

Mexico Flash

Banxico: Fondeo rate at 4.0%. A dovish tone is expected as domestic activity impairs

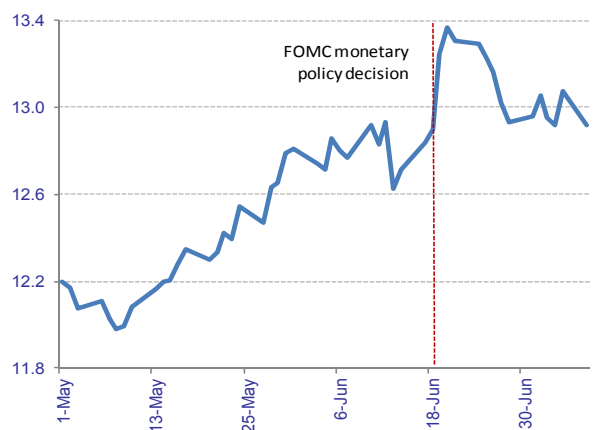
- We expect that domestic activity impairment outweighs less restrictive monetary conditions in Banxico's statement
- Lower GDP growth expectations and an inflation rate below 4.0% in the coming months give Banxico room for a rate cut in September

As FED tapering still dominates the economic landscape, we consider that next Friday's statement will turn more dovish given the impairment of domestic activity and an inflation rate that has decreased according to the central bank expectations.

Recent data point to a slowdown during the second quarter as a consequence of the unusual drop in public expenditure during the first five months of the year (-5.0% YoY) and of the sharp reduction in industrial production in April (-2.1% YoY) stemming from both manufacturing and construction components. The domestic activity slowdown takes place as inflation decreases to a 4.09% annual rate due to vanishing supply shocks, while core inflation is at 2.79%. It is worth noting that inflation is expected to remain below 4.0% since July. In the coming months, even when a recovery of external demand and public expenditure is expected, these will not be enough to bring GDP growth close to the potential growth rate.

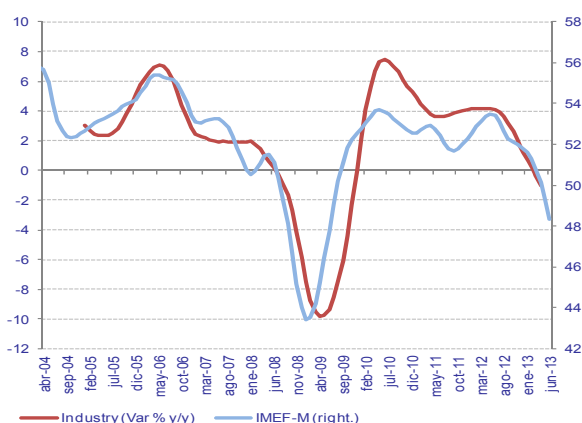
The current conditions and its perspectives coupled with Banxico's communications lead us to maintain our rate cut call for September. Specifically, in the past most members of the board of governors have expressed in favor of achieving inflation convergence at the lowest cost in terms of economic activity. Therefore, a key issue in the coming statement will be Banxico's assessment of the extent of the economic slowdown and its importance in relation to the loosened monetary conditions stemming from the peso depreciation.

Graph 1
Exchange rate (ppd)



Fuente: BBVA Research y Bloomberg

Graph 2
Industrial production and IMEF producer index (% YoY, points)



Fuente: BBVA Research e INEGI

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