

# Mexico Flash

## Banco de México: No change in fondeo rate and a slightly more hawkish tone

- As expected, the persistence of supply shocks impairs the inflation balance of risks in the short term, and lead to a slightly more hawkish tone. In particular, Banxico stresses that even if the shocks persist, even if they seem transitory, and the expected downward trajectory of inflation is not confirmed, a rate hike would be pertinent.
- The balance of risks of global and domestic activity impaired further, leading to a downward bias for inflation in the medium term.
- The monetary pause is expected to remain in the following months given a scenario of supply shocks that fade away and the absence of second-round effects.

In spite of the increase in inflation above 4.6% led to a slightly more hawkish tone, the monetary pause prevails. The less neutral tone of the last statement turned slightly more hawkish as the greater persistence of food and energy prices impairs the inflation balance of risk in the short term. In fact, central bank literally said that “if shocks persist even though being transitory, and the expected downward trajectory of inflation does not occur, the Board estimates that further tightening could be pertinent”. An additional concern is the increase of some nominal wage negotiations above the ones registered in the past.

In spite of the recent inflation spike above the target, we expect the monetary pause to remain. The latter based on the following factors:

- i) At present, there is no evidence of second round effects. Core inflation and inflation of services, gauges more associated to demand pressures on prices, are clearly below the upper bound of the variability interval of the inflation target;
- ii) Recent data confirms that domestic and foreign demand is moderating (e.g. manufacturing exports and automobile production). If this pattern is confirmed in coming months, the current slack in domestic markets would remain.
- iii) Midterm inflation expectations have not been affected by the recent inflation increase. This suggests that, to a certain point, analyst consider this increase as transitory.
- iv) The discussion, by Banxico's Board, about the costs and benefits of a policy reaction to supply shocks, is still pending.

It is worth noting that the possibilities of a rate hike increases significantly if inflation moves upward.

Arnoldo López M  
[arnoldo.lopez@bbva.com](mailto:arnoldo.lopez@bbva.com)

Iván Martínez Urquijo  
[ivan.martinez.2@bbva.com](mailto:ivan.martinez.2@bbva.com)

Av. Universidad 1200, Col. Xoco, México 03339 D.F. | [researchmexico@bbva.bancomer.com](mailto:researchmexico@bbva.bancomer.com) | [www.bbvaereasearch.com](http://www.bbvaereasearch.com) | Follow us on Twitter

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