

Banxico Minutes – A more hawkish skew by the Board

- Banxico published the minutes of the decision held on May 13th, in which the central bank unanimously kept the reference rate unchanged at 4.00%
- In our view the document's tone is still hawkish, albeit less so than what we perceived in the statement. Specifically, we highlight that most members consider that inflationary pressures are transitory, in an environment in which ample slack is expected to prevail
- In line with our expectations, the outlook on prices remains at the forefront of the debate, highlighting:
 - (1) The recognition of the contribution to inflation from higher raw material prices and cost pressures, on top of base effects from energy prices;
 - (2) That despite of this backdrop, price pressures at a global and local scale are transitory; and
 - (3) Short-term inflation expectations have adjusted to the upside, albeit with medium- and long-term remaining anchored, with downward risks from the negative output gap
- Although financial markets had a more stable performance, lower foreigners' holdings of government bonds were discussed again, along the decrease in credit to the private sector
- There were no explicit comments on possible cuts to the reference rate in the future. However, most members seem to prefer to maintain it at current levels for as long as possible
- Despite of the latter, we still expect 25bps hikes in the November 11th and December 16th meetings, with the reference rate closing this year at 4.50%
- The yield curve is pricing-in a scenario of tighter monetary conditions towards the end of the year

Banxico maintains a *hawkish* tone, albeit slightly less than expected. Banco de México published the minutes of the meeting held on May 13th, when they unanimously kept the reference rate unchanged at 4.00%. We believe the tone is still hawkish, albeit less so relative to what we perceived in the statement. We continue seeing greater concerns on inflation and an interesting debate about additional factors that could pressure it. Nevertheless, most members consider these as transitory. In this sense, we highlight that there were no explicit comments on possible rate cuts in the future. In our opinion, this signals that the “window of opportunity” for cuts has been shut, in contrast to the previous minutes in which three members kept seeing this possibility. However, most seem to prefer to remain it at the current level for “as long as possible”. Based on our view that some of the recent price pressures will continue (with inflation at 5.5% by year-end), among other factors, we think said period will be relatively short. Specifically, we still expect 25bps hikes in the November 11th and December 16th meetings, with the reference rate at 4.50% at the end of this year.

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Banxico's 2021 policy decisions

Date	Decision
February 11	-25bps
March 25	0bps
May 13	0bps
June 24	--
August 12	--
September 30	--
November 11	--
December 16	--

Source: Banxico

Document for distribution among the general public

Concerns on inflation prevail, with the balance of risks skewed to the upside... Consistent with what was outlined in the statement, most members concur that the recent increase in prices is explained not only by base effects, but also obeys to price pressures in raw materials and other costs, reflected in a disproportionate rise in some goods. Moreover, several noted hints of a slight reversal in the composition of spending, also resulting in additional increases in some categories, mainly at the core component. Nevertheless, and in a relevant fashion, there were also mentions about supply chain issues, while also noting the effects on agricultural goods from droughts. Therefore, they explicitly stated that the balance of risks is skewed to the upside. In this context, the discussion over factors that could pressure inflation even further is extensive, highlighting concerns over external pressures, costs or the possibility of FX depreciation. Even some keep quoting risks from persistently high core inflation. In this backdrop, one member mentioned that “...*this bias (to the upside) is clear given the behavior of inflation and its expectations...*”. Another added that “...*the balance of risks for headline inflation has deteriorated...*”, and finally, less concerned, one argued that “...*inflation risks are relatively stable...*”.

...albeit highlighting the transitory nature of price pressures. Specifically, most members think these will be transitory. Some argue that this situation is consistent with inflation expectations –both from analysts and market securities– with higher year-end estimates, but with 12-month and longer-term forecasts relatively anchored. In our view, these discussions suggest that there will only be upward revisions in short-term estimates from the institution, which seems to resonate with prevailing slack in the output gap as a downside risk for prices. Moreover, some elaborated on dynamics of “super core inflation”, which remains around 3% and seems to suggest price stability. On the other hand, one elaborated about the difficulty of understanding price dynamics amid the cyclical position of the economy, with possible skews in the measurement of inflation, output gap, NAIRU and the real neutral interest rate (r^*).

More vigorous GDP growth this year, with more balanced risks. Most highlighted that higher growth is expected in 2021, driven by external demand strength, with some forecasting a boost from the progress in vaccinations and the gradual reopening of the economy. However, it is likely that the recovery remains heterogeneous across sectors and regions, similar to what we have seen globally. Hence, the balance of risks for activity has improved and is now more balanced.

Improvement on financial markets, albeit with risks that call for caution. They recognized an improvement in markets, with a slight appreciation of the Mexican peso, gains in the stock market and interest rate stability. This is due to an expectation of higher global growth, increased risk appetite, and the accommodative stance from the Fed, among others. However, they still mention some risks. Within them, they highlight the recent evolution of inflation, especially in the US. One member mentioned the possible tapering from the Fed. They highlighted benefits from the changes of said institution to its long-term strategy; nevertheless, some signaled that EM central banks have started to reduce stimulus. On the other hand, they keep noting the reduction in government bond holdings from foreigners, preferring those Asian economies.

Moreover, they noted that financing to the private sector keeps decreasing and that credit conditions have deteriorated. We noted that, in this occasion, there were no comments on public finances and Pemex's financial situation, as these had been mentioned persistently before. In our opinion, consensus is that the adoption of a cautious stance during the easing cycle was positive. This has left some room to maneuver to avoid making abrupt adjustments and has resulted in conditions for orderly adjustments in local markets despite recent price dynamics and the performance of capital flows.

Divided views prevail about the best monetary stance ahead, despite a less accommodative stance at the margin. In our view, opinions among Board members are still somewhat divided, with a relevant gap between those perceived as more hawkish or dovish. Overall, the skew is less accommodative. Specifically, we recall that in the previous minutes, three members had talked about possible rate cuts in the future. Today, there was no explicit mention about this. Among those that we see as more cautious (Governor Alejandro Díaz de León and Deputy Governor Irene Espinosa), the focus remains on prudence. Apparently, they are more concerned about the inflation outlook and potential pressures from abroad (e.g. higher volatility). On the dovish wing –with Deputy Governors Galia Borja, Jonathan Heath and Gerardo Esquivel– we perceive more agreement about the transitory nature of inflation pressures, especially from Borja and Esquivel. Nevertheless, considering the tone of the comments we identify with them, they also see the margin for rate cuts as greatly diminished. Jonathan Heath looks more worried about the high degree of uncertainty, possibly being the one who argued that: “...*the reference rate should be maintained at its current levels for as long as necessary...*”. Although this is less dovish at the margin, he falls short of mentioning the need to hike. Esquivel could be the one stating that “...*it is important to maintain, as far as possible, an accommodative monetary policy stance for as long as necessary...*”. Broadly speaking, these adjustments confirm that the likelihood of rate cuts has fallen significantly. Nevertheless, and at least for now, opinions look skewed towards keeping the reference rate at its current level for as long as possible.

We reiterate our call that the reference rate will end the year at 4.50%. Despite the absence of clear signals that some members may be evaluating potential rate increases, we continue expecting hikes of 25bps each in the decisions to be held on November 11th and December 16th, closing the year at 4.50%. Our view rests mainly on inflation, [with the headline expected to end 2021 at 5.5%](#). Specifically, we think supply shocks are inducing pressures that will take more time to be resolved, which could continue resulting in upward price surprises. Our forecasted path also implies that core inflation will remain above 4% for the rest of the year –above the upper bound around the target– due to additional passthrough from adjustments already seen in commodities and higher costs. Moreover, we still believe that volatility will increase ahead of the Fed's tapering, expecting an announcement in September, with a formal start at the beginning of 2022. Given this backdrop, it is our take that Banxico's forecast revisions in the 1Q21 *Quarterly Report* (to be published on June 2nd) will be key.

Specifically, adjustments for short-term inflation, both the headline and the core. Although it is difficult to anticipate their magnitude, they will be very important due to their potential implications in terms of monetary policy. In addition, we expect that the convergence of inflation to the target will remain in 2Q22. Nevertheless, it will also be important to see if there are changes for said quarter (currently at 3.0% on average), as this could mean something in terms of the risks that the target is not achieved in the period if we keep seeing surprises to the upside.

From our Fixed income and FX strategy team

The yield curve is pricing-in a scenario of tighter monetary conditions towards the end of the year. The local fixed-income market experienced a limited reaction to the minutes, holding slightly pressures in Mbonos yield and TIEE-28 IRS of ~2bps, following similar dynamics in US Treasuries this Thursday. Mexican rates have depicted a good performance in the last sessions, especially in the long-end, extending the flattening bias observed throughout May and still sensitive to the risk appetite mode, adding to the concerns on global inflation dynamics and possible effects for the ultra-loose stances of the main central banks. In this sense, the yield curve currently discounts implied hikes for Banxico by +48bps for 4Q21, reflecting an appropriate valuation in terms of monetary tightening space considering our expectation of a reference rate closing 2021 at 4.50%. Moreover, this discount has corrected from levels of just under +70bps for 4Q21 a week ago, a pricing we identified as excessive. Despite this adjustment regarding the expectation for Banxico, the mid-end of the nominal curve holds significant pressures accumulated in recent weeks, initially triggered as an overreaction to US economic data that fed expectations of a more hawkish stance from the Fed going forward. In this sense, we hold our [short-term tactical long recommendation in the Mbono Mar'26](#). However, in a mid-term view, we maintain the expectation of higher rates going forward, with the US 10-year Treasury note closing the year at 2.15%.

In the FX market, Treasury pressures have resulted in a weaker Mexican peso in the session, although similar to rates' performance, with little influence following the release of the minutes. The peso trades at 19.95 per dollar, adjusting -0.4% versus yesterday's close, and compared to a more favorable performance in other emerging currencies. In light of the global uncertainty and given the Mexican agenda, with the mid-term elections likely to add more short-term volatility in the coming days, we suggest buying dollars in dips for trading purposes. In technical terms, the currency could respect the support zone near 20.25 in the coming days, with first resistance at 19.75.

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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, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, 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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