and college (1.7%) fees. Also relevant, processed foods increased 0.1%. Meanwhile, other goods added 8bps. In our view, this may be a result of recent pressures in the exchange rate. On the contrary, the core component was helped by more modest pressures in other services, driven by lower airfares (-19.8%) and tourism services (-7.5%) but which could be starting to show more modest pressures given the deceleration of economic activity.

Annual inflation is getting very close to the central bank's target, standing at 3.16% from 3.78% in July. In bi-weekly terms, this is a new low since late October, 2016. In this respect, analysts' expectations for year-end inflation have adjusted strongly to the downside since the release of the first fortnight, which surprised significantly lower.

According to Banxico's survey, the market's median forecast now stands at 3.4% (previous: 3.7%). This remains slightly below our 3.3% estimate. Some of the risks to our forecast include: (1) The possibility of a reversal in energy prices, particularly low-grade gasoline, as subsidies are gradually retired in a context of relatively low flexibility in fiscal accounts; (2) pressures in agricultural goods, particularly tomatoes after the agreement between the US and Mexico described above, although without signs of reversing yet; and (3) additional stickiness and upside pressures at the core, given the strong advance in wage negotiations so far in 2019 and without discarding additional and sizable increases in the minimum wage by the end of this year.

In a similar fashion, Banxico's updated forecast path for headline inflation in the latest *Quarterly Report* also declined significantly, with 4Q19 average annual inflation slashed 50bps to 3.2%. For details, see: "*Banxico QR – New estimates match the recent dovish shift*", <[pdf](#)>, August 28th, 2019. This is relevant *per se*, but also considering that the absolute level of inflation is only 20bps above Banxico's target.

Although the central bank has recognized that this is mostly because of the steep fall in non-core inflation, it is our take that the central bank has also signaled a more comfortable stance with inflation going forward, mainly given the pricing policy of energy of the new administration, and the anticipated moderation of demand-side pressures for inflation given a wider slack in the economy.

We reiterate our view that Banxico will cut the reference rate two more times this year, each by 25bps, in September and December. In this respect, survey data about the economy in 3Q19, such as IMEF PMI's, signal that the economy remains in low-gear mode. Meanwhile, central banks around the world have stayed dovish, including the US Fed, providing room for Banxico to also cut. Finally, we believe the 2020 Budget, released yesterday, shows that the Federal Government remains committed with maintaining healthy public finances, which is relevant as it has been increasingly stressed by the central bank as a risk factor. All in all, we think that conditions remain in place for the central bank to continue with the easing cycle that in our view started in August.

From our fixed income and FX strategy team

The inflation backdrop is supporting the idea of a lower reference rate in Mexico in coming months and positive for our trade ideas in Mbonos Nov'38 and Nov'42. The annual headline inflation continues trending downwards, approaching rapidly to Banxico's target. Today's report came in line with market expectations, with the annual reading moving from 3.78% in July to 3.16% in August. This positive landscape in terms of inflation, in tandem with lower growth rates and dovish central banks worldwide, will give support to the thesis that the Mexican central bank will continue easing monetary conditions in coming months, with an implied probability of 53% for a rate cut on September 26th embedded in the yield curve. In addition, the market is pricing in -59bps of implied cuts of the repo rate in the remaining of 2019 and -174bps until 2020-end. On the other hand, CPI-linked Udibonos continue underperforming nominal-rate Mbonos as the UDI-related carry has been blurred by better than expected inflation prints since May and current valuation in breakevens. Mbonos rallied 42bps in August and 3bps last week, while Udibonos observed a mixed performance in August (22bps of sell-off in shorter tenors and 14bps gains in long-term securities) and finished basically unchanged last week. Short-term breakevens are trading 70bps lower from the levels observed two months ago, hovering around 3.17%, while the 10-year and 30-year breakevens 22bps lower at 3.62% and 3.81%, respectively. Although relative valuation for Udibonos has improved, we expect market participants to maintain a stronger appetite for Mbonos. Taking into account current conditions we hold our trade recommendation of long positions in Mbonos Nov'38 and Nov'42 started on August 16th.

Disclaimer

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalía Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

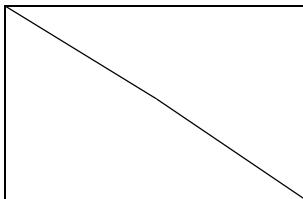
Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY HOLD SELL	When the share expected performance is greater than the MEXBOL estimated performance. When the share expected performance is similar to the MEXBOL estimated performance. When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V., since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Luis Leopoldo López Salinas	Analyst, Global Economist	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Manager, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454