

LATAM Market Update

- **Mexico:** Inflation in line with expectations in July
- **Chile:** Consumer prices rise 0.2% m/m in July with relevant recovery in core prices (0.3% m/m)

MEXICO: INFLATION IN LINE WITH EXPECTATIONS IN JULY

In July, headline inflation printed at 0.38% m/m, in line with market expectations (0.37% m/m) and below last year's result (0.54% m/m). This outcome was mainly driven by monthly increases in the prices of housing, air transportation, and tourism services, which were partially offset by the decline in energy prices (gas and electricity) and some agricultural commodities. In its annual comparison, inflation decelerated from 3.95% y/y in June to 3.78% y/y in July, standing within the central bank's target range for the second consecutive month. Furthermore, the core and non-core components registered annual price increases of 3.82% (from 3.85% in June) and 3.64% (from 4.19% in June), respectively.

Even though the core component has not shown a clear downward trend, these results take some pressure off Banxico's Board of Governors at its next monetary policy meeting scheduled for August 15th. As a result, we expect the institution to maintain a neutral tone while leaving the interest rate unchanged.

CHILE: CONSUMER PRICES RISE 0.2% M/M IN JULY WITH RELEVANT RECOVERY IN CORE PRICES (0.3% M/M)

CPI in July of 0.2% (2.2% y/y) is in line with our forecast, satisfying our vision that we will have more inflation in the short term than expected by the market. Core CPI at 0.3% m/m is above what was expected by the market. This inflation record introduces caution to the vision of cutting 50 bps at the Central Bank meeting in September, and supports our view of a 25 bps cut justified mainly by negative surprises in terms of activity.

Core prices rose 0.3% m/m (2.2% y/y), with goods increasing 0.1% m/m (1.2% y/y) and services 0.4% m/m (2.8% y/y) (chart 1). By divisions, transport and health showed significant increases, but there is a wide-spread increase in prices that affects all divisions (chart 2). Furthermore, the diffusion index for headline inflation remains around its historical average (51.8%), showing no evidence of significant deflationary pressures, despite the sluggish activity dynamic (chart 3).

At the goods level, it is worth noting that its diffusion was high, reaching 50% and becoming the highest level since 2013 for July (chart 4). This, in turn, reveals that CLP pass-through has started to materialize. Within services, bus transportation had the largest increase, but we believe this rise affects a wide range of services, not just transport. For instance, Rent, Domestic services and some Recreational services have started to rise, signaling that the indexation to both past inflation and higher wages is on track. Prices reveal positive pressures that go beyond seasonal factors, which in turn suggests there is no evidence of deflationary pressures on the services side, as was claimed by the Central Bank (chart 5).

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Chart 1

Contributions to monthly inflation in July
(percentage points, monthly contribution)

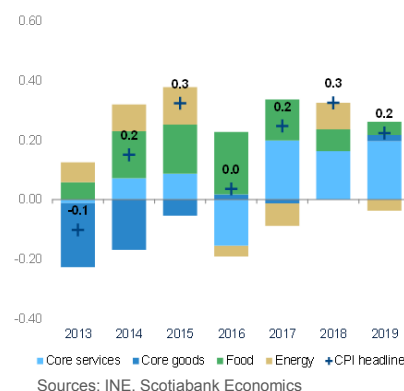
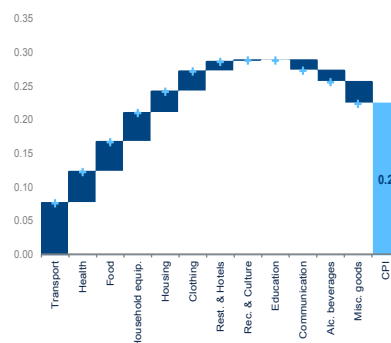


Chart 2

Contributions to inflation of Jul-19 by division
(percentage points, monthly contribution)



We expect the Central Bank to diagnose inflation that begins to respond to the multilateral depreciation of the peso. The spot Real Effective Exchange Rate stands at 96 pts which is above its historical averages, supporting the recovery of exports, but also introducing relevant cost-push shocks that we already observe in imported drugs and chemicals, among others.

At the product level, the main contribution to monthly inflation in July came from Inter-urban transport services, which increased 19.8% m/m, due to higher demand during winter break. Electricity bills also showed a significant increase of 1.5% m/m, and rent jumped 0.5% m/m. On the other hand, the biggest falls came from Food, with lemons decreasing 30% m/m and tomatoes falling 9.5% m/m.

Part of the positive surprise came from the Tourist package product. After its sharp increase in May (+23.4%), we were expecting a reversal that would bring back its price to historical levels. But this reversal has not occurred, neither in June nor July. We believe there has been a structural change in its price dynamic, which has been enhanced by the recent depreciation of the CLP. However, we still believe there are downside risks that could restore its historical price in the following months (chart 6).

In the upcoming months, we expect higher prints than implicit in market prices, due mainly to an update in electricity bills, rising fuels and increasing CLP pass-through. We believe the update in electricity bills, even though significant, will not reach the levels announced in the news (+10% m/m), because some items of this update are not taken into account by the INE's methodology. Indeed, we project an increase of around 4–5% m/m, effective in September or October. Regarding fuels, we estimate additional inflationary pressures in September due to seasonal adjustments in wholesale prices coming from higher quality premium in gasolines, which is implemented every year around this month (increasing prices around \$25 per liter).

Chart 3 Inflationary diffusion of headline CPI
(percentage of products with positive monthly inflation)

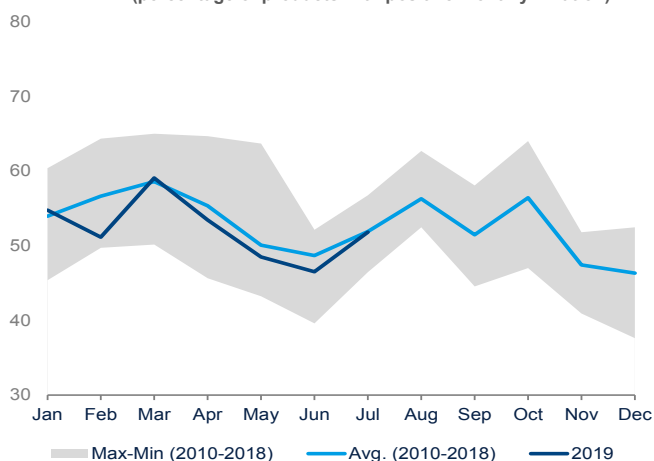


Chart 4 Inflationary diffusion of Core CPI of goods
(percentage of products with positive monthly inflation)

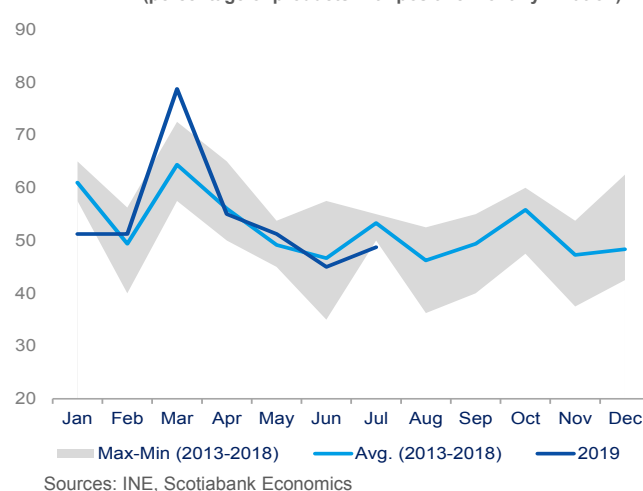


Chart 5 Inflationary diffusion of Core CPI of services
(percentage of products with positive monthly inflation)

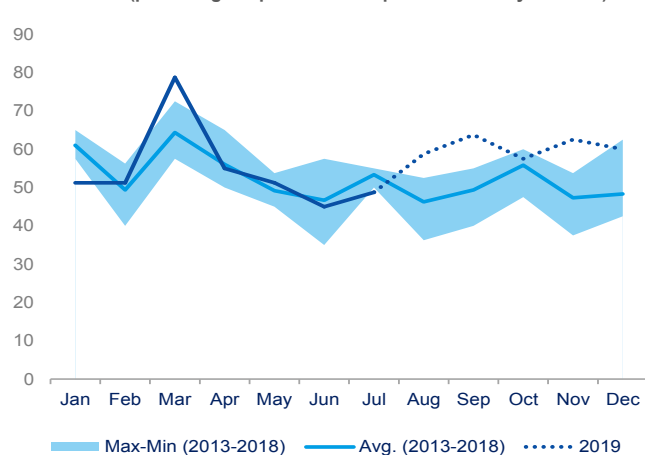
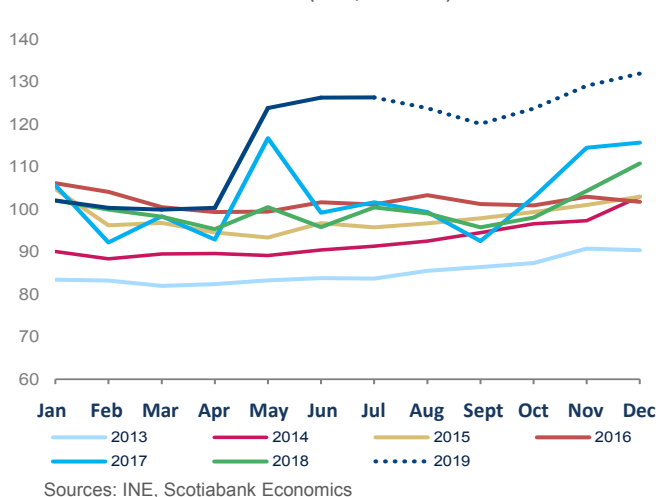


Chart 6 Tourist package remains at a high level
(level, 2018=100)



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