

Mexico Flash

Banco de México: Inflation hike anchors the monetary policy rate

- Recent inflation hike and moderate economic growth perspectives are consistent with a monetary pause
- As the uncertainty regarding domestic activity remains, the coming data releases and Banxico's statement will be key elements to evaluate the balance of risks

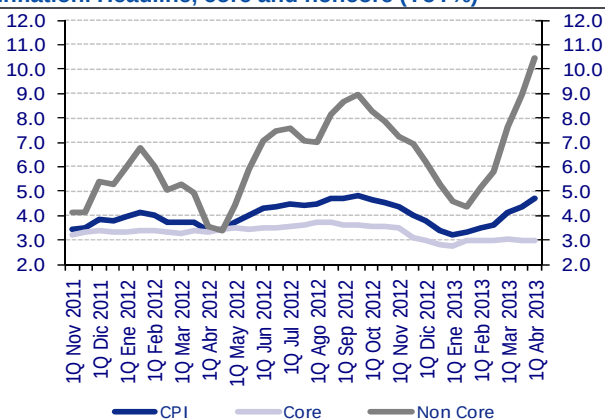
The economic scenario since last monetary policy meeting has been dominated by the effects of global liquidity, the rise in inflation and the weakness of recent domestic activity figures. In this context we expect the monetary policy rate will stay unchanged based on the following arguments. First, the annual inflation rate has increased to 4.7%. Even though this increase has a temporary nature, and core inflation remains around 3.0%, this level leads us to think that inflation will stay above 4.0% during three months more and that it will be around 3.8% at year end, far from the convergence to the inflation target. Second, the 2013 economic growth expectations remain above 3.0%, even though recent domestic figures (manufacturing activity, automotive production) point to a weak first quarter. The latter is supported by the fact that industrial production in the US has increased lately and by the expectation that the US growth will increase during the second half of the year. Thus, we expect that the recent inflation hike will lead to a neutral tone, without leaving aside the downside risks on economic activity.

On the other hand, the recent peso appreciation has brought about several opinions regarding the influence of this variable on the monetary policy stance, even more, given that Banxico supported its rate cut on the argument of an unnecessary tightening of monetary conditions. Although recent appreciation has been relevant, at present it is not possible to affirm that the monetary conditions are restrictive. In addition, we consider that the Exchanges Commission could take advantage of the appreciation perspectives and the global liquidity to increase the international reserves.

Altogether, in the current conditions the perspective of inflation and domestic activity are consistent with a monetary pause during 2013. However, if domestic activity impairs significantly during the second half of the year, a situation of a weaker activity could join a headline inflation below 4.0% and a core inflation around 3.0%. In this situation Banxico could consider a change in the monetary policy stance.

Chart 1

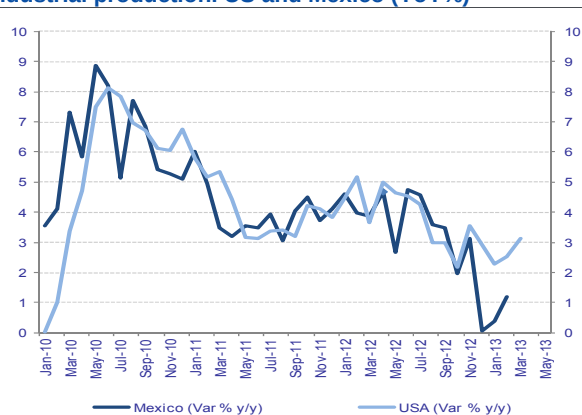
Inflation. Headline, core and noncore (YoY%)



Source: BBVA Research and INEGI

Chart 2

Industrial production. US and Mexico (YoY%)



Source: BBVA Research and INEGI

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