

BBVA Research Flash

Mexico

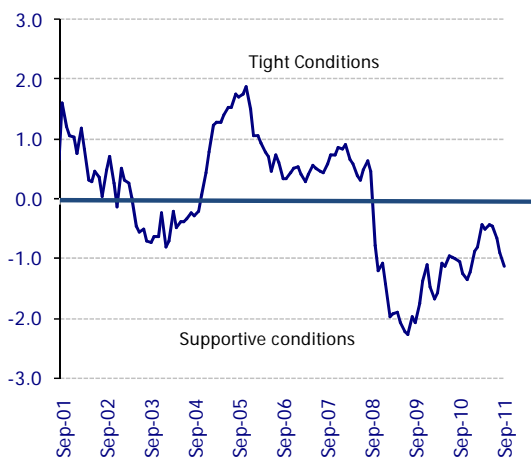
Banxico, October 14th Monetary Policy decision: No change in fondeo rate

- At present, Banxico’s conditions to think about a rate cut are not met. Peso depreciation relaxed monetary conditions and the risk balance on growth shows no further impairment. No changes on inflation balance of risks: lack of demand reduces pass through from commodity prices or exchange rate
- Altogether we think that fondeo rate will be at 4.5% beyond 2012. However, there is a bias to an early cut if balance of risks on growth impairs and/or inflation keeps its downward trend.

Recent data do not reveal a further tightening of monetary conditions. Lack of agreements to solve Europe’s debt crisis and concerns about a US recession brought an increase of global uncertainty that led to a 6.1% peso depreciation since last meeting. As a result monetary conditions eased. On the other hand, US economic growth and employment data have outpaced market expectations and show a path consistent with a continuing growth scenario. In Mexico data shows a similar pattern (see table below). On the inflation side, there are no demand pressures on prices as spare capacity remains in some markets (i.e. labor, credit)

Altogether, we believe that current conditions justify the current monetary policy stance. However, if an economic slowdown or an inflation slump occurs, Banxico would have room to cut the fondeo rate if needed.

Chart 1
Monetary Conditions Index



Source: BBVA Research

Chart 2
Exchange rate implied volatility (%)



Source: Bloomberg

Table 1

Balance of risks

	4Q10	1Q11	2Q11	3Q11 ¹	Effect ²	Value ²
IGAE (YoY, %)	4.4	5.1	3.3	3.7	↔	0
Capacity Utilization (average, %)	72.5	73.7	72.8	72.3	↔	0
Industrial Production (QoQ annualized, %)	4.5	-3.8	10.4	-0.8	↔	0
Industrial Production (YoY, %)	4.8	5.2	3.4	3.2	↔	0
Manufacturing IMEF (index, average)	52.8	52.6	53.5	50.7	↔	0
Unemployment rate (average, %)	5.5	5.1	5.5	5.4	↓	-1
Employment (IMSS, QoQ annualized, %)	4.6	4.4	3.7	3.8	↓	-1
Employment (IMSS, YoY, %)	5.4	4.9	4.3	4.1	↓	-1
Real Wage (YoY, %)	-0.5	0.5	1.0	0.7	↓	-1
Retail Sales (QoQ annualized, %)	5.2	2.9	3.5	2.5	↔	0
Retail Sales (YoY, %)	3.3	2.2	3.5	4.3	↔	0
Consumer Confidence (index, average)	89.6	92.1	90.7	93.8	↔	0
Headline Inflation (fdp, % anual)	4.25	3.46	3.30	3.37	↔	0
Core Inflation (fdp, % anual)	3.57	3.25	3.16	3.18	↔	0
Inflation Expectations (12-month)	3.88	3.85	4.03	4.16	↑	0
Inflation Expectations (3-year)	3.66	3.57	3.57	3.59	↔	0
Inflation Expectations (10-year)	3.43	3.39	3.41	3.43	↔	0
Inflation Deviation (Q-Q, pp)³	0.25	-0.54	-0.70	-0.63	↔	0
Sum	-2	-1	-1	-2		
Weighted Sum⁴	-1	1	1	0		
Qualitative Assesment	Pause	Pause	Pause	Pause		

¹ Only considers the months of the quarter with available information

² Own interpretation of the effect of each variable on monetary policy: ↑ restrictive, ↓ easing, ↔ neutral; a 1 is assigned to ↑, a 0 if therefore, a sum greater (lower) suggests a greater (lower) probability of a hike in the fondeo rate

³ Difference between inflation and the upper-limite of Banxico's target variability range

⁴ Assigns a weight consistent with a Taylor Rule

Source: BBVA Research with INEGI data

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