

Banxico – Maintains a 25bps hiking pace and a hawkish tone

- In a majority decision (4-1), Banxico's Board decided today to hike the reference rate by 25bps to 5.00%, in line with our call and analysts' consensus, but below market expectations
- In our view, the statement maintains a hawkish bias. As in recent decisions, Deputy Governor Gerardo Esquivel was a dissenter, favoring an unchanged rate
- We also highlight that:
 - (1) Banxico adjusted its inflation forecasts higher again for both the headline and the core, especially in the short-term;
 - (2) Nevertheless, the expected convergence of inflation to the target remains "...by the end of the forecast horizon...", which corresponds to 3Q23; and
 - (3) The statement keeps showing concerns about the persistence of inflation, albeit with the shocks still mainly transitory. They also noted less monetary largesse in other countries
- After the decision, we adjust our expected path for the reference rate. We reiterate our call of a 25bps hike in December, closing this year at 5.25%. For 2022, we expect 125bps of accumulated increases, reaching 6.50% by year-end (previous: 6.00%)
- The post-Banxico rally could continue in rates, supporting steeper slopes in the short-term

Banxico hikes 25bps, in a difficult decision. The rate increased to 5.00%, in line with our call and consensus, but below the view priced-in by the market. In our view, the tone remains hawkish, centered around inflation and its expectations. As in the previous decision, the vote was 4-1, with Deputy Governor Gerardo Esquivel as the only dissenter. We also highlight the upward adjustment to inflation estimates (mostly in the short term), although he Board keeps seeing that shocks to prices as largely transitory. In this respect, the expected convergence of inflation to the target remained in 3Q23. Regarding growth, they expect the recovery to resume in the fourth quarter of this year. In addition, they recognized a more restrictive bias in the global monetary policy backdrop. Considering these changes, we reiterate our call of a 25bps hike in December, closing this year at 5.25%. For 2022, we expect 125bps of accumulated increases, reaching 6.50% by year-end (previous: 6.00%)

CPI forecasts
% y/y, quarterly average

	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
CPI									
Current	5.8*	6.8	6.3	4.8	3.9	3.3	3.2	3.2	3.1
Previous	5.8	6.2	5.6	4.3	3.5	3.4	3.3	3.2	3.1
Difference (bps)		60	70	50	40	-10	-10	0	0
Core									
Current	4.8*	5.5	5.8	5.3	4.3	3.5	3.0	2.7	2.6
Previous	4.8	5.3	5.4	4.8	4.0	3.4	3.1	2.9	2.8
Difference (bps)		20	40	50	30	10	-10	-20	-20

Source: Banco de México. *Observed data

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Banxico's 2021 policy decisions

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

Source: Banxico

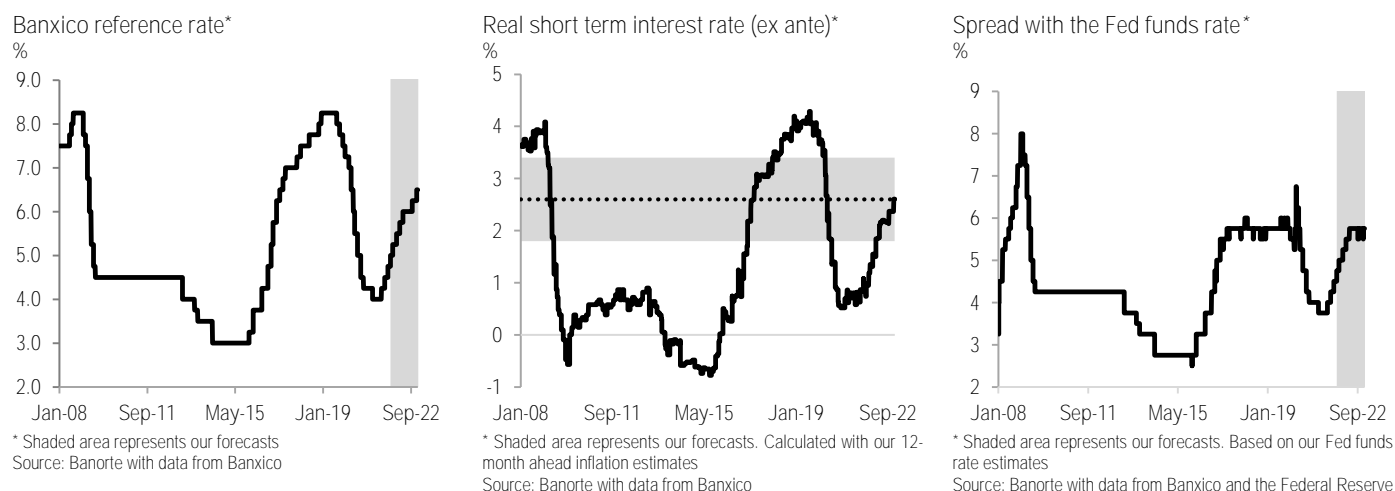
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Vigilance remains on inflation. Once again, most of the modifications were in this front. They added that local inflation pressures, not only those from global drivers, keep affecting annual inflation, both the headline and core. Expectations for this year, 2022, and the next twelve months kept increasing. Nevertheless, they remained stable for the mid-term, but above the target. Among the risks to the upside, we noted the inclusion of energy prices, along agricultural goods. We saw greater doubts about the transitory nature of inflation as they added the word “largely”, and that the horizon in which they could be affected is unknown, but it is still their base case. Going forward, we highlight that they mentioned that the Board “...*will assess thoroughly the behavior of inflationary pressures...*”, consistent with the revisions to the inflation path. As we mentioned in the previous decision, we believe these changes suggest that the hiking cycle is still in an early phase. In this respect, it is our take that the cycle could extend even further than we envisaged before this decision.

Focus also on relative monetary conditions. Regarding growth, the central bank recognized the contraction of 3Q21 GDP, although stating that the recovery will resume in the fourth quarter. This is in line with our view, but our GDP forecast for this year is at 5.7%, below Banxico’s current estimate at 6.0%. More importantly, the beginning of tapering by the Fed was mentioned, as well as the view that advanced economies are expected to withdraw monetary stimulus. In addition, they mentioned that “...*a large number of emerging market economies continue reducing it...*”. In our view, this suggests that the room to maneuver for pausing the hiking cycle has reduced more, even if some members are thinking about this possibility due to economic weakness.

The hiking cycle will continue, with a higher terminal rate. In our view, the details and tone of the statement, changes to inflation forecasts, and the economic and price environment, confirmed that this was a difficult decision. Nevertheless, the central bank also signaled it is comfortable with the current pace, particularly as there was no vote for 50bps. Notwithstanding the latter, these factors also suggest that Banxico will extend the hiking cycle for longer than we thought previously. As a result, we reiterate our call of a 25bps hike in December, taking it to 5.25%. For 2022, we now see accumulated hikes of 125bps, closing said year at 6.50% (previous: 6.00%), as shown in the chart below to the left. Although we do not have specific dates for the decisions to be held in 2022 yet, we estimate that all of them will be 25bps moves in February, March, May, October, and December. Broadly speaking, we see a more difficult environment in several fronts, including: (1) A more difficult backdrop for prices with risks remaining to the upside, as supply chain problems stay for longer and keep annual inflation high, especially the core; (2) a higher probability that the Fed begins its hiking cycle sooner than anticipated, so we changed our expectations and now see two 25bps increases each in 2022, on September and December; and (3) less accommodative policy in a series of emerging markets, as well as signals in this direction from several developed countries, reducing the available room in terms of the relative monetary stance.

Despite a faster cycle, we think Banxico will keep aiming for the most gradual pace possible given that growth remains challenged (as shown in the negative surprises of [3Q21 preliminary GDP](#) and [September's industrial production](#), among others). In this sense, we estimate that Banco de México will take the short-term real interest rate (*ex ante*) towards 2.6% by the end of next year, inside the estimated range of neutrality (based on our 12-month ahead inflation forecasts, see chart below, center). Lastly, said level would be consistent with an interest rate spread with the Fed of 5.75% (chart below, right), coinciding with the high of the latest hiking cycle –disregarding brief deviations due to differences in the calendars of the Fed and Banxico, as well as the measures taken during the pandemic–.



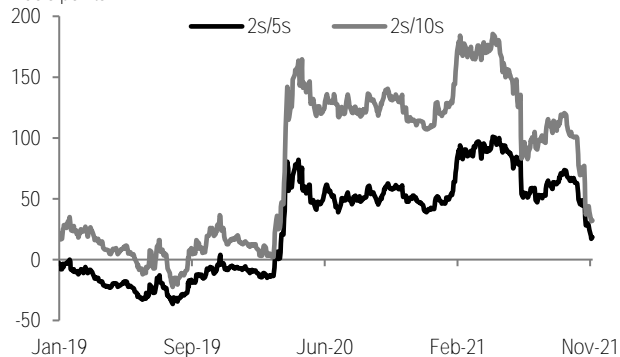
From our fixed income and FX strategy team

The post-Banxico rally could continue in rates, supporting steeper slopes in the short-term. Following the decision, nominal yield curves rallied substantially driven by a correction of the aggressive expectations that the market was pricing for Banxico, resulting in a steepening of the curve. It is worth noting that this price action took place amid low liquidity in the bond market due to the US Veterans Day. In this sense, the Mbonos' curve printed a 21bps rally in short-term tenors, on average, while the long-end appreciated 12bps. Meanwhile, TIEE-28 IRS rallied close to 25bps given the market's pricing of a 50bps hike. During the quarter, nominal yield curves have marked a notorious flattening, as shown in the chart below to the left. In this sense, we recognize that the post-Banxico rally could extend in the following trading sessions as the market continues to digest the decision and US trading resumes, exacerbating the bull-steepening bias. However, on a longer-term view, we hold preference for strategies that benefit from flatter slopes in light of tighter monetary policy conditions.

In the FX market, USD/MXN increased as it assimilated a lower-than-expected adjustment to the reference rate compared with market expectations. Specifically, it moved from 20.48 to 20.68, with the peso ending the session 0.1% weaker. We hold a bias in favor of purchasing USD in dips as we expect the dollar to remain strong, supported by the Fed's stance. For the MXN, pressures could extend towards the next technical region close to 20.80 as some weakening of the implied carry is factored-in, although we hold our estimate of USD/MXN 20.50 by year-end. Furthermore, the 20.30 level remains as an important resistance zone.

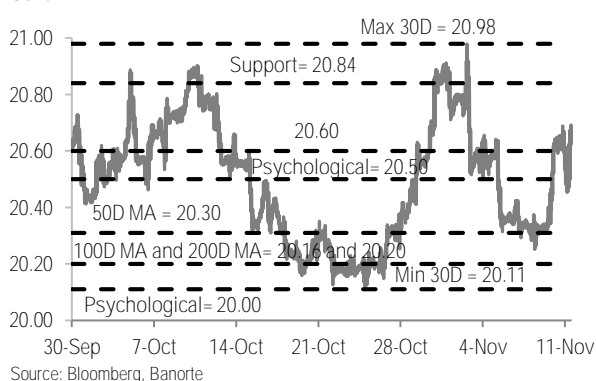
Spreads between TIE-28 swaps

Basis points



Mexican peso intraday performance

USD/MXN



Analyst Certification

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