Banxico – Another 50bps intra-meeting cut, with additional liquidity measures

- **In the second out-of-calendar meeting in a row, Banxico decided unanimously to cut the reference rate by 50bps to 6.00%, in line with our expectations**
- **Moreover, the central bank unveiled ten additional measures to promote orderly market functioning, strengthen credit channels, and provide liquidity to the financial system. These measures add up to $750 billion (US$ 30.7 billion), which on top of the previously announced facilities equate to 3.3% of GDP**
- **Regarding growth, they said the COVID-19 pandemic will lead to an important economic contraction in 1H20. Although the outlook is very uncertain, initial estimates point to a decline of more than 5% y/y, with risks significantly biased to the downside**
- **On inflation, the communique stated that uncertainty about the outlook has increased significantly, although it is expected to converge to target within the time frame in which monetary policy operates**
- **We reiterate our call of an additional 50bps rate cut on May 14th, followed by -75bps on June 25th, for a year-end level of 4.75%**

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Banxico's 2020 monetary policy decisions

Date	Decision
February 13	-25bps
March 20 (intra-meeting)	-50bps
April 21 (intra-meeting)	-50bps
May 14	--
June 25	--
August 13	--
September 24	--
November 12	--
December 17	--

Source: Banxico

Banxico cut the reference rate by 50bps, to 6.00%. With a unanimous vote and in its second consecutive out-of-calendar decision, the central bank cut the reference rate by 50bps to 6.00%, in line with our expectations. In addition, the monetary authority announced ten measures to promote orderly market functioning, strengthen credit channels, and provide liquidity to the financial system. These add up to $750 billion (US$ 30.7 billion) of resources, equivalent to 3.1% of GDP (see table below). Moreover, Banxico fully acknowledged the impact that the COVID-19 pandemic will have on economic activity, with initial estimates pointing to a decline of more than 5% y/y in GDP in the first half of the year, although its magnitude and duration is still unknown. Regarding inflation, uncertainty about the outlook has increased significantly, as some forces could drive inflation higher (*e.g.* exchange rate depreciation) but others lower (*e.g.* lower energy prices and the output gap) impacting prices with different time lags.

Additional measures
MX$ billion, US$ billion, % of GDP

#	Measure	MXN	USD	% of GDP
	Total	**750**	**30.7**	**3.1**
1	Increasing liquidity during trading hours to facilitate the optimal functioning of financial markets and payment systems	- -	- -	- -
2	Extending the securities eligible for the Ordinary Additional Liquidity Facility (FLAO, for its acronym in Spanish), foreign exchange hedging program operations, and USD credit operations	- -	- -	- -
3	Extending the counterparts eligible for the Ordinary Additional Liquidity Facility (FLAO, for its acronym in Spanish)	- -	- -	- -
4	Government securities term repurchase window	100	4.1	0.4
5	Temporary securities swap window	100	4.1	0.4
6	Corporate Securities Repurchase Facility (FRTC, for its acronym in Spanish)	100	4.1	0.4
7	Provision of resources to banking institutions to channel credit to micro-, small-, and medium-size enterprises and individuals affected by the COVID-19 pandemic	250	10.2	1.0
8	Collateralized financing facility for commercial banks with corporate loans, to finance micro-, small- and medium-size enterprises	100	4.1	0.4
9	Swaps of government securities	100	4.1	0.4
10	Foreign exchange hedges settled by differences in US dollars with counterparts not domiciled in the country, to be traded during hours when Mexican markets are closed	- -	- -	- -

Source: Banxico

Banxico acknowledged the negative effects of the COVID-19 pandemic and announced ten additional measures. In tandem with the 50bps rate cut, Banxico called for additional measures to support an orderly functioning of financial markets, improve liquidity conditions and strengthen the different credit channels of the economy. The central bank stressed out that "…*All measures are intended to reduce the possibility of credit institutions having a pro-cyclical behavior, and to create the conditions so that financial intermediaries can fulfill their primary function of providing financing to the economy, in particular to micro, small- and medium-size enterprises, and to those households that have temporarily undergone a reduction in their sources of income…*". The actions announced today will amount up to $750 billion (US$30.7 billion), equivalent to 3.1% of GDP. They highlighted that, if we add [previously announced facilities](), the total will reach 3.3% of GDP. Overall, these measures can be grouped in three broad categories: (1) Five actions to improve market liquidity and strengthen financial conditions of market participants; (2) three measures to enhance credit conditions targeting MSMEs (improving liquidity, harmonizing or reducing collateral provisions for financial institutions, and boosting the capacity of development banks); and (3) two proceedings that will improve liquidity and credit conditions for the entire banking system. In our view, these are timely and bold measures similar to those adopted by other central banks worldwide (*e.g.* Fed, BoE, ECB) to cope with the stressed backdrop triggered by the Coronavirus pandemic. It should be mentioned that all these measures except for one (number 10 in the table above) will be available at least until September 30th, 2020.

Banxico to keep cutting the reference rate. In our view, the central bank fully recognizes the highly complicated situation stemming from the COVID-19 pandemic on both the economy and markets, exhibiting a dovish tone. In this sense, the measures announced today signal the absolute resolution of Board members to keep supporting the orderly functioning of financial markets. In addition, they also acted decisively to improve the flow of credit, as in times of stress the usual channel from financial institutions to households and businesses can be somewhat impaired. In this respect and in our view, today's announcements are positive and go in the right direction, without ruling out additional measures if needed. Given the rapid evolution of market and economic events –both globally and domestically– we have recently updated our framework in a series of notes. On growth, earlier today we lowered our 2020 GDP forecast to -7.8% y/y. Although Banxico will officially update its estimate for this year until the release of the *1Q20 Quarterly Report* (May 27th), we expect GDP to decline 9.8% y/y in 1H20, consistent with their view of a contraction of more than 5% in the same period. On inflation, we also cut our year-end estimate, to 3.2% from 3.6%, in which we incorporate lower energy prices along those of other services (particularly related to tourism) and potential pressures from higher FX-passthrough (factors also mentioned today in the statement), among others. Given these changes, coupled with more ample room to ease as the world has embarked in another round of extraordinary monetary easing, we reiterate our view of an additional 50bps rate cut on May 14th, to 5.50%, followed by -75bps on June 25th to 4.75%, level where we expect the reference rate to end this year.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Jorge Antonio Izquierdo Lobato and Eridani Ruibal Ortega, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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