

Banxico Flash

Mexico

Banxico's improves its perspectives on domestic activity. The report is consistent with a monetary pause

Banxico's Inflation Report January-March, 2012

- **Economic Activity.** Banxico modifies slightly upward its estimate of GDP growth in 2012 from a range between 3.0% and 4.0% to a range between 3.25% and 4.25%. The forecast range for 2013 remains between 3.0% and 4.0%. The increase in 2012 comes as a result of a slight improvement of the US economic perspectives. As in previous inflation reports, the central bank stressed that economic slack will stay and that the output gap is closing at a slower pace. Therefore no demand-side pressures are expected.
- **Exchange rate.** As mentioned in previous monetary policy announcements and at the press conference to present the inflation report, Banxico stressed that as volatility in financial markets recedes, the exchange rate would tend to appreciate to levels consistent with economic fundamentals of the Mexican economy. In addition and at the press conference too, it was mentioned that, at present, the liquidity conditions of the foreign exchange market show an ordered behavior. Therefore, no changes to the USD auctions, in place since November 2011, are expected.
- **Inflation:** it was highlighted the important reduction experienced by inflation since February, which even when it was caused primarily by volatile factors, it ratifies the transitory nature of the spike. It was also highlighted that despite the prices of merchandise have increased more relative to the prices of services due to the peso depreciation, the exchange rate pass-through has been very low and it is considered its effects will be transitory as well. Additionally it was mentioned that given the slack in the Mexican economy, demand pressures are not anticipated. Finally it estimated that inflation will locate between 3.0% and 4.0% during 2012 and 2013, however it was anticipated that during the next year inflation could locate in the lower bound of the mentioned range after the inflationary effects caused by the adjustments in relative prices dissipate. As for core inflation it is estimated that during 2012 it will locate near 3.0%, and that during 2013 it will oscillate around that level, as it is expected that the upwards shocks experienced by some food products such as corn tortillas will vanish.
- **Risks:** Concerning economic activity, the downward risks are concentrated in the reduction of US growth as a consequence of a possible contagion of the European crisis to its financial system and a reduction of foreign inflows as a result of an increase of volatility in the financial markets. Upward risks to inflation are related to a price increase in agricultural prices caused by the draught in the country or a persistent exchange rate depreciation that affects the price formation process. While lower than expected economic activity constitutes the main downward risk to inflation.
- **Assesment:** no significant changes were made since the last statement and its corresponding minutes, Banxico increased its growth forecast for 2012 slightly. Regarding its inflation scenario we think that inflation indeed will remain between 3.0% and 4.0% during 2012 and 2013, however in our scenario we don't give the highest probability to an inflation scenario near 3.0% next year. In conclusion we consider that this report continues supporting the perspective of monetary pause.

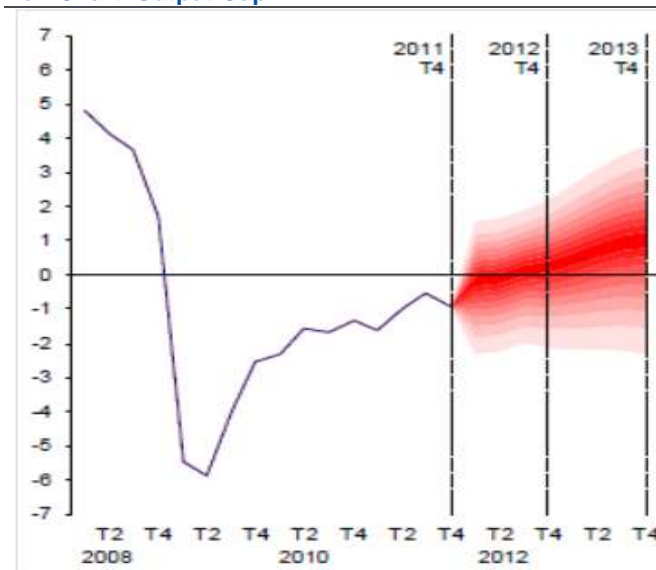
Table 1

Banxico's Macroeconomic Scenario

| | 2Q2011 Report | | 3Q2011 Report | | 4Q2011 Report | | 1Q2012 Report | | |
|--|---------------|-----------|---------------|-----------|---------------|-----------|---------------|-------------|-----------|
| | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2013 |
| Growth US (annual %)* | 1.8 | 2.5 | 1.8 | 2.1 | - | 2.2 | 2.6 | 2.3 | 2.5 |
| Growth Mexico (annual %) | (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) | (3.25-4.25) | (3.0-4.0) |
| Employment (thousands of workers at IMSS) | (575-675) | (575-675) | (560-620) | (500-600) | - | (500-600) | (500-600) | (540-640) | (500-600) |
| Current Account (% of GDP) | 1.1 | 1.6 | 1.0 | 1.4 | 0.7 | 1.2 | 1.4 | 1 | 1.3 |
| Memorandum growth forecast by BBVA Research GDP (annual %) | 4.1 | 3.8 | 3.8 | 3.3 | 3.8 | 3.3 | 2 | 3.7 | 3 |
| *Consensus of Blue Chip survey | | | | | | | | | |

Source: BBVA Research & Banxico

Graph 1

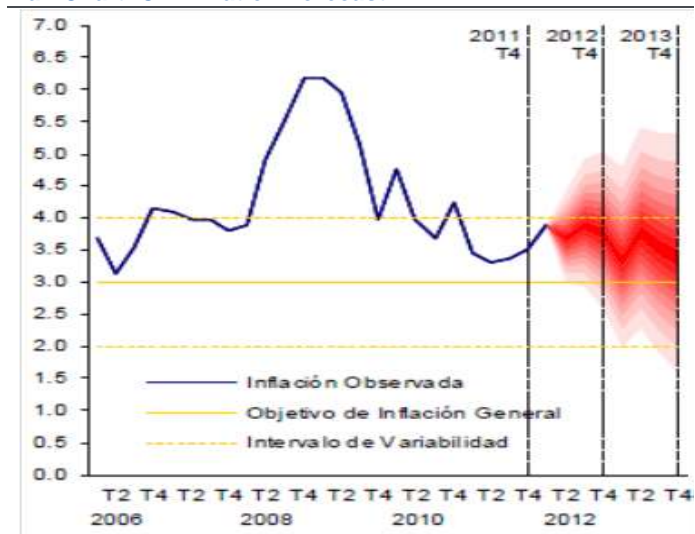
Fan Chart: Output Gap

Source: Banxico

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Graph 2

Fan Chart: CPI Inflation Forecast

Source: Banxico

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