

Banxico Flash

Banxico confirms its dovish tone. The inflation convergence towards the target remains as the main factor behind the possible rate cut

Banxico's Inflation Report October-December 2012

- **Economic Activity.** Banxico kept unchanged its GDP forecasts for 2013. The estimation range stayed between 3.0 and 4.0%, while in 2014 the forecast range was situated between 3.2% and 4.2%. At a press conference, the governor emphasized that the origin of the recent weakness in the domestic activity figures lies in the deceleration of the global economy. In addition the US budget sequestration was considered as one of the main downward risks on domestic activity. On the other hand, Banxico estimates that the recently approved labor reform will increase the output gap in 0.15 percentage points.
- **Inflation.** Banxico highlights the positive behavior of inflation during the 4Q12 thanks to moderations of both its core and non-core components. It was emphasized that the lower core inflation was caused by lower merchandise inflation due to its improved fundamentals and to the sharp decreases in other services inflation thanks to the sharp reductions in mobile phone fees, which it advanced could be more permanent than transitory because of technological advance, recent regulatory resolutions and increased competition in the sector. For 2013 Banxico forecasts inflation will remain below 4% and that it will end the year close to its 3% target, even though it might increase slightly in coming months. For core inflation it ratifies its forecast that it will oscillate around 3% all year. About the risks that might affect its forecasts it highlights higher than expected increases in public prices, new supply shocks in agricultural and livestock prices caused by the weather or sanitary conditions and a new peso depreciation caused by a new period of financial instability. We agree with Banxico's view that inflation will remain below 4% all year as well as with the risks that might affect its path in the short run.
- **Monetary policy.** At a press conference about the presentation of the report, Banxico's governor highlighted that the decision to cut the monetary policy rate has not been made, but it depends on the inflation convergence towards the target. In addition, it made clear that if the rate cut materializes it would not be aimed towards controlling the foreign inflows.
- **Assessment:** Banxico reaffirms the dovish tone showed in the last statement and the minute of the most recent monetary policy reunion. The emphasis on the continuing inflation convergence stands out. We maintain the call for a monetary pause based on the fact that more information is necessary to claim that the inflation convergence has been achieved. However, we incorporate a cut bias based on our inflation scenario that trends lower to a 3.3% on average during the last quarter of 2013, and, above all, on the change in the recent communication.

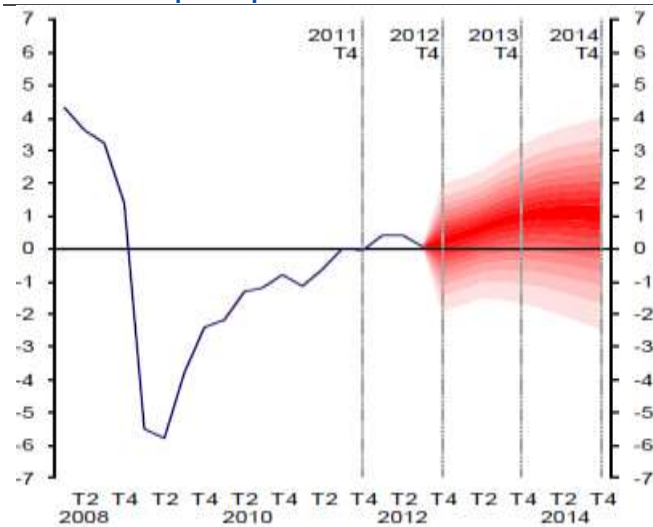
Table 1

Banxico's Macroeconomic Scenario

	2Q12 Report		3Q12 Report		4Q12 Report	
	2012	2013	2012	2013	2013	2014
Growth US (annual %)*	2.2	2.1	2.1	2.0	1.9	2.8
Growth Mexico (annual %)	(3.25-4.25)	(3.0-4.0)	(3.5-4.0)	(3.0-4.0)	(3.0-4.0)	(3.2-4.2)
Employment (thousands of workers at IMSS)	(540-640)	(500-600)	(600-700)	(500-600)	(550-650)	(700-800)
Current Account (% of GDP)	0.9	1.4	0.4	1.6	1.3	1.7
Memorandum:						
BBVA Research GDP forecast (annual %)	3.7	3.0	3.7	3.0	3.1	3.1
*Consensus of Blue Chip survey						

Source: BBVA Research & Banxico

Graph 1

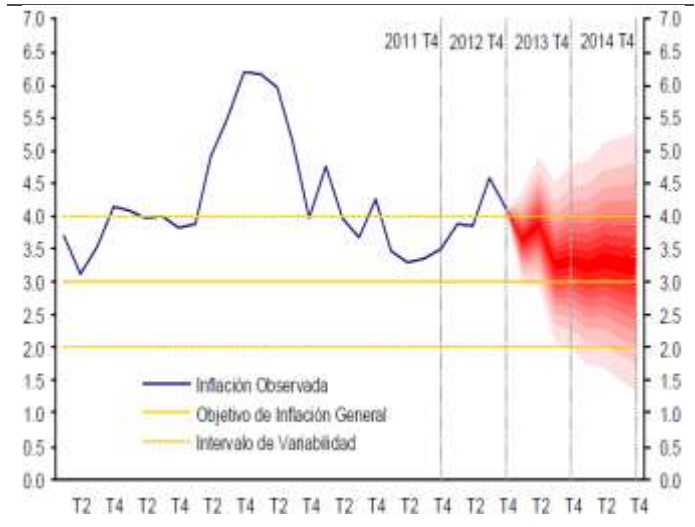
Fan Chart: Output Gap

Source: Banxico

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Graph 2

Fan Chart: CPI Inflation Forecast

Source: Banxico

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