

Mexico Flash

No change in monetary policy rate. Special attention on foreign developments.

- Considering the spike in global risk aversion and lower than expected US growth data, a moderate increase in inflation and an exchange rate depreciation do not modify the neutral balance of risks for inflation.
- In our opinion, fondo rate will remain unchanged at 4.5% during 2012. However, we stress that the odds of a rate cut increase considerably if domestic economic activity impairs

Banxico will hold its next monetary policy meeting in a foreign environment characterized by a spike in financial markets volatility arising from the impairment of the European financial crisis and, more recently, the lower than expected jobs report in the US. Altogether, these factors help to explain the peso depreciation of around 7.54% since April 27th to date. Regarding domestic activity, the GDP growth was better than expected during the first quarter (1.3% vs 0.8% q/q), while inflation reached an annual rate of 3.7 percent in the first fifteen days of May.

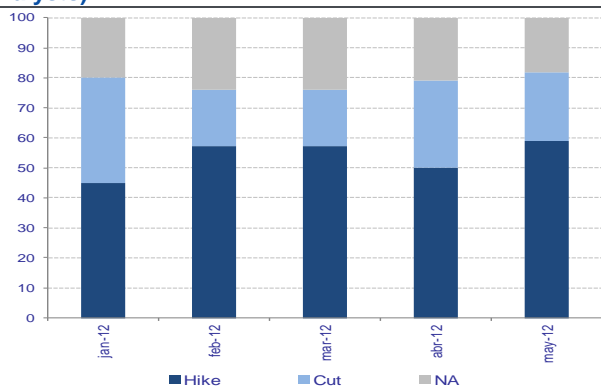
In this context, we expect Banxico to keep monetary policy rate unchanged and to adopt a wait and see stance. We consider that the central bank will emphasize the downward risks to the world economy coming from the European financial crisis and from the structural economic weaknesses and fiscal uncertainty in the US. Concerning domestic activity, even when recent data has been above market expectations, we expect that the mention of a resilient economy will remain. Regarding inflation, we expect the balance of risks will remain neutral as the absence of demand side pressures on prices and the downside risks to economic activity will prevail over the recent increase in inflation. Finally, in face of the recent peso depreciation, which has loosened the monetary conditions, it is possible that Banxico underlines that the economic fundamentals anchor the exchange rate, as it did in the monetary policy announcements of the fourth quarter of 2011.

In sum, we expect no change in the monetary policy rate and that the central bank will follow closely the possible effects of foreign events on the balance of risks of domestic activity and inflation. However, we stress that the odds of a rate cut increase considerably if domestic economic activity impairs.

It is worth noting that some events in the coming weeks will be important to monetary policy decision making. In particular the FED will release the statement of its FOMC meeting on June 20th and the Greeks will hold parliamentary elections on June 17th. Under current circumstances, the tone of the FOMC statement and the results of the Greek elections could have an important influence on global risk aversion, and therefore, on Mexican variables and economic expectations.

Chart 1

Expectation of the next monetary policy movement (% of analysts)



Source: Encuesta de expectativas de especialistas de mercados financieros. Banamex.

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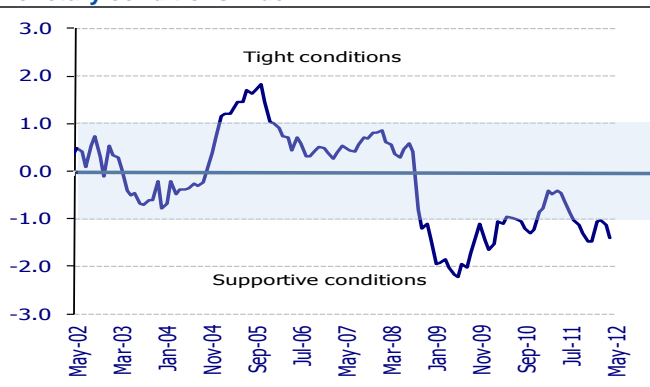
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Chart 2

Monetary conditions index



Source: BBVA Research.