

Decision: Central Bank acts to lower policy rate by 25bp to 3.75%

- The Central Bank of Mexico (Banxico) reduced the policy rate by 25bp to 3.75% per year on Friday, September 6th 2013, in an unexpected move. Banxico's decision comes upon the deceleration of GDP growth and downward trajectory of core inflation. (Figure 1.)
- Today's rate cut is the second one delivered by Banxico this year; in March, Banxico delivered a 50bp cut on account of structural gains in the growth-inflation dynamic.

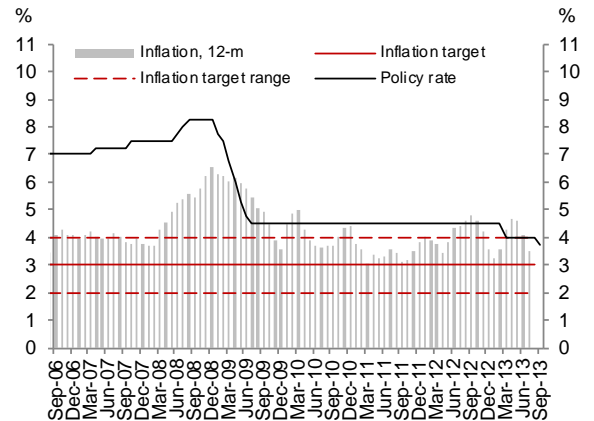
Focus on GDP growth

- Banxico has been keeping its policy options open, and the focus of today's action was clearly on GDP growth.
- With inflation within the target range, Banxico has flexibility to maneuver monetary policy to support growth. Yet, the timing of today's decision was a surprise since the market was expecting Banxico to place greater importance on the stance of monetary policy relative to that of the US and on financial market stability.
- In the statement accompanying its decision, Banxico cited concern over the weakened pace growth in 2Q13 and downside risks to inflation. (Figure 2.) It also referenced the expected structural improvement of public finances as an important component of the convergence process of inflation to the 3% target. Banxico is now expecting that the negative output gap will persist for longer, though it still expects growth acceleration in 2H13 and 2014.
- Banxico did not seem overly concerned with the recent depreciation of the MXN, nor with its effects on higher inflation. It views that the weakening of the MXN has occurred in an orderly manner, and maintains the view that pass-through to inflation is low.
- The cyclical deceleration of the Mexican economy in 1H13 has been broad-based and reflective of external and domestic factors. Real GDP contracted -0.74% quarter-on-quarter in seasonally-adjusted terms (qoq/sa) in 2Q13, compared to nearly flat growth of 0.03% qoq/sa in 1Q13. In year-on-year terms, it expanded by 1.45% in 2Q13 versus 0.57% in 1Q13.
- On the supply side, economic activity has slowed in the industrial and services sectors. (Figure 3.) The performance of industrial production in 1H13 has lagged the pick-up in the US. On the demand side, public consumption has been weak as the new administration has been reviewing its spending programs, and fixed investment has slowed in line with industrial activity.
- From the statement accompanying the decision: "The Bank of Mexico expects a larger degree of slack in the economy for a prolonged period, along with the expectation of significant advances in the structural strengthening of fiscal accounts. The monetary policy stance is congruent with the efficient convergence of inflation to the permanent target of 3%. Looking forward, the Committee will be attentive to the implications on the inflation outlook from the evolution of economic activity, as well as the stance of monetary policy relative to other countries."

Policy flexibility keeps door open for another cut in October

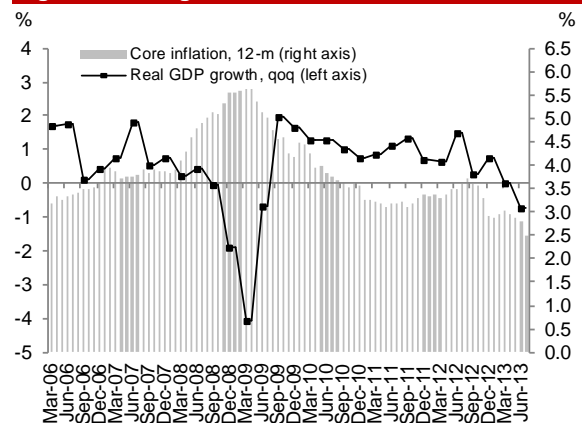
- This language in the accompanying statement suggests that Banxico will maintain its policy flexible—helped by disciplined fiscal policy—and keep the door open for another 25bp cut at its next meeting, which will be held on October 25th.
- Banxico's forthcoming decision will be influenced by the releases of key indicators between now and the October meeting, including the monthly proxy for GDP (IGAE), industrial production, retail sales, and the demand-side breakdown for 2Q13 GDP, as well as the evolution of global financial conditions.

Figure 1: Policy rate and 12-month inflation



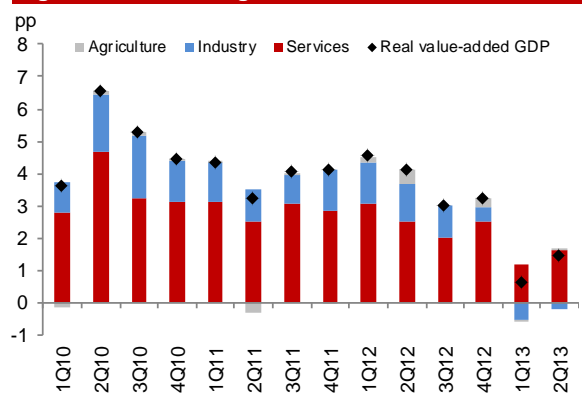
Source: Central Bank; BTMU Economic Research.

Figure 2: GDP growth and 12-month core inflation



Source: Central Bank; BTMU Economic Research.

Figure 3: Real GDP growth contribution



Source: INEGI; BTMU Economic Research.





For historical data and commentary following BTMU's Economic News Releases, see our website at: <http://www.bk.mufg.jp/report/ecolatin2013/index.htm>

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by The Bank of Tokyo-Mitsubishi UFJ, Ltd. (collectively with its various offices and affiliates, "BTMU") is or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by BTMU. BTMU hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. While BTMU believes that any relevant factual statements herein and any assumptions on which information herein are based, are in each case accurate, BTMU makes no representation or warranty regarding such accuracy and shall not be responsible for any inaccuracy in such statements or assumptions. Note that BTMU may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the analysts who prepared them, and BTMU is under no obligation to ensure that such other reports are brought to your attention.