

April's Inflation – Summer discounts on electricity prices ease pressures from fruits and vegetables' higher prices

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- **INEGI just published its inflation report for April**
- **Headline inflation (Apr): 0.12% m/m; Banorte-Ixe: 0.1% m/m; consensus: 0.06% m/m (range of estimates: -0.03% to 0.11%); previous: 0.61% m/m**
- **Core inflation (Apr): 0.45% m/m; Banorte-Ixe: 0.46% m/m; consensus: 0.46% m/m (range of estimates: 0.41% to 0.48%), previous: 0.57% m/m**
- **Inflation in April was explained by the start of the summer discounts in electricity prices, which held off the impact from higher fruits and vegetables prices**
- **With these numbers, annual inflation stands at 5.82%, above the 5.35% seen in March**
- **We continue to expect year-end inflation at 5.7%**
- **Higher-than-expected inflation could keep investor's bid in Udibonos**

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Consumer prices increased 0.12% m/m in April (Banorte-Ixe: 0.10% m/m).

In addition, core inflation grew 0.45% m/m, in line with our estimate. The main deviation from our forecast comes from: (1) A higher than expected contribution of fruits and vegetables prices (12bps vs our 9bps); (2) a lower than expected contribution of meat and egg prices (5bps vs our 8bps); and (3) a higher contribution of energy prices (-42bps vs. our -44bps), as shown in the table below.

April inflation by major subcomponent

Monthly incidence, %

	Observed	Banorte-Ixe forecast	Difference
Headline	0.12	0.10	0.03
Core	0.34	0.34	-0.01
Goods	0.21	0.20	0.00
Processed foods	0.10	0.11	0.00
Other goods	0.11	0.10	0.01
Services	0.13	0.14	-0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.11	-0.01
Non-core	-0.21	-0.25	0.04
Agricultural	0.17	0.17	0.00
Fresh fruits and vegetables	0.12	0.09	0.03
Meat and egg	0.05	0.08	-0.02
Energy and government regulated	-0.39	-0.42	0.03
Energy	-0.42	-0.44	0.02
Government regulated	0.04	0.03	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 April was explained by the start of the summer discounts in electricity prices, which held off the impact from higher fruits and vegetables prices. In particular, electricity tariffs came down 13.36% m/m, as summer discounts came into effect. Along with this, prices of gas and low grade gasoline prices decreased 3.30% m/m and 0.26% m/m, respectively. Together, these categories subtracted 42.1bp to inflation during the period in question. Such declines were offset by the pressures in agricultural prices, fresh fruits and vegetables rose 3.53% m/m –due to higher tomato (25.59% m/m), avocado (18.54% m/m) and chilies (16.43% m/m) prices–, as well as prices of meat and egg, up 0.64% m/m –driven by higher prices of poultry (2.25% m/m)–. Moreover, processed foods prices were up 0.64% m/m, on the back of increases in the price of dairy products.

Finally, services inflation was 0.32% m/m, explained by higher housing (0.19% m/m) and other services prices (0.54% m/m). Within this last category, we highlight pressures on the price of dining away from home items (0.76% m/m) and tourism services (3.46% m/m).

With these numbers, annual inflation stands at 5.82%, 47bp above the previous figure. Moreover, core inflation in the first half of April increased from 4.48% to 4.72%. 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

Higher-than-expected inflation could keep investor's bid in Udibonos. Broadly in line with our expectations but less than market consensus, inflation surprised to the upside in April, with the annual rate pushed from 5.62% in March to 6.01%. In our view, the difficult short-term inflation backdrop is likely to keep the relatively strong appetite for inflation-linked securities for now, particularly from local institutional investors. In this context and despite some increase in inflation breakevens in recent days and expectations of a negative carry from UDIS's during 2Q17, it is our take that the most attractive valuation in these instruments is in the 10-year zone. On the other hand, short-term inflation dynamics suggest that market pricing of Banxico's rates hikes during the rest of the year is limited to the downside, currently at 53bps (Banorte-Ixe: +50bps). As a result, we see short-term rates as fairly valued at current levels. In terms of strategy and even though we acknowledge that Mexican sovereign securities are still attractive (mainly against other EM and G10), we suggest waiting for better entry levels for long directional position in Mbonos. We take into account the low duration-adjusted premium in the long-end as a result of the strong flattening bias since last year, granting a more attractive relative valuation in the belly of the curve, mainly those in the 5- to 10-year zone.

In FX, the Mexican peso reacted with a brief loss after the report, going from 19.20 to a maximum of 19.24 per dollar but has reversed the move at the time of writing, influenced more heavily to external factors and broad USD strength. Since last Friday we advised buying USD/MXN on dips around 19.00 per dollar for trading purposes. Similar to our rates outlook, we continue avoiding directional positions at current levels. Nevertheless, we believe that the cross could test the 19.30 resistance zone in coming days, which in case of a strong break could open the way to the 19.60 zone, near a key technical resistance at the 200-day MA currently at 19.64 per dollar.

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