

## Economic Research

Mexico

## Banxico – Greater concerns on inflation reaffirm possible rate hikes this year

- In a unanimous decision, Banxico decided today to keep the reference rate unchanged at 4.00%, in line with consensus and our call
- In our view, the statement was more hawkish given increased cautiousness on inflation and a better outlook for growth, despite recognizing a relatively more stable financial backdrop
- In this sense, we highlight that:
  - (1) They added that the balance of risks for inflation is skewed to the upside, when it had previously been described as uncertain;
  - (2) They said that inflation forecasts for both the headline and the core will be higher in the update within the next *Quarterly Report*; and
  - (3) They modified the order and added one additional upside risk for prices
- Our linguistic analysis showed a higher absolute weight of the word “inflation”, with greater relevance also on “risks” and “core”
- We modify our monetary policy view for the remainder of the year, now expecting two 25bps hikes, in the November and December meetings, with the reference rate closing 2021 at 4.50% (previous: 4.25%)
- The local yield curve depicts a fair pricing for Banxico

**Banxico keeps the rate unchanged at 4.00%.** The decision was in line with both consensus and our call. In addition, it was unanimous. In line with our view, the tone of the statement was more hawkish relative to the previous one, given increased cautiousness on inflation and a better outlook for growth. On the former, we highlight that the balance of risks was characterized as being skewed to the upside, with the last decision removing comments on this while in the 15 statements before that, it was judged as “uncertain”. On the latter, they recognized that the recovery of the Mexican economy decelerated in 1Q21, although they expect an improvement in the year. Given this situation, we modify our monetary policy outlook, now expecting two 25bps hikes this year, in November and December, with the reference rate closing 2021 at 4.50% (previous: 4.25%)

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### Banxico's 2021 policy decisions

Date	Decision
<a href="#">February 11</a>	-25bps
<a href="#">March 25</a>	0bps
May 13	0bps
June 24	--
August 12	--
September 30	--
November 11	--
December 16	--

Source: Banxico

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general public

May 13th, 2021 Statement Word Cloud



Source: Banorte with data from Banxico

March 25th, 2021 Statement Word Cloud

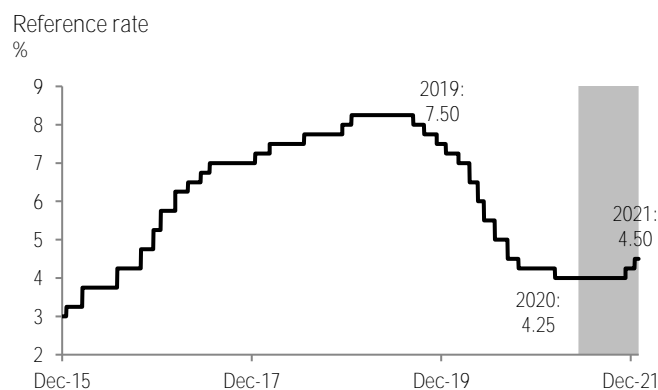


Source: Banorte with data from Banxico

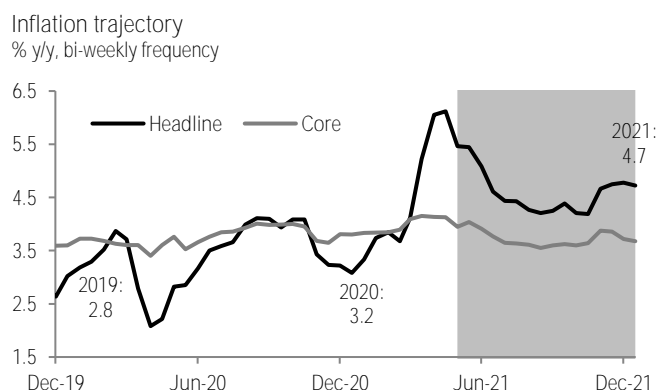
**Better growth and a more stable financial backdrop.** Globally, they remarked that the rebound continues to be heterogeneous among countries and regions, related to vaccine availability and the magnitude of stimulus. Locally, they stated that the recovery decelerated in 1Q21, although expecting an improvement in the remainder of the year. This suggests that Banxico will revise their expectations up in the next *Quarterly Report*, to be published on June 2<sup>nd</sup>, with the mid-point currently at 4.8%. They also added that the risks are more balanced. We agree with this, as [we forecast a 5.9% expansion in GDP](#). Moreover, they eliminated the tightening of financial conditions as a risk and highlighted better dynamics for the Mexican peso and interest rates.

**Balance of risks for inflation to the upside.** Once again, we noted more cautiousness in this front. First, the balance of risks was characterized as skewed to the upside, after it had been removed [in the previous decision](#) and in the 15 before that, it was judged as “uncertain”. In this context, they suggested that headline and core inflation forecasts will be higher in the next *Quarterly Report*. This is reaffirmed by saying that annual inflation in April was higher than expected. Moreover: (1) They modified the order of upside risks, quoting external inflation pressures in first place; and (2) they added the persistence (to the upside) of core inflation, when it had been removed previously. Despite of the latter, they still expect headline inflation to converge to the 3% target in 2Q22.

**We expect the reference rate at 4.50% by year-end.** We modify our monetary policy call for 2021, anticipating two 25bps hikes, taking place on November 11<sup>th</sup> and December 16<sup>th</sup>, with the reference rate ending this year at 4.50% (chart below, left). Previously, we only saw +25bps in December. Specifically, it is our take that the inflation outlook remains very complicated. Although the difficult base effect in annual inflation will start to fade away after April and would reach around 4.3% on average in 3Q21 (chart below, right), we consider three main factors: (1) Our estimate that inflation will be closer to 5% y/y by year-end, with a slight uptick again in 4Q21; (2) a high likelihood that the Fed will announce *tapering* as soon as September, giving the market time to digest it before it starts at the beginning of 2022; and (3) Governor Alejandro Díaz de León’s period as head of the central bank ending, with his replacement still uncertain (despite our view that it would be excellent news if he stays at least one more period).



Source: Banxico, Banorte



Source: INEGI, Banorte

*From our fixed income and FX strategy team*

**The local yield curve depicts a fair pricing for Banxico.** Banxico's communiqué portrayed a hawkish bias, validating the market's expectation, with a curve that is pricing-in just over 50bps of implicit increases by the end of 2021. This backdrop helped Mbonos and TIE-IRS curves to continue the mild relief rally from today's session, with additional gains of 3bps after Banxico's announcement. This comes after significant losses throughout the week of 28bps on average, reacting to the surprise rise in the CPI report released yesterday in the US. Given current conditions and the valuation of the yield curve, we see opportunities for short-term tactical strategies based on long positions that capitalize on the recent adjustment in local rates, especially in mid-term securities when considering the curve's structure and Mbonos' spreads against US Treasuries which are trading particularly high for the 5-year area. In the FX market, the Mexican peso also benefited after the decision, appreciating from 20.00 per dollar to a session close near 19.90 (+1.2% d/d). Banxico's relative monetary position will prevail as a supporting factor for the currency, although due to the shortest-term backdrop, including the potential volatility associated with the local mid-term election, we prefer to hold a cautious view for the MXN and buy USD in dips for trading purposes.

## Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, 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, Eridani Ruibal Ortega and Juan Barbier Arizmendi, 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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<b>SELL</b>	When the share expected performance is lower than the MEXBOL estimated performance.

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