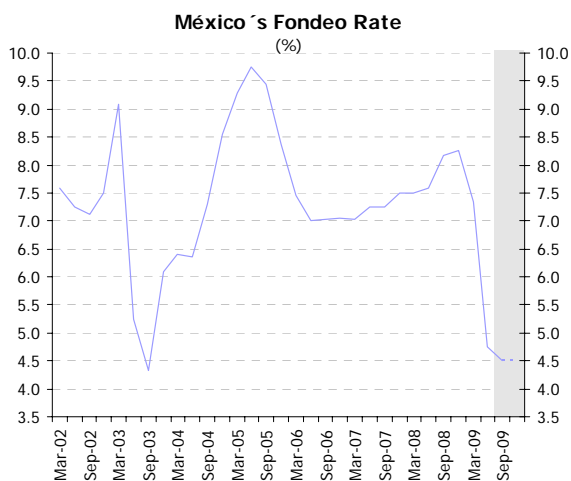


On Friday 17 July, Banxico will reduce the policy rate by 25 bps to 4.50%, but we cannot rule out a further cut as large as 50 bps.

- When Banxico announced a 50 bps cut in the benchmark rate at its last Governing Board's meeting on 16 June, it stated that "... the Governing Board considers that the cycle of relaxation is approaching its end, and therefore any future actions that could be taken will possibly be of lower magnitude ...".
- This measure taken by Banxico is in line with the severity of the domestic economic contraction resulting from Mexico's high exposure to changes in the external demand and the impact of the actions taken to prevent the spread of the AH1N1 virus. The Bank of México also stated its expectations that the rate of contraction in the economic activity will slow down, forecasting the Mexican economy to perform better in the second half of the year.
- With regard to inflation, Banxico considered that it will converge to its forecast as soon as the real exchange rate depreciation effects on goods' prices are discounted and services' prices continue to slow down in response to lower demand pressures.
- We expect larger figures for the decline in activity in 2009 and the deceleration of prices than those announced by the Central Bank in its last inflation report. With regard to GDP, we expect a fall above 6% in 2009 given the slow rate of recovery of the Mexican economy observed in recent months –affected by the flu outbreak– and the forecast for growth in the second half of the year to be dependant on the performance of the global economy. We consider quite likely that inflation will reach the official target for 2009, although we cannot dismiss certain upside risks related to the most volatile components in the basket of products used in the calculation of the CPI and, in particular, the dynamics of the exchange rate and how those effects are absorbed by the consumer prices.
- In summary, we expect Banxico to lower the policy rate at its next meeting on 17 July by 25 bps to 4.50%. Although we do not rule out the possibility of a further cut as large as 50 bps, in any case, Banxico is already close to conclude the current easing cycle. From this time on, the benchmark rate will be hold steady in line with the degree of accomplishment of Central Bank's inflationary expectations and a positive growth demand well into the second half of 2009.



Note: The policy rate target scheme was adopted by the Central Bank in April 2004
Source: ERD BBVA

