

Mexico | Inflation, on a downward course for 2018

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The most recent inflation figure, corresponding to the first half of November, surprised on the upside. After falling in September and October, headline inflation showed an upturn from 6.4% to 6.6%. This increases the likelihood that the Banco de México will increase its monetary policy rate as a preventive measure.

With analysts even anticipating a rise at the next monetary policy meeting in December. I think this is unnecessary and will not happen. The Bank of Mexico will continue with its monetary policy pause, with the next movement downward, by the middle of next year. This is for several reasons.

Firstly, the change of governor announced this week, which I think this is a wise decision. Alejandro Díaz de León is a very good economist with in-depth knowledge of the central bank, where he worked for many years in various roles. He has a solid knowledge of both macroeconomics and the financial sector. In terms of monetary policy, I think he will represent continuity with respect to Agustín Carstens.

Secondly, this rise in inflation will be transitory. It can be explained by the effects of earthquakes and, significantly, by increases in LP Gas prices. These increases are due to the fact that the prices were liberalised within an industry with a rather uncompetitive oligopolistic market structure. In as far as this industry's competition problems are attacked, prices should be regulated.

The important point is that these are transitory increases in the prices of some goods, rather than generalised increases in prices; no second-order effects have been reported. In addition, medium-term inflation expectations remain well anchored. I estimate that inflation will start to drop off in January, when the base effects of this year's increases in gasoline prices dissipate, continuing to fall throughout 2018.

Inflation will close this year at levels of around 6.5%, falling to levels of 5.2% in January and continuing to fall below the upper range of the Banco de México target (4%) in the third quarter of the year.

It should be stressed that the inflationary increase observed in 2017 has specific causes, such as the depreciation of the exchange rate, the above-mentioned increases in fuel prices, and some supply shocks in agricultural products. All these causes are transitory and will not mean generalised increases in prices.

Thirdly, the increases in the monetary policy rate, which were proactively carried out by the Bank of Mexico (400 basis points in just under two years), have contributed to anchoring medium- and long-term inflation expectations. Those increases have been enough. No more will be required.

Even if we see additional depreciations in the exchange rate, we must remember that a transfer was already made to imported goods that reflected the 22 pesos per dollar exchange rate. As long as the exchange rate remains below that level, no additional transfers should be made to prices, which would not be favourable due to the degree of slack still presented by the economy. And I think that even in the scenario when the United States leaves the North American Free Trade Agreement (NAFTA), the peso will not depreciate

beyond that level.

To sum up, the most recent inflationary increase is transitory. Inflation will begin to decline significantly in January, expectations are well anchored and the Bank of Mexico should maintain its monetary pause.

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