

July inflation – Food items remain to the upside, pushing annual rates higher

- **Headline inflation (July): 0.74% m/m; Banorte: 0.80%; consensus: 0.73% (range: 0.71% to 0.80%); previous: 0.84%**
- **Core inflation (July): 0.62% m/m; Banorte: 0.63%; consensus: 0.58% (range: 0.54% to 0.63%); previous: 0.77%**
- **Core prices remain pressured, still concentrated in processed foods (1.0% m/m), highlighting items such as beverages and wheat-based products. In ‘other goods’ (0.4%), discount campaigns likely kept helping at the margin. Services (0.5%) were relatively high, recalling an adverse seasonality in tourism. At the non-core, agricultural (1.6%) moderated in the second half, while energy rose slightly (0.5%)**
- **Annual inflation picked up to 8.15% from 7.99% on average in June. The core advanced to 7.65% from 7.49%, higher for a 20th consecutive month**
- **We expect Banxico to increase the reference rate by 75bps on Thursday to 8.50%. We also think that they could revise their inflation forecasts higher and maintain a hawkish tone**
- **Markets widely expect a 75bps hike in next Banxico’s decision**

Inflation at 0.74% m/m in July, in line with expectations. Specifically, we note that the core at 0.62% was higher than the market, but closer to our call. Processed foods (1.0%) dynamics are still concerning, highlighting wheat-based products –recalling that Bimbo announced higher prices in its product catalog (*e.g.* pastries, loafs, tortillas), as well as sodas –not ruling out an impact from water scarcity in the northern part of the country. ‘Other goods’ (0.4%) were more muted, still benefited by summer discount campaigns, including supermarkets. In services (0.5%), airfares (5.2%) and tourism (3.5%) accelerated due to the holiday season as well as calendar changes to the end of the school year. Dining away from home is still reflecting passthrough from cost pressures. At the non-core, agricultural goods (1.6%) kept advancing in both fruits and vegetables (2.4%) and meat & egg (1.1%), albeit with negative variations in the second half of the month. Energy was higher at the margin (0.6%), mainly on domestic gas (0.7%) and electricity (1.4%)

July inflation by components
%, monthly incidence

	INEGI	Banorte	Difference
Total	0.74	0.80	-0.06
Core	0.47	0.47	0.00
Goods	0.29	0.30	-0.01
Processed foods	0.22	0.23	-0.01
Other goods	0.07	0.07	0.00
Services	0.17	0.17	0.00
Housing	0.04	0.04	0.00
Education	0.00	0.00	0.00
Other services	0.13	0.13	0.00
Non-core	0.28	0.33	-0.05
Agriculture	0.19	0.25	-0.06
Fruits & vegetables	0.12	0.15	-0.03
Meat & egg	0.07	0.10	-0.03
Energy & government tariffs	0.09	0.08	0.01
Energy	0.05	0.05	0.01
Government tariffs	0.04	0.03	0.00

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

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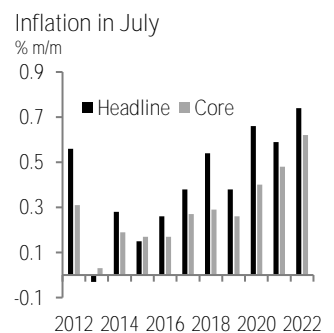
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July inflation: Goods and services with the largest contributions

% m/m: monthly incidence in basis points

Goods and services with the largest positive contribution	Incidence	% m/m
Eggs	7.8	8.3
Potatoes	5.3	12.0
Dining away from home	4.1	0.9
Oranges	3.3	15.5
Onions	3.1	13.8
Goods and services with the largest negative contribution		
Chicken	-3.9	-2.1
Avocados	-3.9	-8.9
Tomatoes	-2.9	-5.0
Grapes	-1.0	-16.8
Poblano chillies	-0.6	-10.7

Source: INEGI

Annual inflation still moving upwards. The headline stood at 8.15% y/y from 7.99% on average in June, above the 8% mark for the first time since January 2001. The core remains in focus, up to 7.65% from 7.49% in the same period, its 20th month on the upside. Despite still being early in the quarter, our forecasts suggest that headline inflation could keep moving higher in August, with the core extending the move in the same direction until September. Based on this, we do not rule out that Banxico revises higher its short-term inflation forecasts, with the headline and core forecasted at 8.1% and 7.4% on average, respectively. On the other hand, news has been mostly positive in terms of global commodity prices, with some declines in energy (oil, gasoline), grains and industrial metals. Coupled with a relatively stable exchange rate, this may help the non-core component and other input prices in coming months, dampening the rate of inflation. Nevertheless, it is too early to call, so the central bank will likely remain cautious. In this backdrop, we maintain our year-end inflation forecast at 8.1% (above consensus, at around 7.7%), with the core at 7.8% (market: 7.3%).

Banxico to hike 75bps on Thursday. In our view, conditions are set for the central bank to hike the rate by this magnitude to 8.50%, in line with consensus. Specifically, we note: (1) An adjustment of the same magnitude by the Fed in its July 27th meeting; (2) no meaningful evidence yet of an inflation slowdown, as well as renewed pressures at the core; and (3) an additional uptick in expectations, especially those for the mid-term, as informed by the central bank's survey. Moreover, it is our take that Banxico's cautiousness has played a key role in the relative stability of the exchange rate and the predictability of the monetary stance. In this backdrop, we expect another unanimous decision and a hawkish tone. There is a modest chance that Deputy Governor Esquivel votes for less. For details, please refer to our document, [Ahead of the Curve](#).

From our fixed income and FX strategy team

Markets widely expect a 75bps hike in next Banxico's decision. In a backdrop of inflationary pressures, the market is convinced that the central bank will hike by 75bps on August 11th, maintaining the pace of the previous meeting. In addition, it is pricing-in a moderation to +50bps in September and November, with a terminal rate of 9.50%. This is slightly below our call of a year-end rate at 10.00%. In this environment, August began with a strong flattening. Short-term Mbonos have lost 9bps on average, while long-term securities have rallied up to 23bps. Hence, the 2s10s spread stands at -65bps from -53bps at the end of July.

In similar fashion, the TIE-IRS curve has lost 21bps at the short-end and has seen few changes at the long-end. In our view, nominal rates will maintain a flattening bias despite inverted curves in the short- and mid-ends. This would happen as markets eventually recognize the need of even more monetary tightening than what is already discounted. For their part, CPI-linked bonds (Udibonos) begin to show higher relative value except for short-term securities, considering the recent rally in Mbonos. In this sense, the 5-, 10-, 20-, and 30-year breakevens have declined below their 12-month averages. We highlight the 5-year tenor, at 4.49%. However, we believe they still do not reflect enough relative value for new positions at these entry levels.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivios Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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