

Mexico

Banxico Watch

February 9, 2011

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Q4 2010 Inflation Report

Banxico maintains that inflation will remain in its target range, but the risk balance will skew upwards

- **Banxico raises its growth forecast for 2011 from 3.2 – 4.2% to 3.8 – 4.8%. In line, it is forecasted that the output gap will become positive in the second half of the year, earlier than previously expected, but without demand pressures on prices being perceived, which is a risk that is not valued as imminent**
- **The forecast range for Q1 2011 inflation decreases from 3.75 – 4.25% to between 3 and 4%. Its baseline expects inflation to remain, with the highest probability, below 4 percent in both 2011, as well as in 2012, despite the decline in the risk balance**
- **Banxico consolidates a communication that puts inflation outlook at the center of its decisions through evaluating the impact that a wide range of variables may have on them. Without automation in decision making, with a leeway consistent with a preventive approach to achieving price stability**
- **The scenario proposed by Banxico is consistent with our view of continued monetary pause until well into 2012, albeit with a risk balance that is skewed towards a more rapid rise than a more delayed one**

The Q4 2010 Inflation Report revealed the better global environment, both in the activity of developed economies and as well as in emerging markets. However, the growth of the former is, according Banxico, largely due to fiscal and monetary stimulus, so that risks of a slowing economy persist once these are removed. On the other hand, given the abundance of global liquidity, some emerging countries with strong increases in aggregate demand are facing the dilemma of running their monetary policy stance to address the excessive strengthening of the exchange rate or higher inflation.

With regard to domestic activity, Banxico revised its growth forecast upwards for 2011 from between 3.2 and 4.2 percent to a range between 3.8 and 4.8 percent, due to the improved performance of domestic demand, especially consumption and investment, to a lesser extent, as well as the improvement in the global context. Based on the foregoing, the formal job creation forecast for 2011 increased by 100 thousand jobs to stand between 600 and 700 thousand.

In terms of inflation, the Q1 2011 forecast range decreased from a range of 3.75 and 4.25 to stand between 3 and 4 percent, based on the fact that Q4 2010 inflation was below the limit of the previous forecast because a strong base effect from the same period of 2010 will be seen during Q1 2011. Additionally, the first fan chart forecast was presented; according to which, in its most likely scenario, inflation will remain between 3 and 4 percent over the next two years. Nevertheless, the upper limit of the forecast range is above the 4 percent of the target range in recognition of the existence of several upside risks.

The risk balance highlights that, unlike the previous report, firstly raw materials, grains in particular, are on the increase. Secondly, there may be possible increases in the prices of goods and services determined by local governments. An emerging risk in the balance is the greater vulnerability to cost disruptions in an environment where the output gap has been closing. Finally, the risk of abrupt capital outflows triggering exchange-rate volatility is mentioned again.

Table 1

Banxico: Economic Scenario

	For 2010					For 2011	
	Quarterly Report					3Q10	4Q10
	4Q09	1Q10	2Q10	3Q10	4Q10		
Published:	27-Jan-10	28-Apr-10	28-Jul-10	27-Oct-10	9-Feb-11	27-Oct-10	9-Feb-11
U.S. Growth (annual %)*	2.8%	--	--	-	-	--	--
Mexico Growth (annual %)	(3.2 , 4.2%)	(4.0 , 5.0%)	(4.0 , 5.0%)	(5%)	(5.4%)	(3.2 , 4.2%)	(3.8 , 4.8%)
Employment (IMSS-registered workers, thousands)	(350 , 450)	(500 , 600)	(525 , 625)	(575 , 675)	-	(500 , 600)	(600 , 700)
Current Account (% GDP)	-1.2%	-1.1%	-0.8%	-0.6%	-	-1.1%	-1.2%

* Market Consensus quoted by Banxico

Source: Banxico

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