

1H-June inflation – Again above expectations, with pressures at the core

- **Headline inflation (1H-Jun): 0.34% 2w/2w; Banorte: 0.35%; consensus: 0.22% (range: 0.06% to 0.35%); previous: 0.17%**
- **Core inflation (1H-Jun): 0.35% 2w/2w; Banorte: 0.29%; consensus: 0.21% (range: 0.13% to 0.29%); previous: 0.22%**
- **The print showed pressures especially at the core. Among them, processed foods (0.4%) were pushed again by corn tortillas, among others. Others were even higher, at 0.5%, while services accelerated to 0.3% At the non-core, we flag fresh fruits and vegetables (0.8%), likely still affected by persistent droughts. Energy was mixed, highlighting LP gas (1.6%)**
- **Annual inflation inched higher, to 6.02% from 5.89% on average in May. The core reached 4.58% from 4.37% and the non-core to 10.61% from 10.76%, in the same order**
- **We expect today’s decision by Banxico to keep showing a hawkish tone, likely unanimous in maintaining the rate at 4.00%. Given inflation risks, we reiterate our call of two 25bps hikes in the final meetings of the year**
- **Inflationary pressures validate a hawkish perception for Banxico**

Inflation at 0.34% 2w/2w in 1H-Jun, still above expectations. The print was above consensus at 0.22%, but closer to our 0.35%. The core reached 0.35%, surprising even more to the upside. Specifically, processed foods (0.4%), pushed again by corn tortillas, among others. In turn, these are likely related to higher grain costs. Other goods were even higher, at 0.5%, with a potential reversal of *Hot Sale* discounts. In our view, services (0.3%) showed early signs of spending rebalancing on higher mobility and passthrough effects. At the non-core, fresh fruits and vegetables (0.8%) were likely still affected by severe droughts –mainly in the northwestern parts of Mexico and the US. Meat and egg fell 0.4%. Energy (0.6%) was mixed, with LP gas (1.6%) once again higher on international prices, albeit with low-grade gasoline (0.1%) helped by higher subsidies.

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

	INEGI	Banorte	Difference
Total	0.34	0.35	0.00
Core	0.27	0.22	0.05
Goods	0.17	0.14	0.03
Processed foods	0.08	0.09	-0.01
Other goods	0.09	0.05	0.04
Services	0.10	0.08	0.02
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.06	0.02
Non-core	0.08	0.13	-0.05
Agriculture	0.01	0.08	-0.07
Fruits & vegetables	0.04	0.08	-0.04
Meat & egg	-0.02	0.01	-0.03
Energy & government tariffs	0.06	0.05	0.01
Energy	0.06	0.04	0.01
Government tariffs	0.00	0.01	0.00

Source: INEGI, Banorte.

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

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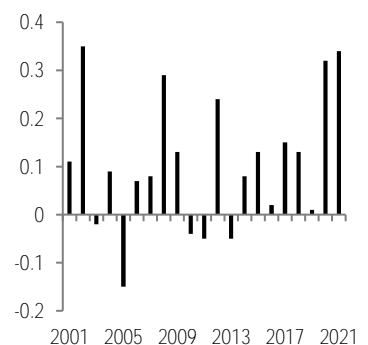
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Headline inflation in 1H-Jun
% 2w/2w



Source: INEGI

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1H-Jun 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	8.4	13.9
LP Gas	3.9	1.6
Dining away from home	2.9	0.6
Airfares	1.8	7.7
Oranges	1.6	10.0
Goods and services with the largest negative contribution		
Eggs	-3.4	-3.9
Serrano chillies	-2.0	-17.5
Chicken	-1.6	-0.9
Husk tomatoes	-1.2	-7.7
Lemon	-1.1	-8.4

Source: INEGI

Annual inflation higher at the margin despite a more benign base effect. This measure picked up to 6.02% from 5.89% on average in May (and 5.99% in the 2nd half of the latter month). This was observed even with a less challenging base effect, with inflation at 3.17% from 2.84% in the same period of 2020. Core inflation also increased, to 4.58% from 4.37%. In terms of price dynamics, year-to-date accumulated pressures reached 3.23%, highest for the same timeframe since 2000. Moreover, we note that [Banxico's forecast for average annual inflation for 2Q21](#) is 5.8%. For this to happen, inflation in the 2H-Jun needs to be at or below -0.38% 2w/2w. We see this as unlikely given that the five-year average (excluding 2020 because of the pandemic) for this period is +0.09%. We reiterate our year-end inflation forecast of 5.5%, albeit warning that risks seem to be skewing to the upside once again.

Banxico to stay unchanged and with a hawkish bias in today's decision. In the statement, to be released at 2:00pm ET, we expect the central bank to keep the reference rate at 4.00%, most likely with a unanimous vote. Nevertheless, we expect a hawkish tone. For more details, see our latest [Ahead of the Curve](#). In our view, the focus will be on the complex inflationary outlook. Specifically, we will be attentive to potential language tweaks given results that suggest a more adverse backdrop for prices at the margin, as seen today. Another factor to remain cautious is the less accommodative tone by the Fed last week and signals of a more restrictive stance in other countries (including Chile this week, among others). We reiterate our call of two 25bps hikes each in the November 11th and December 16th meetings. This would take the reference rate to 4.50% by the end of the year, expecting additional tightening at the beginning of 2022.

From our fixed income and FX strategy team

Inflationary pressures validate a hawkish perception for Banxico. The local yield curve prices-in ahead of Banxico's decision today a full 25bps hike for the September 30th meeting, with implied hikes of +36bps. For year-end it incorporates +74bps, slightly below the +77bps it reached to price in mid-May. It is worth considering the yield curve priced +50bps for December before the Fed's decision last week. Although this valuation is more elevated than our current estimate for the reference rate closing this year at 4.50%, today's report will validate the hawkish perception for Banxico. In this context, inflation breakevens have surged to fresh highs since 2010 in short-term readings, with the 3-year mark trading at 4.85%. Considering this enriching we prefer to wait for better entry levels in Udibonos.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalia 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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