1H-July inflation – The downward trend continues, but some risks are materializing

July 24, 2023

- **Headline inflation (1H-Jul): 0.29% 2w/2w; Banorte: 0.28%; consensus: 0.26% (range: 0.22% to 0.50%); previous: 0.16%**
- **Core inflation (1H-Jul): 0.24% 2w/2w; Banorte: 0.26%; consensus: 0.22% (range: 0.16% to 0.28%); previous: 0.21%**
- **Within the non-core (0.44%), energy remained to the downside (-0.3%), dragged once again by LP gas (-2.8%). Nevertheless, dynamics in agricultural items were more adverse (1.1%), noting a relevant increase in fruits and vegetables (3.1%) for a third consecutive fortnight. In the core (0.24%), goods (0.2%) grew once again, highlighting a slight rebound in processed foods (0.2%). In services (0.3%), increases persist given the seasonality on tourism categories**
- **In bi-weekly terms, annual inflation fell to 4.79% from 4.93%. The core came in at 6.76% from 6.86%, still showing some reluctance to decline**
- **We believe the outlook remains challenging for Banxico, supporting our view that the monetary pause will extend through the remainder of the year, with the first cut materializing until February**
- **We cut our preference for nominal vs real rates**

Inflation at 0.29% 2w/2w, slightly above consensus. In the non-core (0.44%), energy prices fell again (-0.3%), with LP gas (-2.8%) more than offsetting increases in low-grade gasoline (0.1%) and electricity (0.6%). On a more negative note, agricultural items advanced 1.1%, with a notable rise in fruits and vegetables (3.1%; adding three fortnights with strong increases), albeit with meat and egg to the downside (-0.5%). In particular, we highlight expansions in avocadoes, onions, and oranges, to name a few. Within the core (0.24%), goods remain somewhat high (0.2%), with processed foods (0.2%) impacted by adjustments to the upside in sugar and some alcoholic beverages. 'Others' (0.1%) benefited at the margin from the start of summer sales in clothing. Services climbed 0.3%, with 'others' (0.5%) affected by seasonal increases in airfares (15.9%) and tourism services (7.5%) ahead of the summer holiday period.

1H-July 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
Avocadoes	4.4	18.5
Airfares	3.7	15.9
Onions	2.9	16.1
Tourism services	2.4	7.5
Oranges	2.2	8.7
Goods and services with the largest negative contribution		
LP gas	-3.9	-2.8
Eggs	-3.0	-3.2
Tomatoes	-1.5	-3.0
Grapes	-1.3	-17.8
Potatoes	-1.1	-2.3

Source: INEGI

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Annual inflation keeps declining, although the core keeps showing more reluctance to the upside. In bi-weekly terms, headline inflation fell to 4.79% from 4.93%, accumulating a 398bps decline relative to its peak in this cycle (8.77% in 2H-August 2022). Meanwhile, the core came in at 6.76% (previous: 6.86%), retreating 191bps vs. its peak (8.66% in the 1H-November 2022). We think the divergence in the rate of decline could continue in the short-term, identifying more present risks for the latter stemming from the persistence of services at levels above 5.0% since July last year. We believe that these were initially impacted by the increase in various material inputs; however, as we have mentioned on previous occasions, they are currently more pressured by expansions in wage costs and partly by an adjustment in consumption patterns, resulting in greater demand pressures. Turning to the non-core –at -0.97% y/y from -0.74% in the previous fortnight–, we believe that the turning point is very close. Specifically, signals from the agricultural sector in this report were more adverse, a situation that we believe will extend with reports of more droughts, as well as the impact of the *El Niño* phenomenon. In addition, we believe that the room for improvement in energy could be more constrained, limiting additional gains on this front. Thus, and also considering base effects, we believe headline inflation will continue to moderate through October, reversing higher in the last months of 2023 to reach our 4.5% forecast.

Banxico will maintain its 'extended pause' for the remainder of the year. We believe that given the challenges on inflation and less room to maneuver in terms of the relative monetary stance –with the Fed raising the *Fed funds* rate further–, Banxico will maintain a cautious stance, postponing the first cut until February next year. For us, this became more evident in the latest minutes, where we identified a more hawkish tone from the Board. In this context, and with little participation of its members during the summer, our attention turns to the information that will be contained in the statement of its next decision, taking place on August 10th.

From our fixed income and FX strategy team

We cut our preference for nominal vs real rates. In terms of strategy, we reduce our preference for nominal vs. real rates, considering a significant decline in breakevens for all terms. We see more relative value in 3-year CPI-linked bonds (Udibonos) with a breakeven below 4.00%, a level that has previously triggered strong buying interest. This shift was also reflected in investors' preferences in the last weekly government auction. 3-year securities were placed at nominal and real rates, the Mbono Sep'26 and the Udibono Dec'26, respectively. Appetite for the former collapsed to two-year lows at 1.65x, while demand for the latter remained strong at 2.56x.

Analyst Certification

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, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Juan Carlos Mercado Garduño, Daniel Sebastián Sosa Aguilar, Jazmin Daniela Cuautencos Mora and Andrea Muñoz Sánchez, 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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