



Weekly Observatory

February 15th, 2010

February 19 Monetary Policy Meeting: the monetary pause will continue

The Bank of Mexico (Banxico) stated that in the absence of indirect effects on inflation from increased public prices and indirect taxes, and if inflation forecasts remain anchored, the impact of temporary shocks on inflation should not be counteracted. The above points to incoming information continuing to be appraised in coming months and the Board not being in any hurry to raise the interest rate, in an environment in which medium- and long-term inflation forecasts remain anchored.

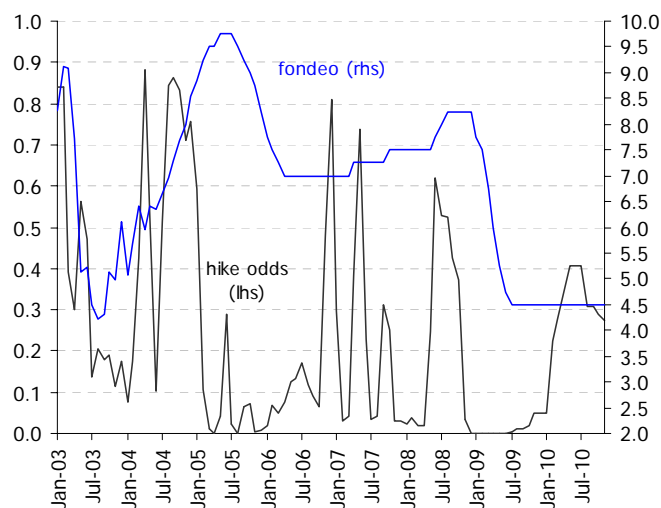
While economic recovery is gradual enough to keep the output gap negative, which holds true for the forecast horizon for Banxico and SEE BBVA, these sound conditions should offset the transfer in taxes and public consumer prices. We forecast that Banxico will maintain the monetary pause throughout 2010, although the probability of a higher lending rate will increase in the 4Q10 when, in line with the SEE BBVA scenario, inflation could be higher than the average evolution range expected by Banxico and the recovery process more consolidated. In fact, the quantitative instruments used (see chart) suggest that the probability of Banxico not maintaining the monetary pause throughout the coming meetings is low, in accordance with our economic scenario.

The transparency of Banxico's monetary stance ("The Bank of Mexico should not, in principle, counteract the direct impact on prices from the fiscal measures"), had an influence not only on delaying and reducing monetary policy expectations from the market on the tightening of monetary policy, but also on analysts' perspectives. If the consensus anticipated in December 2009 that the first increase in the bank lending rate would occur at the beginning of the year, now, with this information from the first week of February, it is now delayed to July.

The Banxico assessment of the risk balance for 2010-11 has been consistent in its most recent communication, i.e. it remains moderately inclined towards lower inflation. Banxico's communication strategy continues to have a clear goal: to maintain inflationary expectations well anchored. Therefore, we predict that the report for the meeting on February 19 will continue to emphasize the role of "the wide output gap" to soften the effect of the change in taxes and public prices. We also forecast that Banxico will maintain the bank lending rate and "wait-and-see" strategy, adopted after the previous report on its monetary policy decision at January 15.

We believe that the Board will not rush to increase the interest rate, except in reaction to adverse inflationary expectations and/or an accumulation of supply shocks that results in a new upward revision of inflation forecasts, i.e. if price pressures acquire a general character. Therefore, we continue anticipating the balance of risks described by Banxico will continue to justify the maintenance of the monetary pause throughout 2010.

Fondeo Hike Odds*



* BBVA ERD's Ordered-Probit Model

Economic Calendar

February 15 to 19

	Monday	Tuesday	Wednesday	Thursday	Friday
	15	16	17	18	19
Mexico					Monetary Policy Decision (Feb) 4.5% (4.5% prev)

Macroeconomic and Financial Forecasts

Mexico	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
Inflation (% , avg)	5.1	5.3	4.7	6.2	6.0	5.1	4.0	4.3	4.2	4.4	5.3
Core (% , avg)	4.9	5.3	5.0	5.8	5.6	5.1	4.7	4.7	4.9	5.0	5.2
GDP (real annual % change)	1.4	-6.8	3.8	-8.9	-8.9	-6.3	-2.9	4.9	5.6	2.9	1.8
Bank funding (% end of period)	8.25	5.42	4.50	6.75	4.75	4.50	4.50	4.50	4.50	4.50	4.50
28-day Cetes (% , avg)	7.62	5.43	4.48	7.26	5.45	4.53	4.49	4.47	4.47	4.47	4.53
28-day TIE (% , avg)	8.28	5.94	4.90	8.01	5.92	4.90	4.91	4.90	4.90	4.90	4.90
M 10 years (% , avg)	8.37	7.98	7.57	8.02	7.86	8.12	7.94	7.90	7.67	7.52	7.57
Peso/dollar (avg)	11.1	13.5	13.0	14.4	13.3	13.3	13.1	13.2	13.2	13.0	12.7

U. S.	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10
Fed Funds (% , end of period)	0.50	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25
10-year bond (% avg)	3.64	2.35	3.075	2.71	2.35	2.00	2.35	2.55	3.00	3.25	3.50
Dollar / euro (avg)	1.47	1.39	1.27	1.29	1.38	1.43	1.46	1.42	1.38	1.35	1.32

* Forecast in **bold**

Financial Markets

February 4 to 11

Spreads	Previous close	Week chng. bp	Currencies	Previous close	Week % chng.	Bolsas	Previous close	Week % chng.
U.S. corporate (BAA)	421	12	Peso / dollar	12.96	-1.01	IPC	30,845.6	-1.41
EMB+Mexico	165	-38	Real Brazil / dollar	184	-1.79	Dow Jones	10,144.2	-1.23
EMB+Brazil	205	-34	Dollar / euro	137	-0.22	S&P	1,078.5	-1.71
EMB+LatAm	346	-25	Yen / dollar	89.8	0.81	Bovespa	66,128.9	-1.46