

Banxico Watch

Mexico

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Economic Analysis

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No changes in Banxico monetary policy Inflation Report, January-March 2011

- Banxico has once more made clear its confidence that inflation will continue along the path of price stability, given the room available for reacting to probable **future increases in demand, the anchoring of agents' expectations, and the behavior of the exchange rate.**
- It has maintained its inflation forecast unchanged and adjusted growth upwards by 0.2%, within a range of 4.0-5.0%.
- Banxico is maintaining its balance of risks of prices biased upwards due rising imported inflation via commodity price increases and/or exchange-rate volatility; or as a result of swifter growth. This means that figures released over the coming months are of particular importance.

Economic activity: Better expectations for Mexico, with 2011 growth rising from 3.8-4.8% to 4.0-5.0%, as well as an improved balance between domestic and foreign demand. In contrast, Banxico is more cautious with respect to the U.S. economic outlook, as analysts' expectations for 2011 growth have dropped from 3.2% to 2.7%. The moderate outlook is based on the continued fall in housing prices, which is depleting household wealth, and high unemployment.

Inflation: Forecasts unchanged from the previous report. The output gap is closing, although there is still room for continued growth without pressure on prices. However, there may be an upturn in the non-core component. Risks for inflation are the same as in the 4Q10 report. They include commodity prices and exchange-rate pressures fuelled by volatility on the financial markets.

Risks: Uncertainty regarding the sustainability of the recovery in the U.S., high commodity prices, unstable financial markets, reversal of capital flows to emerging economies, in particular given the changes in monetary policies in some countries.

Reaction on the financial markets: The interest rates of government bonds fell following the presentation of the inflation report. The exchange rate dropped slightly, from 11.55 to 11.65 at the close. This also reflected the strength of the dollar against other currencies.

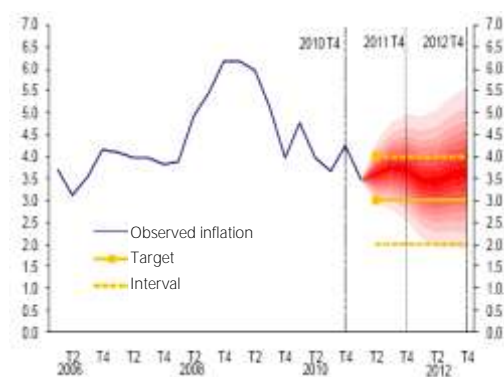
Assessment: Banxico appears more moderate with respect to the foreign environment, and maintains its position on the lack of pressure from domestic demand. However, it considers that an upturn in non-core inflation is possible, and that an increased pace in the closure of the output gap represents another potential risk. This suggests to us that its monetary stance will depend significantly on how these factors develop over the coming months.

Table 1
Bank of Mexico macroeconomic framework

	4Q2010 Report		1Q2011 Report	
	2011	2012	2011	2012
U.S. growth (annual %)	3.2	3.3	2.7	3.2
Mexico growth (annual %)	(3.8-4.8)	(3.8-4.8)	(4.0-5.0)	(3.8-4.8)
Employment (IMSS registered, thousands)	(600-700)	(600-700)	(600-700)	(600-700)
Current account (% GDP)	1.2		1.0	
Memorandum item: Mexico growth forecast, BBVA Research	4.3	3.8	4.7	3.8

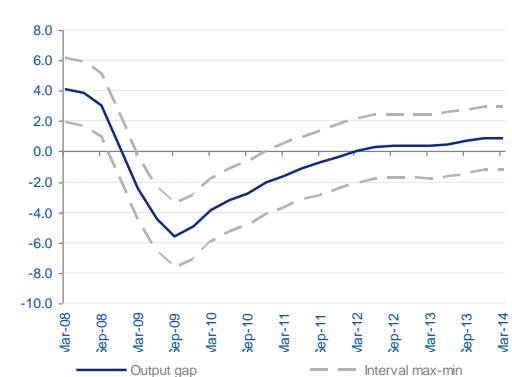
Source: BBVA Research and Banxico

Chart 1
Banxico inflation forecast (% y/y)



Source: Banxico: January-March 2011 Inflation Report

Chart 2
BBVA Research, estimate of the output gap (% potential GDP)



Source: BBVA Research

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