

# Banxico Watch

## Mexico

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### Economic Analysis

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## No change to lending rate. Monetary pause for the rest of the year

### Monetary policy decision on July 8, 2011

- **Banxico will keep the lending rate at 4.5% at its next meeting and will insist on the improvement in the balance of risks on forecast inflation and the slack in factor markets.**
- **Be aware of any mention of the slowing US economy.**

Against a background of inflation below analysts' expectations and a reduction in activity growth (temporary in theory), the uncertainty a few months back surrounding Banxico's monetary policy stance for the coming months has abated. The reduction in commodity prices and the little effect that their increases have had on consumer prices in Mexico have resulted in an improvement in the inflation risk balance compared to the start of the year. Furthermore, the slowdown in growth will keep the economy slack for a longer time. In the medium term no widespread pressure on prices is foreseen and consequently there is no reason to predict a change in the monetary policy rate.

It is worth pointing out that the lower-than-expected inflation results are partly due to temporary factors (e.g. fall in agricultural prices, fall in electricity prices) and factors which are hard to predict (e.g. telecommunications prices), which could see a reversal toward the second half of the year. However, in light of the lack of pressure on demand, we don't expect this to push inflation over Banxico's inflation target variability range.

As regards global activity, we will have to wait to see how temporary the Central Institute considers the US economy slowdown to be, following mixed reports in recent weeks and statements that there is uncertainty over a recovery once the fiscal and monetary stimulus packages have been withdrawn. The reference to fiscal problems in Europe and their potential effects on global growth and financial markets will be important because it could have upward effects (e.g. depreciation due to outflows in emerging countries), and downward effects (e.g. less economic activity) on inflation. All while taking into account that Banxico's latest statement mentioned that the risk balance for the global economy has shown "some decline".

To sum up, the latest information is in keeping with an upturn in the inflation risk balance and activity that is far from exerting pressure on prices. Therefore, against a background of limited inflationary risks, we think that the monetary pause will continue for at least the rest of 2011.

Table 1  
Risk balance

	3Q10	4Q10	1Q11	2Q11 <sup>1</sup>	Effect <sup>2</sup>	Value <sup>2</sup>
<b>IGAE (YoY, %)</b>	5.6	4.4	5.0	2.5	↔	0
<b>Capacity Utilization (average, %)</b>	71.7	72.5	73.7	72.8	↔	0
<b>Industrial Production (QoQ annualized, %)</b>	2.4	1.5	8.0	-1.7	↔	0
<b>Industrial Production (YoY, %)</b>	6.5	4.4	4.4	2.6	↔	0
<b>Manufacturing IMEF (index, average)</b>	53.1	52.8	52.6	53.4	↔	0
<b>Unemployment rate (average, %)</b>	5.2	5.4	5.1	5.4	↓	-1
<b>Employment (IMSS, QoQ annualized, %)</b>	4.2	4.7	4.5	3.8	↓	-1
<b>Employment (IMSS, YoY, %)</b>	4.9	5.4	4.9	4.3	↓	-1
<b>Real Wage (YoY, %)</b>	-0.5	-0.5	0.6	1.3	↓	-1
<b>Retail Sales (QoQ annualized, %)</b>	4.2	5.1	3.2	5.1	↔	0
<b>Retail Sales (YoY, %)</b>	3.2	3.3	2.2	4.7	↔	0
<b>Consumer Confidence (index, average)</b>	89.2	89.6	92.1	90.7	↔	0
<b>Headline Inflation (fdp, % anual)</b>	3.67	4.25	3.46	3.36	↔	0
<b>Core Inflation (fdp, % anual)</b>	3.69	3.57	3.25	3.18	↔	0
<b>Inflation Expectations (12-month)</b>	4.30	3.88	3.85	4.03	↔	0
<b>Inflation Expectations (3-year)</b>	3.59	3.66	3.57	3.57	↔	0
<b>Inflation Expectations (10-year)</b>	3.38	3.43	3.39	3.41	↔	0
<b>Inflation Deviation (Q-Q, pp)<sup>3</sup></b>	-0.33	0.25	-0.54	-0.64	↓	0
<b>Sum</b>	-2	-1	-1	-1		
<b>Weighted Sum<sup>4</sup></b>	-1	1	1	1		
<b>Qualitative Assessment</b>	<b>Pause</b>	<b>Pause</b>	<b>Pause</b>	<b>Pause</b>		

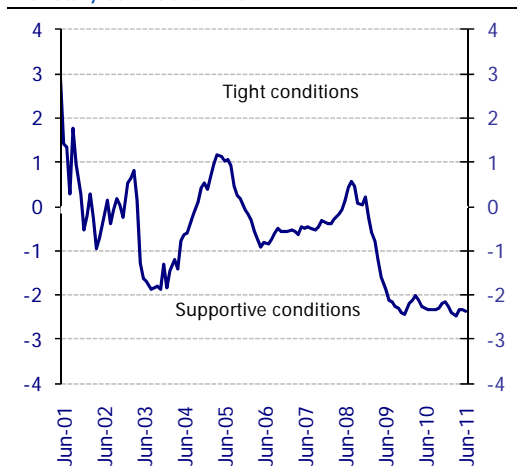
<sup>1</sup> Only for the months in the quarter for which information is available.

<sup>2</sup> Interpretation of the effect of each variable on monetary policy: ↑ restriction, ↓ relaxing, ↔ neutral; 1 is assigned to ↑, 0 to ↔, and -1 to ↓. Therefore, a greater (lesser) sum suggests a greater (lesser) likelihood of an increase in the bank lending rate.

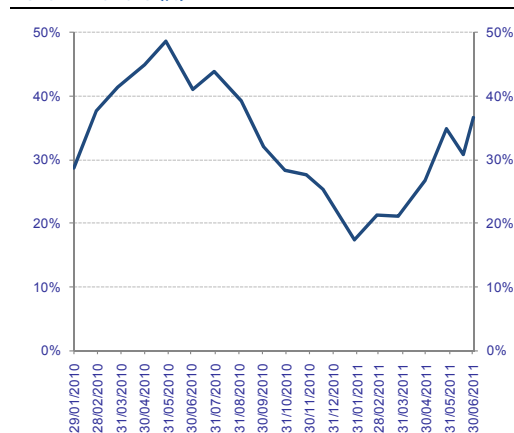
<sup>3</sup> Difference between inflation and the upper limit of the Banxico target variability range.

<sup>4</sup> Assigns a weighting consistent with a Taylor's Law.

Source: BBVA Research with data from Bloomberg, INEGI, Banxico and IMSS.

Chart 1  
Monetary conditions index


Source: BBVA Research

Chart 2  
Standard deviation in inflation expectations for the next 12 months (%)


Source: BBVA Research and Infosesl

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