

Mexico Flash

Banco de México: No change in fondeo rate and a slightly more hawkish tone

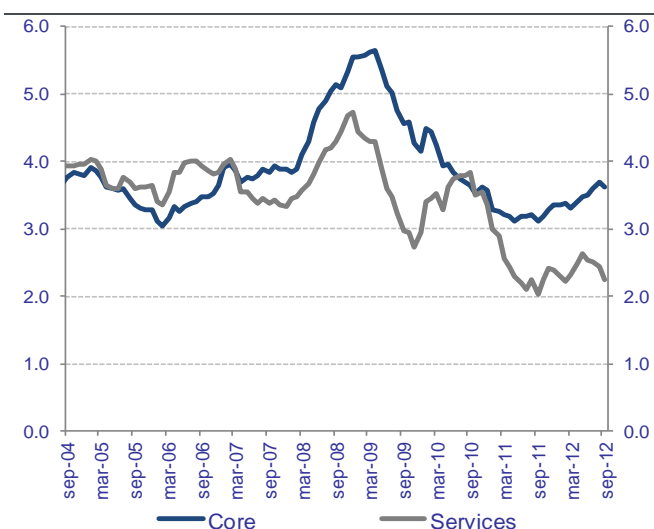
- The persistence of supply shocks impairs the inflation balance of risks in the short term and could lead to a slightly more hawkish tone.
- However, the temporary nature of the shocks, in addition to the absence of second round effects and increases in inflation expectations, are consistent with a monetary pause.

The increase in inflation above 4.6% could lead to a slightly more hawkish tone, nevertheless the monetary pause will prevail. The less neutral tone of the last statement could turn slightly more hawkish as the greater persistence of food and energy prices impairs the inflation balance of risk in the short term. In fact BBVA Research estimates that inflation will remain above 4.0% at least until the first quarter of 2013.

In spite of the recent inflation spike above the target, we expect the monetary pause to remain. The latter based on the following factors: i) At present, there is no evidence of second round effects. Wage indicators are not growing, while core and inflation of services, gauges more associated to demand pressures on prices, are clearly below the upper bound of the variability interval of the inflation target; ii) recent data of foreign demand (e.g. manufacturing exports and automobile production) have shown moderation. This pattern, if confirmed, would make more lasting the current slack in domestic markets. iii) midterm inflation expectations have not been affected by the recent inflation increase. This suggests that, to a certain point, analyst consider this increase as transitory. iv) The discussion about the costs and benefits of a policy reaction to supply shocks is still pending between Banxico's Board members.

The aforementioned factors in addition to an expected inflation slump during the second half of next year lead us to think that the monetary pause will remain during 2013. However, it is worth noting that if evidence of second round effects emerge, the monetary stance could tighten.

Chart 1
Core inflation and inflation of services (%YoY)

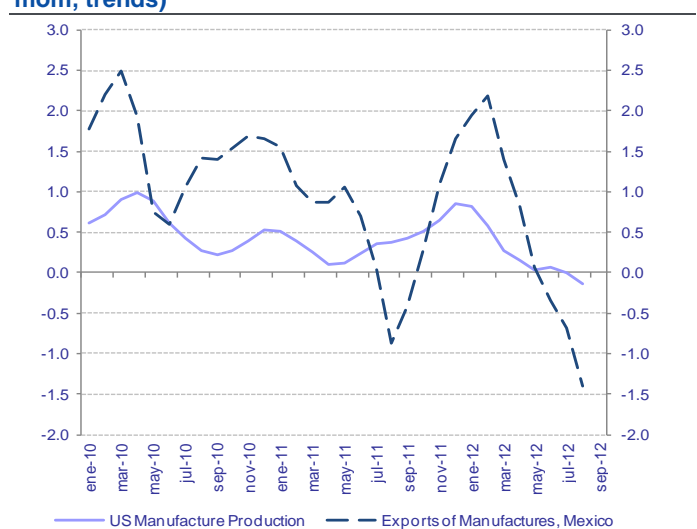


Source: BBVA Research and INEGI

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Chart 2
US Manufacture and Mexico's manufacture exports (% mom, trends)



Source: BBVA Research and INEGI

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