June inflation – Another upward surprise pushes the annual rate to 3.3%

- **Headline inflation (June): 0.55% m/m; Banorte: 0.42%; consensus: 0.44% (range of estimates: 0.36% to 0.59%); previous: 0.38%**
- **Core inflation (June): 0.37% m/m; Banorte: 0.27%; consensus: 0.30% (range of estimates: 0.27% to 0.38%); previous: 0.30%**
- **The increase was distributed almost evenly among core and non-core prices. In the former, we observed a rebound in goods (0.6%) relative to the previous month, especially in other goods (0.9%), which may be related to the reopening of the economy. In the latter, we highlight higher energy prices (6.0%) along pressures in meat and egg (1.0%)**
- **Annual inflation increased to 3.33% from 2.84% in May, slightly above target but still quite muted. Core inflation was also pressured at the margin, at 3.71% from 3.64%. In this context, we maintain our year-end forecast at 3.2%, although we recognize risks to the upside**
- **Price pressures consistent with our view of better carry conditions for inflation-linked Udibonos in the second half of 2020**

Consumer prices increase 0.55% m/m, above expectations. This was higher than consensus at 0.44%, which matched very close to our forecast (0.42%). We highlight several changes, both at the core and non-core. In the former, goods drove again most of the increase (0.6%), although now concentrated in other goods (0.9%) while processed foods moderated (0.4%) after increasing more than 1% in the previous two months. In our view, this may be related to the reopening of the economy, which started this period. On the other hand, services were more stable at 0.1%, practically in line with May. The latter advanced 1.12%, driven by higher energy prices (6.0%), with low-grade gasoline adding 39bps while LP gas was also up, contributing 6bps. Agricultural goods were down 2.1%, but with a mixed performance inside as fresh fruits and vegetables declined but meat and egg observed relevant pressures, particularly in the second fortnight.

June inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.55	0.42	0.13
Core	0.28	0.21	0.07
Goods	0.24	0.16	0.08
Processed foods	0.08	0.05	0.03
Other goods	0.16	0.11	0.05
Services	0.04	0.05	-0.01
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.04	-0.01
Non-core	0.27	0.21	0.06
Agriculture	-0.23	-0.27	0.04
Fruits & vegetables	-0.29	-0.31	0.01
Meat & eggs	0.06	0.04	0.02
Energy & government tariffs	0.50	0.47	0.03
Energy	0.51	0.48	0.03
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.

July 9, 2020

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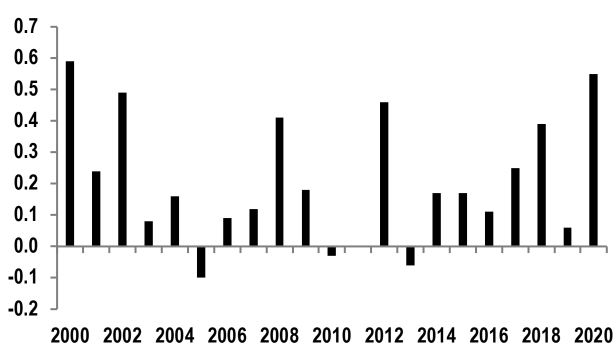
June inflation: Goods and services with the largest contributions
% m/m; monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	m/m
Low-grade gasoline	39.0	8.9
Chicken	11.9	8.3
LP gas	6.3	3.2
High-grade gasoline	3.8	6.7
Oranges	3.3	18.1
Goods and services with the largest negative contribution		
Tomatoes	-16.3	-20.8
Eggs	-7.6	-7.8
Serrano chilies	-4.0	-21.6
Lemons	-2.6	-20.3
Beer	-2.6	-1.8

Source: INEGI

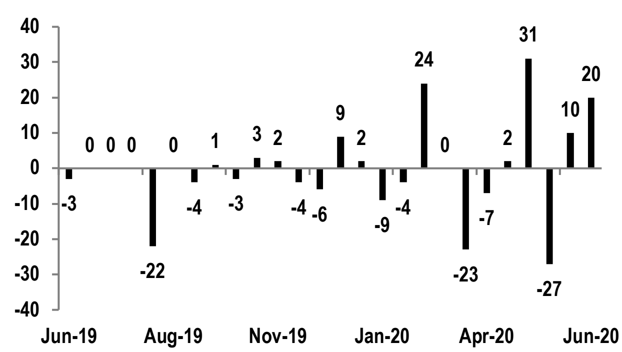
We still expect year-end inflation at 3.2%, with risks to the upside. After recent prints, including today's report, we recognize that upside risks have increased, particularly driven by: (1) Core prices showing pressures despite higher slack in the economy, concentrated mostly on goods; and (2) the non-core component rising at a faster rate than we had anticipated. In this context, we also note that June's result was the highest for the same month since year 2000 (see chart below, left). In addition, we also point out that recent surprises have been skewed to the upside (see chart below, right) and have shown higher volatility –in our view, mainly due to distortions caused by the pandemic–. On the other hand, we note the median forecast according to the latest central bank survey has caught up and even slightly surpassed our estimate, standing at 3.3% from 3.1% previously. In contrast, we believe the central bank could be signaling that their expected trajectory may be biased to the upside. In this respect, we will be focused on additional comments in this front in Banxico's minutes, to be released later today. In either case, we continue believing that the inflation outlook keeps the the window open for the central bank to continue easing policy. Specifically, we expect two additional cuts this year of 50bps each, in August and September, taking the rate to 4.00%, where we estimate the end of the current easing cycle. We think most of the Board keeps favoring a cautious approach, given that: (1) Uncertainty –both domestic and foreign– remains very high, which could exacerbate financial stability concerns if the rate is too low; (2) core inflation has been unable to move decisively below 3.50% despite the high degree of economic slack, with mid- and long-term expectations remain above target; and (3) geopolitical concerns could build up later this year, particularly ahead of the US elections on November 3rd.

Headline inflation in June
% m/m



Source: INEGI

Inflation surprises
Bps, actual minus median forecast, bi-weekly frequency



Source: INEGI and Bloomberg

From our fixed income and FX strategy team

Price pressures consistent with our view of better carry conditions for inflation-linked Udibonos in the second half of 2020. Today's report showing an upward surprise, once again, continues to favor our view of better carry conditions for Udibonos during the second half of 2020. In this sense, we wait for better entry levels for long positions in these securities, expecting a positive reaction in the Udibonos' curve in today's session, coupled with pressures in the Mbonos' curve. In this context, inflation breakevens have become more expensive in 3- and 5-year tenors since mid-June, currently trading at 3.17% from 2.81% and 3.05% from 2.94%, respectively. Regarding the 10- and 30-year, these have compressed in the same time frame, with stronger incidence in the former, standing at 3.44% from 3.60% and 3.65% from 3.75%, in the same order.

Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, 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.

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

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