Economic Research Department

BBVA

Mexico

BanxicoWatch

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Banxico keeps monetary easing rate at 75 bps: bank lending rate is 5.25%

- The Bank of Mexico has not surprised the market and has cut 75 the bank lending rate by 75 bps for the third time. This move is in keeping with the further decline in economic activity, which continues to push the balance of risks towards slower growth.

- The statement hints that the global economic slowdown is easing off and stresses that there are signs that it has touched bottom in industrialized countries. This trend is also already evident in some emerging economies. The statement also mentions greater stability in the international financial situation, but that borrowing ability continues to be limited for emerging countries. Banxico's evaluation of the international scenario has a more favorable slant than in previous statements.

- However, as was to be expected, the domestic economic situation is still negative, especially due to the outbreak of the influenza A (H1N1) virus. While there are signs of a curb in the economic slowdown in the US, in our opinion economic activity in Mexico could be thrown out of phase in this first stage of the recovery cycle. Banxico says that due to the effects of the epidemic, the heavy decline recorded so far will accelerate over the next three to four months. In short, the balance of risks continues to lean towards slower economic growth within a climate of financial stability, which allows inflationary risks to be mitigated.

- In relation to the inflationary balance, Banxico stresses that the fall in inflation has been more moderate than expected due to the effects of the exchange rate depreciation. However, it also says that inflation should fall more dramatically in the future, especially in light of the heavy economic slowdown made worse by the influenza A (H1N1) virus epidemic, as well as exchange rate stability.

- We consider that the balance of risks for economic activity will continue to deteriorate, which contributes to inflation convergence in the medium-term, and that the central bank will continue with the monetary easing cycle. Banxico speaks clearly about its future actions: the bank lending rate will continue to fall but to a lesser extent – *"the actions taken so far have been of a preventative nature, and future measures will probably be of a narrower scope"* -. We think that Banxico will cut its monetary policy by 50 bps at the next meeting, and will end the year at 4.5%. Nevertheless, because the exchange rate trend has proven to not be linked to monetary actions but rather to global aversion, and due to the possibility that inflation will converge more quickly towards the end of the year, there could be more leeway to conduct policy easing.

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