

Mexico Flash

Banco de México: Upward inflation risks increase the probability that the rate cut takes place in April

- Waiting some weeks to assess the upward inflation risks and the magnitude of US sequestration could bring more elements for a rate cut

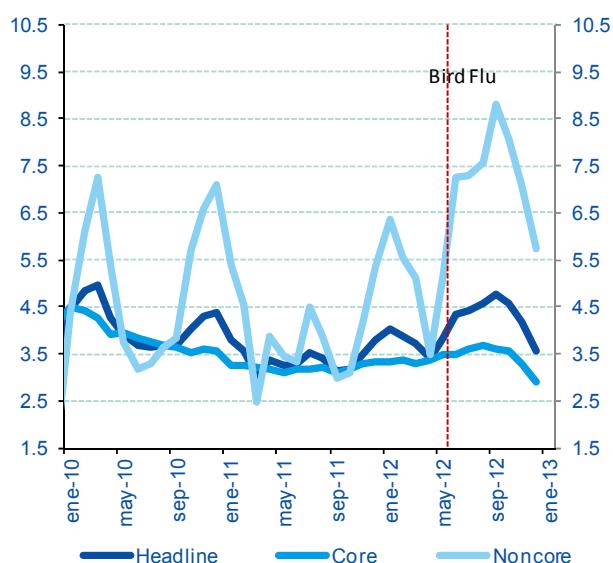
As Banxico surprisingly turned dovish in recent communication, the market and most of analysts followed and are now expecting a rate cut as soon as this Friday. However, there are some upward inflation risks that lead us to think that it is more probable that the rate cut takes place in April. Among these risks are the following. First, the recent bird flu outbreak. Some weeks will be necessary to assess the impact on inflation of this new outbreak, even though at the moment it seems less widespread than last year's. Second, the future path of telephony prices is still unclear, particularly following the increase that this component registered in the last months and after it represented a 0.75 percentage points of the annual inflation reduction last December. Third, US budget negotiations and Italian politics could prompt some risk aversion episodes in the next weeks. Finally, it is worth noting that inside Banxico's board there is still debate regarding the time inflation should be around the target to confirm the convergence. Altogether these risks factors suggest that waiting some weeks could bring more support to cut rates, especially when it is expected that inflation will peak in April.

In addition, the perspective of domestic economic activity will be clearer in some weeks as relevant US and Mexico economic data is released. It is worth noting that in spite of lack of agreement regarding US sequestration, at the moment, US output and confidence indicators show no major impairment.

In sum, we consider that a 50 basis points rate cut is more probable in the April meeting. However, considering Banxico's surprising and repeated dovish tone a rate cut the next Friday cannot be dismissed.

Chart 1

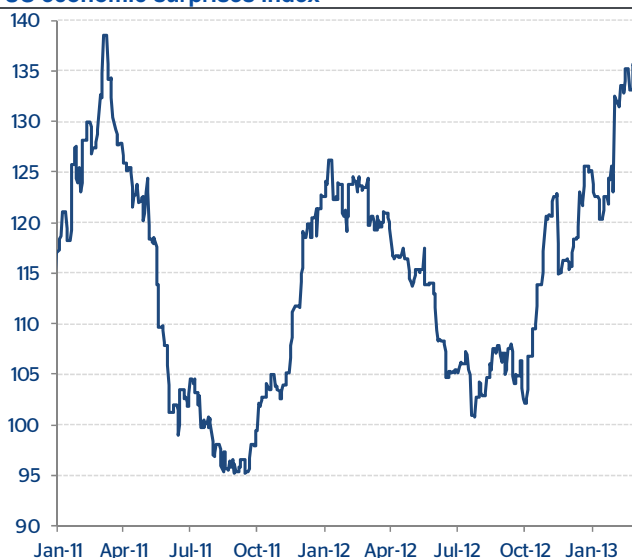
Inflation. Headline, core and noncore (YoY%)



Source: BBVA Research and INEGI

Chart 2

US economic surprises index



Source: BBVA Research

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