Economic Research Department

BBVA

Banxico Watch

July 17, 2009

Banxico cut bank lending rate by 25 bp to 4.50%, notifying in addition it will take a break in the present easing cycle

- In line with previous releases and with regard to the global economic scenario, the Banxico Board maintains its view of a rapid improvement in economic activity in industrialized countries, although stating that the weak US job market is a factor to be considered in the speed and duration of said recovery. It also states that general consensus estimates the recovery will be weak and, due to this, fiscal and monetary stimulus packages need to be maintained longer. In turn, emerging economies, especially Asian economies, appear to be improving given the strength of domestic demand and the, albeit moderate, improvement in foreign trade.

- With regard to Mexico, Banxico highlights the severity of the economic contraction over the 1S09. Specifically, it gives as reasons the domestic economy's high dependence on international trade and, in particular, US development with a highly concentrated export structure in durable goods. The measures taken to prevent virus A (H1N1) contagion also had an impact on this negative development. Despite the above, Banxico expects improved economic performance in the second half of the year.

- With regard to inflation, monetary authorities point out that it has continued its downward trend and it is expected to converge to levels around 4% at year-end. Although at the start of the year it had been affected by the upward trend in the goods sub-index, since May, this and the services sub-index began their downward trend.

- Taking into account the above, the Board decided to cut the lending rate by an additional 25 bp, notifying in addition it will take a break in the present quantitative easing cycle. In addition, it stated that any future action will be subject to the development of risk balance based on the inflation rate with regard to the 3% target for the end of 2010 and economic activity.

- In this situation, we believe an additional 25 bp decrease in lending in October or November is not unlikely based on the intense fall in inflation and the expected economic recovery.

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