Mexico Flash

Banco de México: The recent inflation reduction supports the monetary pause

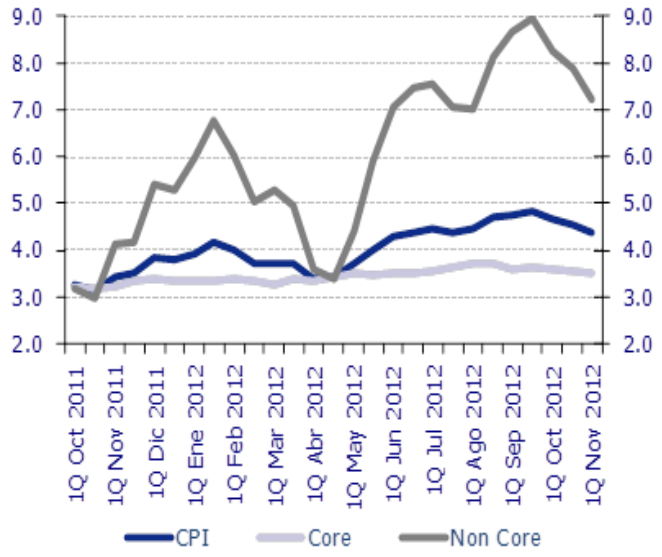
- Recent decrease in headline and core inflation, as Banxico predicted, leaves aside the preventive rate hike.
- The monetary pause should linger in a scenario of inflation reduction and moderate economic growth

During the last month headline and core inflation decreased from 4.64% to 4.36% YoY and from 3.58% to 3.50% YoY, respectively. These reductions are in line with Banxico's forecast and support the idea of the temporary nature of recent supply shocks. As inflation continues trending downwards and there is no evidence of second round effects on prices (inflation of services slowed from 2.2% to 2.0%) the perspective of a monetary pause strengthen. However, upward risks on inflation such as the potential increase of public tariffs or commodity prices remain. These risks along with an inflation above 4.0% will add up for Banxico to maintain its hawkish tone. With regard to the upwards inflation risks, it is worth noting that wage increases above historic levels are limited to some workers of the public sector and therefore it is not expected to affect the price formation process.

Regarding economic activity, the pace of GDP growth has moderated from 4.9% YoY in the first quarter to 3.3% YoY in the third quarter, while the expected growth rate for 2012 remains in 3.7% YoY. The slowdown will continue in 2013 and will lead to a GDP growth of 3.0% YoY. In this environment the possibilities of demand side pressures decrease. In addition, the uncertainty concerning the US fiscal cliff will add up for Banxico to maintain the impairment in the balance of risks of economic activity.

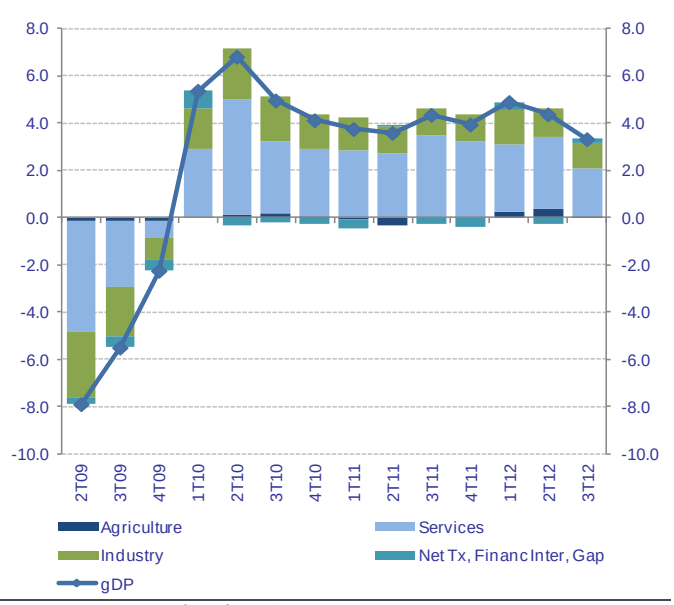
The economic scenario of BBVA Research forecasts an inflation reduction below 4.0% during the first half of 2013 and a slowdown of economic growth to around 3.0%. This scenario is consistent with a monetary pause. However, if current inflation risks develop a preventive rate hike is not dismissed.

Chart 1
Headline inflation and its components (%YoY)



Source: BBVA Research and INEGI

Chart 2
GDP Mexico, YoY% and contributions



Source: BBVA Research and INEGI

Arnoldo López M
arnoldo.lopez@bbva.com
Iván Martinez Urquijo
ivan.martinez.2@bbva.com
Av. Universidad 1200, Col. Xoco, México 03339 D.F. | researchmexico@bbva.bancomer.com | www.bbvaresearch.com | Follow us on Twitter

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