

## 1H-August inflation – Still above expectations on core and non-core prices

- **Headline inflation (1H-Aug): 0.24% 2w/2w; Banorte: 0.13%; consensus: 0.13% (range of estimates: 0.06% to 0.26%); previous: 0.14%**
- **Core inflation (1H-Aug): 0.18% 2w/2w; Banorte: 0.08%; consensus: 0.14% (range of estimates: 0.06% to 0.17%); previous: 0.09%**
- **The core component remained on the upside (contribution: 14bps), explained by seasonal pressures in other goods (+0.4% 2w/2w), despite lower pressures in education (0.0%). Services provided slight signals of higher dynamism, at 0.1%. Within the non-core, agricultural prices increased 0.8% while energy was stable at 0.0%, with the latter helped by a decline in gasolines**
- **Annual inflation increased to 3.99% from 3.62% in July, highest in little over a year. Core inflation stood at 3.93% from 3.85% while non-core prices came in at 4.18 % from 2.92%, highlighting a more challenging base effect**
- **Despite this was not an entirely favorable print, we believe Banxico will continue cutting the reference rate. We maintain our view of -50bps on September 24<sup>th</sup>**
- **We hold a view of an attractive carry in Udibonos**

**Consumer prices up 0.24% 2w/2w in the first half of August.** This was above consensus, which matched our 0.13% forecast. The core increased 0.18%, relatively in line with previous years. Overall, a large part of the increase was due to an advance in other goods (+0.4%). Meanwhile, education was unchanged (0.0%), which we believe is an indirect effect of the pandemic, especially as “back to school” will be remote. Services remain modest at 0.1%, although starting to show some signs of a rebound. On the other hand, the non-core was 0.43%, with mixed changes. On the positive side, energy was unchanged (0.0%), benefited by lower gasoline prices. On the contrary, we saw some pressures in agricultural goods (0.8%), in line with our monitoring and likely with some impact to crops from hurricane Hanna at the end of July.

1H-August inflation by components  
%, bi-weekly incidence

	INEGI	Banorte	Difference
Total	0.24	0.13	0.11
Core	0.14	0.06	0.07
Goods	0.10	0.07	0.03
Processed foods	0.03	0.03	0.01
Other goods	0.07	0.05	0.03
Services	0.03	-0.01	0.04
Housing	0.01	0.00	0.01
Education	0.00	0.01	-0.01
Other services	0.02	-0.02	0.04
Non-core	0.11	0.06	0.04
Agriculture	0.08	0.06	0.02
Fruits & vegetables	0.11	0.04	0.07
Meat & eggs	-0.03	0.02	-0.05
Energy & government tariffs	0.03	0.00	0.02
Energy	0.00	0.00	0.00
Government tariffs	0.03	0.01	0.02

Source: INEGI, Banorte.

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

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1H-August inflation: Goods and services with the largest contributions

% 2w/2w: bi-weekly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% 2w/2w
Tomatoes	5.8	9.5
Water supply rights	2.6	2.8
LP gas	2.1	1.1
Lemons	1.8	15.7
Husk tomatoes	1.2	11.0
Goods and services with the largest negative contribution		
Low-grade gasoline	-2.7	-0.6
Chicken	-2.0	-1.2
Oranges	-1.6	-7.3
Eggs	-1.1	-1.3
Beer	-0.9	-0.6

Source: INEGI

**Market attention on Banxico’s *Quarterly Report* and minutes this week.** With these results, annual inflation increased to 3.99% from 3.62% in July, highest in little over a year. Core inflation stood at 3.93% from 3.85%, while non-core prices came in at 4.18% from 2.92%, highlighting a more challenging base effect in the latter –remembering that, in 2019, we saw a relevant decline in fresh fruits along lower pressures in energy, which extended further into September–. For 3Q20 so far, annual inflation –based on bi-weekly prints– has averaged 3.75%. This is relevant ahead of the publication of Banxico’s 2Q20 *Quarterly Report* (QR) on Wednesday, around 1:30pm (ET). [As detailed in our preview](#), we think the Board will make relevant upward adjustments to their inflation path for the rest of this year. In this backdrop, we think today’s result remains consistent with our view of an increase of around +30bps in 3Q20, to 3.8% from 3.5%, albeit with some upside risks. Notwithstanding, we also believe they will be less concerned about the mid-term outlook, as a result of ample slack in the economy, which should dampen demand-side pressures for prices. In this sense, services inflation has stayed muted at 2.4%, arguably the most sensitive component to domestic conditions. Moreover, we also see as positive that pressures in core goods, especially some staples, seem to have dampened somewhat since the previous fortnight, component that has raised some flags among Board members. We should warn also that we have only observed this in the last couple of bi-weekly figures, so it is too early to judge if it has indeed stabilized. Overall, considering these factors along our expectations for the QR and minutes (on Thursday), we reiterate our call of a 50bps cut on September 24<sup>th</sup>, to 4.00%, albeit with the risk towards more modest easing (only -25bps). Last but not least, we also maintain our year-end inflation estimate at 3.7% y/y, above market expectations and with risks still broadly balanced, in our view.

*From our fixed income and FX strategy team*

**We hold a view of an attractive carry in Udibonos for the remainder of 2020.**

Upward surprise in this Monday's CPI report continues to support our perspective of attractive carry gains in Udi-linked securities, which considering our inflation estimates implies 1.91% for the 129 days left in 2020 (5.40% annualized). Nevertheless, we acknowledge a valuation that has become more expensive with inflation breakevens elevating mainly in short-term tenors, averaging a +39bps increase for the 3- and 5-year readings in the last month. In this sense, the 3-year mark stands at 3.58% and the 5-year one at 3.47%. In tactical terms, we wait for better entries for new directional strategies ahead of a highly relevant agenda for Banxico this week where the market discusses on the magnitude for the last rate cuts this year.

## 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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