

Mexico Banxico Flash

No change in monetary policy rate. Special attention to the assessment of the balance of risks of economic activity

- The uncertainty of the external environment could lead Banxico to a more cautious assessment of the downward risks on economic activity
- Given no demand side pressures on prices, the recent inflation hike is expected to be transitory as long as the core inflation remains anchored.
- In our opinion, fondo rate will remain unchanged at 4.5% during 2012. A rate cut remains possible as the persistence of risk factors could impair the global economy.

The central bank will hold its next monetary policy meeting in a very uncertain foreign environment. On the one hand, recent agreements regarding the Euro zone crisis are not conclusive and there are still some doubts concerning the implementation of recent measures. On the other hand, the uncertainty surrounding the nature of the recent US slowdown lingers. Altogether these factors suppose downside risks to domestic activity and possible tightening of credit conditions.

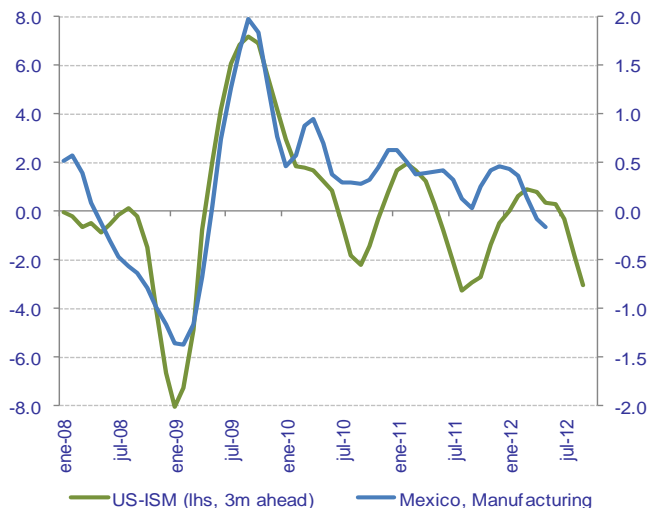
On the domestic side, recent figures of inflation and economic activity are still consistent with a monetary pause. Regarding economic activity, although GDP growth forecasts remain above 3.5% in 2012, there are signals of moderation consistent with the US recent slowdown. As an example, industrial production in Mexico decreased more than expected in May (-0.9% vs. -0.2%), especially in the manufacturing industry (-1.4%). In addition, consumer confidence has been weakening in the last months. Therefore, the central bank could be more cautious on the tone of domestic activity.

With respect to consumer prices, the 4.3% inflation figure in June is the result of an increase in the non-core index. Even considering this level, we expect inflation to recede and to finish 2012 inside the variability interval of the central bank's inflation target. However, it is important to be aware of corn and poultry prices, given the recent bird flu outbreak in Mexico and the drought in the US could result in upward pressures on these products.

The recent central bank announcements have been balanced regarding the inflation risks. On the one hand, it has stressed the downside risks related to a slowdown in economic activity, while, on the other hand, supply shocks and an exchange rate depreciation constitute upward risks. In our opinion Banxico will maintain this balanced tone, given that core inflation remains anchored and the transitory nature of the recent inflation shocks.

In sum, we consider that the current economic conditions are consistent with a monetary policy pause. However, we stress that the odds of a rate cut increase considerably if domestic economic activity impairs.

Chart 1

US ISM and manufacturing activity in Mexico (% MoM)

Source: BBVA Research INEGI & Bloomberg

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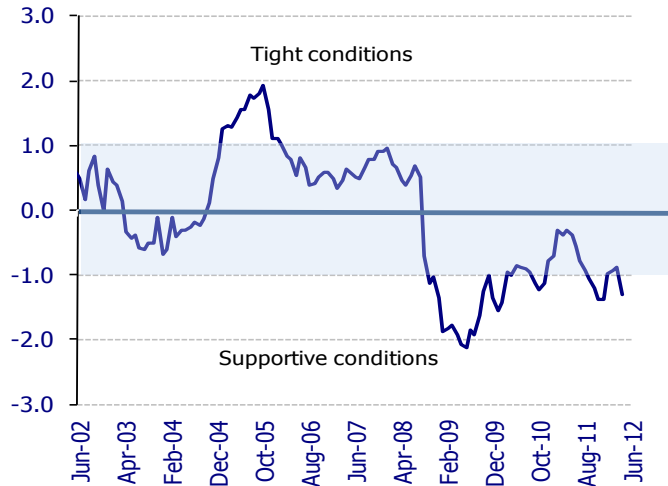
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Chart 2

Monetary conditions index

Source: BBVA Research.