

Banxico Flash

Mexico

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FX&Rates:
Ociel Hernández
ociel.hernandez@bbva.com
+5255 5621 9616

Claudia Ceja
claudia.ceja@bbva.com
+5255 5621 9715

Economics:
Arnoldo López
arnoldo.lopez@bbva.com
+5255 5621 3095

Iván Martínez
ivan.martinez.2@bbva.com
+5255 5621 6503

Javier Amador
javier.amador@bbva.com
+5255 5621 6503

Banxico: Getting ready to pull the trigger if necessary

Bottom line: Banxico's monetary policy statement showed that current inflationary pressures are expected to be transitory and the board rather focused on activity risks. The board seems to be communicating the factors that could justify an easing in the monetary policy stance. Banxico's communication and wording will be crucial to face the big challenges ahead as part of a risk management approach. We continue to favor the short end of the TIIE and MBonos curve while keeping a positive bias for MXN.

The board focuses in the downside activity risks

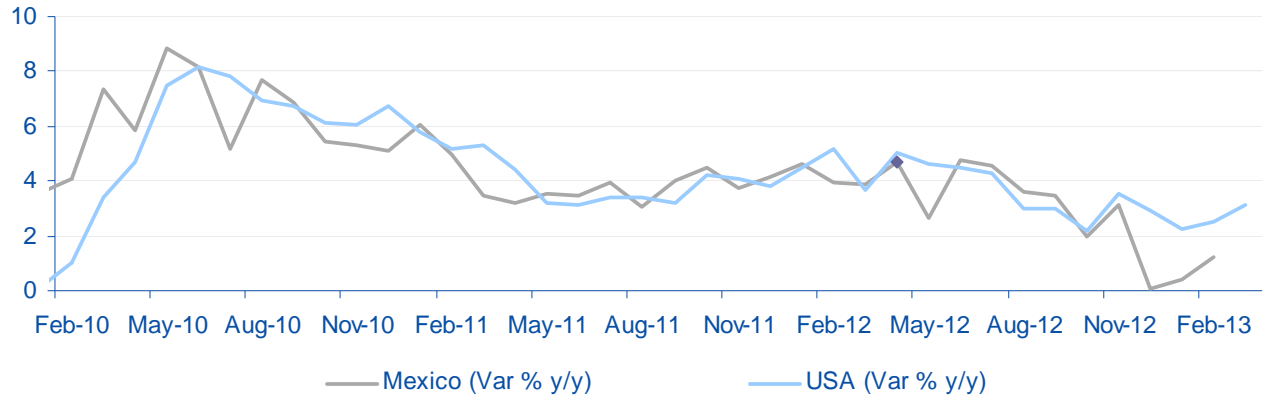
On Friday, Banco de México kept unchanged its monetary policy rate at 4.0%. The decision was based on the following arguments: i) inflation has shoot up recently, but the spike is considered transitory as core inflation remains at around 3.0% and, therefore, no second round effects are expected; and ii) the economic activity remains a source of concern, especially the possibility of an intensification in the recent US slowdown, while Mexico's fiscal stance is expected to be in accord with the convergence of inflation to the target (i.e. a balanced public budget).

The statement from Banxico argues in favor of a monetary pause, but with an emphasis on the downside risks on economic activity and the evolution of Mexico's monetary stance vis-à-vis that of other countries. These arguments resemble those stated in the September 2012 communiqué, after inflation reached 4.6%. Banxico seems to be communicating the market the factors that could prompt an adjustment in its monetary stance. That is an inflation rate below 4.0% -with the core component around 3.0%— and a significantly impaired US economic activity during 2H13 that could result in further monetary easing around the world.

As the communication came in broadly in line with market expectations, local assets were driven instead by external factors. Overall, we read the statement as dovish even though current inflation levels provided room for a more restrictive language. The MBoho curve posted another decline that was not a response to expectations of an imminent cut, as it flattened by the end of the day. The MXN saw a muted reaction and maintained its positive bias notwithstanding the dovish tone. Investors will probably be more sensitive to coming activity data, leaving inflation readings in the background. We therefore continue to favor the short tenors of the TIIE and MBoho curve. We also believe MXN will become more sensitive to activity data, but as long as the cut is not imminent, investors will continue profiting from the current carry and the prevalent, reform-related bullish-MXN stance.

In sum, given that expectation point to an inflation below 4% after June, the economic activity will gain attention with respect to any policy adjustment. The possibility of a cut seems to be increasing as the relative monetary policy is turning more restrictive in view of a downward inflation path and a weak economic activity. As we have mentioned in our recent publications, Banxico's communication and wording will be crucial to face the big challenges ahead as part of a risk management approach, which is now the name of the game in the global front.

Figure 1
Industrial production, Mexico and USA



Source: BBVA Research

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