Economic and Financial Markets Research
Economic Research, Mexico

August 7, 2025

July inflation – Annual headline inflation falls, but challenges persist at the core

- **Headline inflation (July): 0.27% m/m; Banorte: 0.27%; consensus: 0.28% (range: 0.22% to 0.33%); previous: 0.28%**
- **Core inflation (July): 0.31% m/m; Banorte: 0.31%; consensus: 0.30% (range: 0.26% to 0.32%); previous: 0.39%**
- **The result was supported by the non-core at 0.13%. Agricultural products were more stable at 0.1% after several months of volatility –with improvements in both fruits and vegetables (0.2%) and meat and egg (0.1%)–, while energy maintained its favorable streak (0.1%). In the core, goods (0.2%) moderated at the margin, helped by 'others' (0.0%). However, services were higher (0.4%), with seasonal pressures in education (0.1%) and 'others' (0.5%), albeit with more structural issues persisting in the latter**
- **With a substantial base effect in play, annual inflation declined to 3.51% from 4.32% in June. However, core inflation remained above the target range at 4.23% (previous: 4.24%)**
- **We expect Banxico to cut its reference rate by 25bps to 7.75% later today, with our attention in the statement focused on the forward guidance and inflation estimates**

Inflation of 0.27% m/m in July. The result was supported by the non-core component at 0.13%. In detail, agricultural products were more limited at 0.1%, with a better performance in both fruits and vegetables (0.2%) –with increases in lettuces and potatoes, but with grapes and avocadoes down– and meat and egg (0.1%) –helped by chicken. In energy (0.1%), a favorable trend prevailed, with stability in low-grade gasoline (0.0%) and modest gains in electricity (0.4%) and LP gas (0.3%). Government tariffs rose 0.2%. Moving on to the core (0.31%), goods were slightly lower at 0.2%, helped by 'others' (0.0%). However, processed foods remained somewhat high at 0.4%. Services also maintained an upward bias at 0.4%, with an adverse seasonality partly impacting education (0.1%), but also 'others' (0.5%). In the latter we highlight tourism items (*e.g.* air fares at 8.9%). However, pressures on 'dining away from home' (0.5%) and 'restaurants' (0.4%) prevailed. Finally, housing moderated marginally to 0.3%.

July inflation: Goods and services with the largest changes
Monthly incidence in basis points; % m/m

Goods and services with the largest positive contribution	Incidence	% m/m
Eggs	6.0	5.9
Housing	4.0	0.3
Dining away from home	2.9	0.5
Air fares	2.2	8.9
Other cooked foods	2.0	0.9
Goods and services with the largest negative contribution		
Chicken	-7.0	-3.6
Grapes	-1.5	-18.4
Avocadoes	-1.2	-6.0
Tomatoes	-1.0	-1.9
Detergents	-0.9	-0.9

Source: INEGI


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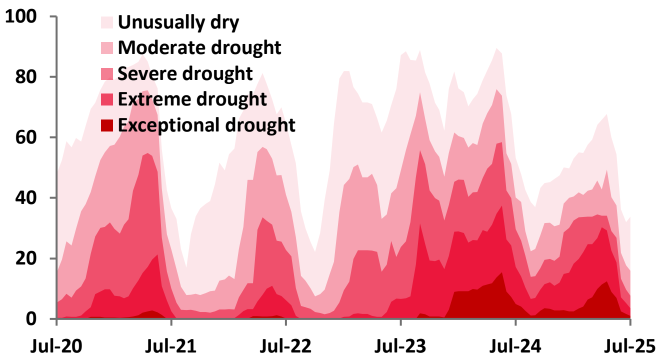
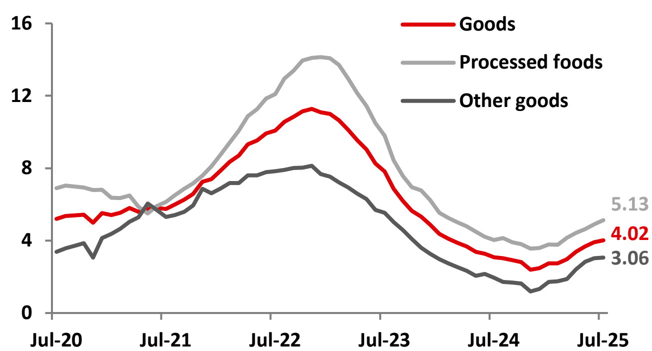
Strong moderation in the annual comparison for the headline due to a positive base effect, although the core remained high. With these results, headline inflation stood at 3.51% from 4.32% y/y in June. This was driven by the non-core at 1.14% (previous: 4.33%), with widespread decreases within. Many of these are explained by base effects, which is most evident in agriculture (0.2%). Recent dynamics have been more favorable for both fruits and vegetables and meat and egg, but price volatility could return relatively quickly. For the former, the rainy season has had a positive impact on drought levels (see chart below, left), while there are no relevant reports of crop losses due to excess water. However, we will continue to monitor the entry into force of tariffs on tomato exports to the US. As for the latter, international prices remain high. Combined with other phytosanitary issues, this could lead to further increases. Energy prices (0.8%) are facing a similar situation. At the margin, the latest actions by OPEC+ and the recent behavior of the Mexican peso against the dollar should help stability in the sector to prevail. Moving on to the core, it remained above the target range at 4.23% (previous: 4.24%). Goods continued to rise, now at 4.0%, with processed foods extending gains, but with 'others' stabilizing somewhat (see chart below, right). On the latter, it should be noted that adverse base effects will continue for the rest of the year, so they are likely to maintain an upward trend. Finally, services slowed marginally to 4.4%. Although there is a better trend for housing, we will continue to monitor: (1) The increase in education costs between August and September, considering that their annual metric remains high; and (2) 'other services', with structural challenges limiting a more substantial decline, as discussed in our *View from the Top*.

Drought monitor
% of the territory impacted



Source: Banorte with data from CONAGUA

Core inflation: Goods
% y/y, monthly frequency



Source: Banorte with data from INEGI

Banxico will cut its reference rate by 25bps to 7.75% later today. This will be the fifth reduction so far this year, extending the cycle, albeit at a slower pace. We believe the vote will be divided again (4-1), with Deputy Governor Jonathan Heath opposing. Despite this, we expect the dovish tone to prevail among the remainder members of the Board, resulting in little or no changes to the forward guidance, which in turn would suggest that cuts will likely continue in subsequent decisions. On inflation, we believe recent dynamics could prompt a limited adjustment down in short-term forecasts for the headline, although the core will likely be revised upwards.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Santiago Leal Singer, Víctor Hugo Cortes Castro, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Carlos Hernández García, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, José De Jesús Ramírez Martínez, Daniel Sebastián Sosa Aguilar, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Marcos Saúl García Hernandez, Juan Carlos Mercado Garduño, Ana Gabriela Martínez Mosqueda, Jazmin Daniela Cuautencos Mora, Andrea Muñoz Sánchez and Paula Lozoya Valadez, 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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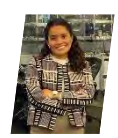

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