

Flash Banxico

Mexico

Banxico's Inflation Report supports our monetary pause perspective

Banxico's Inflation Report October-December, 2011

- **Economic Activity.** Banxico estimates that GDP growth in 2011 was around 4 per cent, while in 2012 and 2013 its forecast lie in the 3 to 4% range. A reduction in US industrial production explains the 2012 decline. As it did in its recent communication, the central bank stressed that economic slack remains and that output gap will close slower than previously expected and, as a result, there will not be demand-side pressures on prices. It is worth noting that during the press conference it was claimed that output gap will close in the middle of 2012.
- **Inflation.** As it did in its Minutes, Banxico highlights that the recently observed rise in inflation is transitory and of Non-core nature mainly. It reiterates that the exchange rate depreciation has limited effects over inflation and more so, given the current phase of the economic cycle. Despite the recent rise in prices, the central institute expects general inflation ends 2012 between 3 and 4 percent and to remain within that range in 2013. As for core inflation, it estimates it will remain close to 3 percent in both years.
- **Risks:** Concerning economic activity, the downward risks are concentrated in the reduction of US growth as a consequence of the retirement of fiscal stimulus and/or a possible contagion of the European crisis to its financial system. However, it was highlighted that the probability of a catastrophic event in Europe has reduced but cannot be dismissed. Upward risks to inflation are an additional supply shock to commodities that translates to higher grain prices or an exchange rate depreciation that alters the price formation process. While lower than expected economic activity constitutes the main downward risk to inflation.
- **Assessment.** There are no big changes in the tone with respect to the last policy statement or the corresponding minute. In addition, GDP growth forecasts are unchanged. Concerning its inflation forecast, we think inflation will break the 4 percent threshold with higher probability than Banxico does, but we agree that in the end of 2012 inflation will be inside the 3 – 4 percent range. Altogether, we think that this inflation report supports the monetary pause perspective, at least during next months.

Table 1

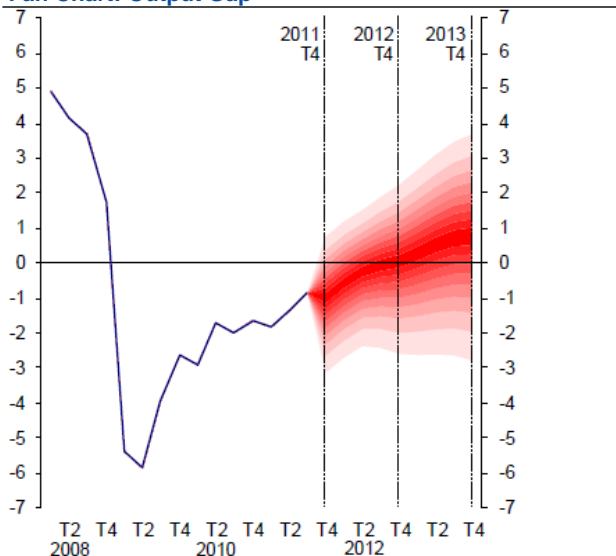
Banxico's Macroeconomic Scenario

	1Q2011 Report		2Q2011 Report		3Q2011 Report		4Q2011 Report		
	2011	2012	2011	2012	2011	2012	2011	2012	2013
Growth US (annual %)*	2.7	3.2	1.8	2.5	1.8	2.1	-	2.2	2.6
Growth Mexico (annual %)	(4.0-5.0)	(3.8-4.8)	(3.8-4.8)	(3.5-4.5)	(3.5-4.0)	(3.0-4.0)	3.9	(3.0-4.0)	(3.0-4.0)
Employment (thousands of workers at IMSS)	(600-700)	(600-700)	(575-675)	(575-675)	(560-620)	(500-600)	-	(500-600)	(500-600)
Current Account (% of GDP)	1		1.1		1.0	1.4	0.7	1.2	1.4
Memorandum growth forecast by BBVA Research GDP (annual %)	4.7	3.8	4.1	3.8	3.8	3.3	3.8	3.3	2

*Consensus of Blue Chip survey

Source: BBVA Research & Banxico

Graph 1

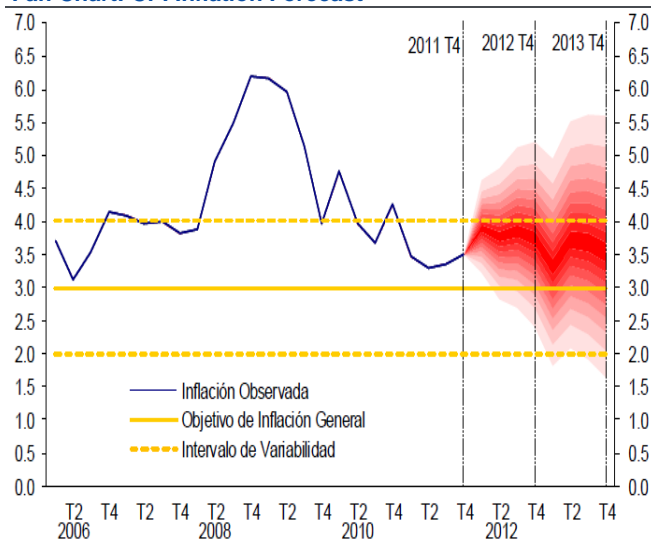
Fan Chart: Output Gap

Source: Banxico

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Graph 2

Fan Chart: CPI Inflation Forecast

Source: Banxico

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