

Banxico – 2020 Monetary Program and changes to the communication strategy

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- In compliance with its legal obligations, Banco de México released the guidelines under which it will conduct monetary policy in 2020
- Within the document, the institution elaborates on its objective –maintaining price stability–, including the costs and consequences of failing to do so
- In addition, there is an analysis of the monetary policy tools, the channels in which they operate, and also regarding the forecasts-based inflation targeting regime
- Finally, Banxico summarizes the policy actions taken in 2019, describing the general context in which they were made, for then to dive deeper into the main considerations for the current year
- On the latter, we believe that the language used is consistent with the one outlined in the most recent communications from the central bank, reaffirming our forecast that the easing cycle will continue in 2020, maintaining an orderly and prudent stance
- In addition, the central bank presented modifications to their communication strategy, which we consider positive given that they will result in added clarity and transparency in the institution's decisions

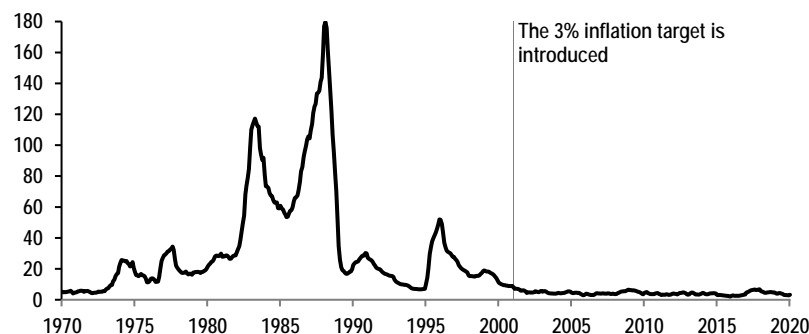
Banxico published its 2020 Monetary Program. In compliance with Article 51 of the Banco de México Law, the central bank released its Monetary Program for 2020. In this document, the institution presents the guidelines under which it will conduct monetary policy in the year. In addition, considerations about the objective of the monetary authority and ways of influencing it are outlined, on top of policy tools and a brief summary of actions undertaken in 2019.

Main objective: Price stability. The publication starts with a section that reminds us the goal of Banco de México, which is “...ensure the stability of the purchasing power of the national currency, thereby strengthening the national development that corresponds to the State...”. In this sense, they mention that the current way to measure if this goal is met is through an inflation targeting regime, which in our country was established in 2001 and has as a target of 3% annual variation of the CPI (see chart below). In addition, considering the existence of possible shocks, a variability range of +/- 1% was introduced. The importance of maintaining this target resides on the economic and social costs that stem from high and/or volatile inflation. In particular, the institution describes six: (1) Reduction of real wages, especially impacting the lower income population –acting as a regressive tax–; (2) uncertainty over medium- and long- term planning for economic agents; (3) adverse impacts on resource allocation in the economy; (4) higher real cost of credit due to heightened uncertainty; (5) promotes financial disintermediation; and (6) affects the stability of the financial system. In this regard, the institution argues that the fulfillment of its goal is necessary, while not sufficient, to foster an adequate environment for the well-being of the population.

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Headline inflation

% y/y



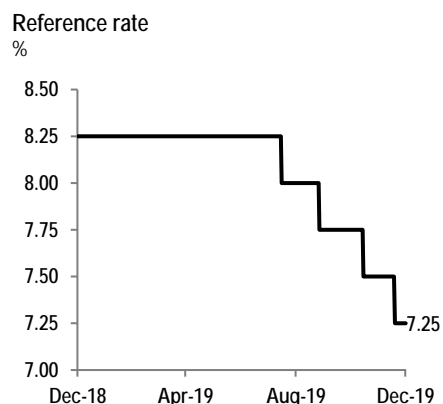
Source: INEGI

Monetary policy instrumentation. The central bank states that it must act continuously in order to achieve its objective. In this sense, a key piece to implement this is confidence from economic agents that the monetary authority will take the necessary actions in order to fulfill its goal. In this context, anchoring expectations at a level around the inflation target facilitates the work of the institution. Since 2008, and in order to influence monetary conditions, Banxico defines an objective for the one-day Interbank Interest Rate (TIIE). This, in turn influences the rest of interest rates of the economy, acting through different channels, which the institution lists as: (1) Interest rates; (2) credit; (3) asset prices; (4) exchange rate; (5) risk taking behavior; and (6) inflation expectations.

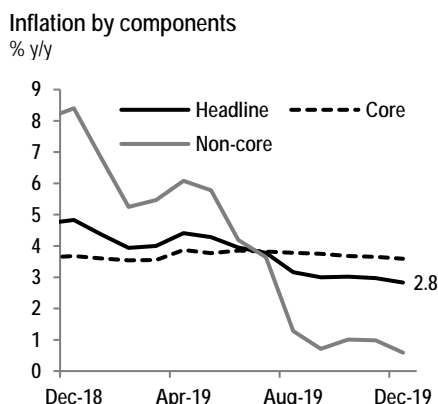
Nevertheless, there is a lag between a monetary policy decision and the moment it starts having an effect on economic activity and prices. In this regard, the central bank undertakes a careful analysis of current economic, financial and monetary conditions, as well as forecasts for these variables. With the goal of improving its communication and work, since 2018 the central bank publishes point estimates of expected inflation, which must be aligned to the fulfillment of the mandate. Therefore, these can be considered as an intermediate target. These allow both the monetary authority, as well as economic agents, to evaluate the actions that must be taken by the institution, whether the estimate is met or not. This process consists of three steps: (1) The elaboration of a new estimate with the latest available information, which, if consistent with the previous estimate, would result in a monetary position relatively similar to the one that had been implemented; (2) if the new forecast is not consistent, the shocks and the deviation interval, in their magnitude and time dimensions, should be evaluated to assess what monetary policy changes are required; and (3) the new estimates are published, explaining the changes made (if any) and the impact of the monetary position on these is mentioned. In particular, with more information being made publicly available, this regime can contribute to an increase in the credibility of the central bank, and so, as we previously mentioned, helps to anchor inflation expectations more effectively.

Actions in 2019. Out of the eight policy meetings that were carried out last year, in four of them the central bank kept the reference rate unchanged at 8.25%, in a highly uncertain environment for inflation (chart below, middle), which made a cautious stance necessary. In particular, these decisions took place on [February 7th](#), [March 28th](#), [May 16th](#), and [June 27th](#).

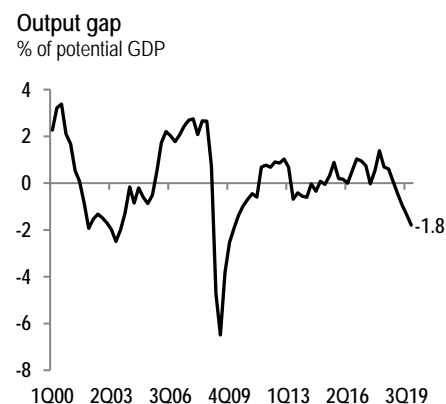
Nevertheless, in the second half of the year, the monetary authority reduced the rate by an accumulated 100bps, with a 25bps cut in each of the four remaining meetings (chart below, left). The latter materialized in a context of improved conditions for inflation, higher slack in the economy (chart below, right) and more favorable external conditions, which included easier monetary conditions at a global scale, positive developments on trade (such as the US-China agreement and USMCA). Specifically, these meetings were held on [August 15th](#), [September 26th](#), [November 14th](#), and [December 19th](#).



Source: Banxico



Source: INEGI

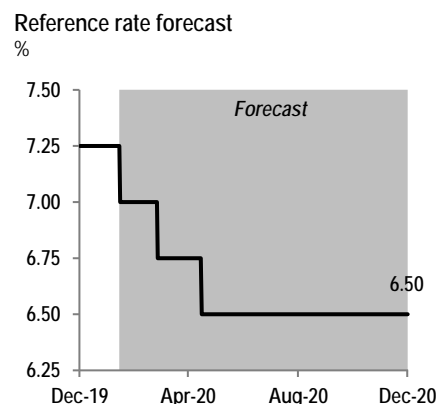


* For 4Q19 we use figures from the preliminary estimate released by INEGI
Source: Banorte with data from INEGI

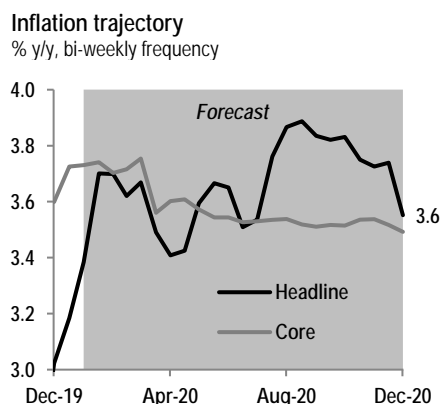
Considerations for 2020. The outlook outlined is consistent with comments from Banxico in their latest communications, particularly with their latest policy statement and minutes. On economic activity, they expect a recovery of GDP, although with the balance of risks still skewed to the downside. Regarding inflation, they expect it to reflect both slack in the economy as well as cost pressures that could stem from the minimum wage increase, with the latter possibly pushing inflation higher than what the institution currently anticipates. In this context, the balance of risks for inflation is still highly uncertain. It should be noted that relative to the list presented in the last communiqué, one upside risk was eliminated, this being: “...possible tariff and compensatory measures...”, which they already saw as diminished. Meanwhile, one risk to the downside was also erased: “...that the prices of certain goods included in the non-core subindex register lower rates of change...”.

We expect Banxico to continue its easing cycle in 2020. In particular, [we expect a 25bps cut in Thursday’s meeting](#), which would be followed by two reductions of the same magnitude in the March and May decisions. In our opinion, the institution will maintain a cautious and prudent stance, mainly due to two factors. First, it is our take that inflation could keep trending gradually higher at least until late 2Q20 or the start of the third quarter, contrary to the reversal seen by the central bank. Second, we also think volatility of the exchange rate could increase as we approach the US election (November 3rd). In this context, the level of the reference rate has helped anchor the exchange rate and to support the stability of short-term capital flows.

In this sense, our forecasts on these two factors, as well as growth (we estimate GDP at 0.8% y/y in 2020, as shown in the table below on the right) and the degree of slack of the economy, in addition to risks associated with the inflation trajectory and its expectations, make us think that monetary easing could stop with the rate at 6.50%, staying at that level until the end of the year (see chart below, left).



Source: Banxico



Source: INEGI

2020 growth estimates
% y/y

	1Q20	2Q20	3Q20	4Q20	2020
GDP	0.9	0.8	1.0	0.6	0.8
Private consumption	1.5	1.2	1.4	0.7	1.2
Investment	-1.0	1.1	0.9	0.1	0.3
Government spending	0.5	0.6	0.4	0.0	0.4
Exports	2.3	1.5	2.2	1.2	1.8
Imports	0.6	1.3	1.2	0.7	1.0

Source: Banorte

Modifications to the communication strategy. Recognizing that central bank communication is a key instrument for the instrumentation of monetary policy, Banxico announced changes to its communication strategy with the goal of improving it and increasing transparency. Specifically, three measures were announced: (1) The publication and update of the General Communication Criteria for the Board of Governors and public servants of Banco de México; (2) improvements in clarity and extension of the monetary policy statements and minutes; and (3) the addition of the quorum in each policy statement.

On the first subject, the document includes 10 points under which members of the Board, as well as other figures from the institution must abide by in their communications with the press, as well as market participants and economic agents in general. It should be noted that most of these practices were already followed by the institution, which might not result in a tangible change in the interaction of the central bank with the public. These are outlined in the following table.

General Communication Criteria for the Board of Governors and public servants of Banco de México

General Criteria

1. Board members are allowed to express their point of view in an open manner. Regarding sensible information, they must do so in a prudent manner, taking into account institutional messages. If someone wishes to comment on the diversity of opinions among the Board, they must refer to the latest minutes
2. Board members must specify that their comments, statements, presentations and documents are personal opinions, and might not reflect the opinion of the Board
3. There is a 7-day silence period that must be observed before a monetary policy meeting in which members must not give opinions regarding monetary policy (with the exception of financial authorities)
4. Media outlets must follow institutional channels to solicit information, interviews or presentations by a member of the Board
5. All public interventions of members of the Board of Governors consisting of speeches or presentations will be published on the institution's web page
6. Monetary policy statements will specify if the decision taken was by unanimous or by a majority. The minutes will include the vote of each member as well as a section in which dissenting opinions and arguments are presented
7. The transcripts from the meetings from the Board of Governors will be published three years after the corresponding meeting, with the first one to be published being that of May 2018
8. Both the monetary policy statements and minutes will be published on the web page in Spanish and English, with the Spanish version prevailing as the official release
9. Quarterly Reports and Financial Stability Reports will be presented in a press conference. In addition, after the release of a monetary policy statement and minutes, the Governor, as the spokesperson of the institution will conduct interviews in case they are solicited by the media
10. Public servants of Banco de México must abide by the points previously outlined

Source: Banxico

On the second aspect, the reduction in the extension of the documents is aligned with the practices carried out by other global central banks, seeking greater clarity in them. In this sense, we consider that this point is particularly relevant to increase the effectiveness and scope of the central bank's communication with economic agents. On the third point, we believe this is a response to the situation that presented in the last monetary policy decision, in which at first glance it was not clear if the majority vote had been 4-1 with all members present or 3-1 with an absent member. In this sense, the quorum publication should eliminate this problem going forward.

In general, we believe that changes announced in terms of the communication strategy are very favorable, increasing transparency in the actions not only of the Board of Governors, but of the institution in general. Additionally, we applaud the effort to improve the communication of the central bank, which we think can have an important impact on the way monetary policy is conducted in our country.

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	Reference
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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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