

Mexico Flash

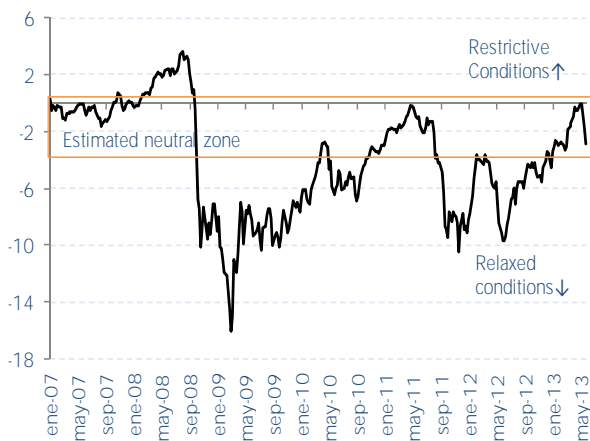
Banco de México: No change in monetary rate. Dovish tone due to economic activity

- As inflation remains above 4.0% it is still early to expect easing signals
- However, economic growth moderation and downward inflation expectations, in a context of high liquidity, give room for a rate cut during the second half of the year
- Follow closely any mention to the relative monetary stance of Mexico following the recent peso depreciation and the relevance of this factor in Banxico's communication

The economic scenario since last monetary policy meeting has been dominated by the uncertainty about a possible slowdown of FED's asset purchases; the reduction of the domestic growth rate and an inflation rate that is expected to move downward since June. The uncertainty concerning the FED asset purchases has led the peso to a 6.0% drop and interest rates to a hike since early May. This in turn was reflected in an easing of monetary conditions as several central banks around the world keep cutting their reference rates. In face of these developments attention will have to be paid to how the Banxico statement talks about Mexico's relative monetary policy stance, given that Banxico's has stressed this factor in recent communication. With regard to the domestic activity, the GDP growth figures for the first quarter (2.2% y/y), the lowest annual rate of growth since 2009, confirm the signs of weakness in economic activity, above all in the manufacturing sector. At the same time, there are mixed signs in the U.S., with the indicators of manufacturing activity down and the indicators of consumer confidence up. Finally, annual inflation is expected to begin a downward trend to under 4.0% at the end of July, while core inflation should remain around 3.0% the rest of the year.

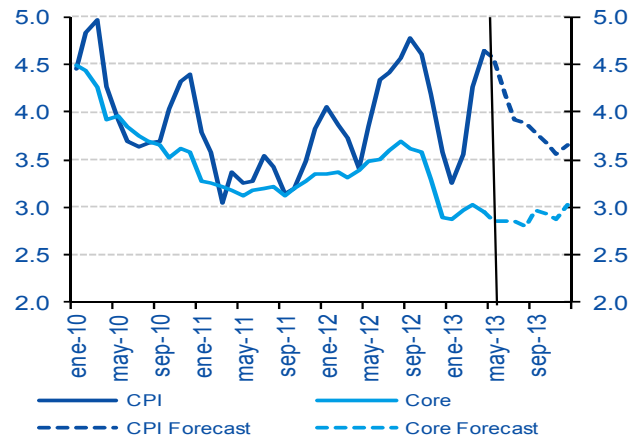
Central Bank's communication becomes more relevant in this context. The minute from last monetary policy meeting showed that most of the board had a pessimistic take on domestic output as well as agreeing that core inflation remaining around 3.0% is proof of convergence to the inflation target. Therefore, we consider that once the dovish tone of Banxico's communication is taken into account, the current economic outlook is consistent with a 50 basis points rate cut in September, once inflation is below 4.0%.

Chart 1
Monetary conditions index



Source: BBVA Research, Banxico and Bloomberg

Chart 2
Headline and core inflation (YoY%)



Source: BBVA Research and INEGI

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