

# Banxico minutes –A fast and furious hiking cycle

- **Banxico published the minutes of the decision held on May 12<sup>th</sup>, in which they hiked by 50bps to 7.00% in a split decision, with Deputy Governor Irene Espinosa pushing for +75bps**
- **In our view, the document shows an even more hawkish bias than the statement. We see greater concerns about the inflation outlook given new shocks and risks**
- **The debate was centered on the more adequate pace and length of the hiking cycle. Specifically, we highlight:**
  - (1) Comments by the majority about the real ex ante interest rate, a key variable to assess the most adequate policy stance;**
  - (2) That at least two members talked about the terminal rate; and**
  - (3) Awareness of the benefits of guiding expectations about policy moves, underpinning the addition of the phrase about “more forceful measures”**
- **Given the tone of the minutes and recent interviews, our assessment of each members’ views and the balance of the Board, our inflation and Fed path forecasts, we see an even more front-loaded hiking cycle**
- **Specifically, we now expect a 75bps rate hike on June 23<sup>rd</sup> (previous: +50bps). Moreover, we see the year-end rate at 9.50% (previous:9.00%), instead of reaching this terminal rate by early 2023**
- **The market reaffirms its expectation of +75bps in June**

**Banxico’s minutes are more hawkish.** In our view, the document provided valuable and more detailed information about the central bank’s stance, especially on the different opinions among Board members. Broadly speaking, we saw even more concerns about the potential impact from new shocks to inflation. Among them, it was highlighted the global tightening of monetary policy and financial conditions –including the Fed, which will hike by 50bps in at least its next two decisions–, higher geopolitical uncertainty, and the impact to global trade from new lockdowns in China, among the most relevant. More importantly though, we noted a more restrictive bias from all members. This includes Governor Victoria Rodríguez and Deputy Governor Galia Borja. [Since the decision](#), we warned that they can be decisive to determine the most likely magnitude of the hike in the next meeting (see next section). Given the tone of the minutes and recent interviews, our assessment of each members’ views and the balance of the Board, as well as our forecasts for the Fed and Mexico’s inflation –with annual core inflation still moving higher at least until the 2<sup>nd</sup> half of July–, we expect a faster and more aggressive hiking cycle. We believe there is enough consensus about the need to reach a restrictive monetary policy promptly. In this backdrop, we now expect a 75bps rate hike to 7.75% on June 23<sup>rd</sup> (previous: +50bps). Moreover, we see the year-end rate at 9.50% (previous:9.00%). We keep seeing the latter level as the terminal rate of this cycle, albeit it will be reached before our previous forecast, which was at the beginning of 2023.

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### Banxico's 2022 policy decisions

Date	Decision
<a href="#">February 10</a>	+50bps
<a href="#">March 24</a>	+50bps
<a href="#">May 12</a>	+50bps
June 23	--
August 11	--
September 29	--
November 10	--
December 15	--

Source: Banxico


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**More clarity about the most likely move.** After the statement, and considering member’s participations before this release, we thought the most relevant comments would be from Governor Victoria Rodríguez and Deputy Governor Galia Borja. This is because their votes may be decisive for the result of the next meeting. In this context, and in a somewhat unexpected fashion, we believe their views were much more *hawkish*. This constitutes the most important factor behind our adjustment for the reference rate path. On remaining members, we were more convinced about the bias of Deputy Governors Irene Espinosa –given her diverging vote–, Jonathan Heath –because of comments in *Twitter* and in interviews with *Bloomberg* and *El CEO*– and Gerardo Esquivel –taking into account his dovish skew. We consider this was validated by the document. Up next, we present a table with our assessment about each member comments:

**Banorte’s assessment on Board member’s comments in the May 12<sup>th</sup> minutes**

Bias	Member	Order in the minutes	Relevant comments
 Hawkish	Irene Espinosa	4°	"...pointed out that it is time to raise the rate of adjustment of monetary policy by 75 basis points..." "...act decisively and in a timely manner to curb inflationary inertia and avoid more severe rate increases in the future..." "...complacency in the face of the observed adjustments warns about the possibility of them starting to become unanchored [regarding inflation expectations], which would imply high costs for society..."
	Jonathan Heath	3°	"...pointed out that raising the rate by 75 basis points would send a stronger message of commitment to the central bank's primary objective..." "...the reference rate would need to be above 8% and possibly at levels above 9%..." "...The challenge is to establish an ideal trajectory, in terms of timing and pace of adjustment, to be able to attain such level..."
	Galia Borja	2°	"...it is essential to consolidate a robust approach that provides absolute certainty about the central bank's commitment to its mandate..." "...it will consider taking more forceful measures in the next monetary policy decisions, and that it might be necessary for the ex-ante real interest rate to reach a level higher than the neutral rate..." "...the importance of monetary policy operating with predictability in order to influence an orderly formation of expectations..."
	Victoria Rodríguez	5°	"...pointed out that extraordinary conditions, such as those being faced, may require extraordinary actions..." "...appropriate monetary policy stance could be significantly more stringent than in other circumstances..." "...warned that an un-anchoring of expectations must be avoided by taking forceful actions..."
	Gerardo Esquivel	1°	"...it is unnecessary and even imprudent to adopt a pace of rate increases above that of the Federal Reserve..." "...the room to raise the policy rate without affecting economic activity is rather limited..." "...it is important to continue the cycle of increases prudently and avoiding an excessive tightening..."
Dovish			

Source: Banorte with information from Banxico

**Debate on the pace and extension of the tightening cycle.** We consider the three points to highlight are comments on: (1) The ex-ante real interest rate; (2) the level of the terminal rate; and (3) benefits of guiding expectations. Regarding the first point, we believe Heath stated that the reference rate needs to be above 8%, –consistent with his recent declarations that it could go up to 10%– considering inflation expectations. This is addressed by calculating the ex-ante rate, placing the upper threshold for neutrality at 3.4%. Based on our estimates, an additional 75bps hike would take the real rate exactly to that level. Meanwhile, Borja argued that, relative to previous cycles, the adjustments in this one has not achieved a proportional adjustment between the ex-ante real rate and the institution’s hikes. Based on this, more forceful actions are justified in upcoming decisions. On the terminal rate, Esquivel’s comments suggested that the rate should only reach neutrality, as there is not much room left to increase the rate without impacting economic activity. Meanwhile, Heath was more emphatic that reaching restrictive territory may be needed –especially given his comments outside of these minutes.

In addition, at least three members spoke about the benefits of forward guidance. In our view, this was precisely one of the factors that stopped Heath from voting for +75bps on this occasion, since he assessed that it would surprise the market and could set a new pace of adjustments. Borja endorsed this tone, alluding to the fact that predictability in their decisions is relevant. She considered that their communications should convey the message about the possibility of faster adjustments –already included in the statement–. Lastly, Espinosa even argued that surprising on the side of prudence would not be necessarily bad since it would portray a central bank whose priority is to control inflation, it was not entirely ruled out by the market, and financial instruments price-in even a greater adjustment in rates for the rest of the year.

*From our Fixed income and FX strategy team*

**The market reaffirms its expectation of +75bps in June.** In our view, the market remains comfortable with the current pricing for Banxico, with a modest reaction in local rates after the minutes. In this sense, short-term Mbonos lost 4bps, while long-term tenors gained 2bps, resulting in a further curve flattening. Similarly, TIEE-28 IRS reflected the same dynamics. In particular, the 1s2s spread moved into negative territory (-4bps) for the first time since August 2020. In this backdrop, the market consolidated its view of a 75bps hike in June. In addition, it sees two 50bps increases in August and September, as well as +25bps in the last two meetings of the year. As a result, the tightening cycle would conclude with the benchmark rate at 9.25%, slightly lower than our 9.50% call. In terms of strategy and given our new view of the hiking cycle, we expect nominal curves to flatten further. Specifically, we could see even greater inversion between shortest tenors (less than one year) and the belly in both Mbonos and TIEE-IRS. Despite of this, we believe long-term Mbonos continue to look more attractive, especially the Nov'42 and Nov'47 securities. Their attractiveness has improved at the margin given the possibility of a more aggressive cycle, which could contribute to a stronger reduction in mid- and long-term inflation expectations. However, high volatility limits their attractiveness for directional positions. Finally, short-term Udibonos have traded more defensively, which has led to a significant compression in breakevens, although they have not yet reached sufficiently attractive levels for new directional trades.

Meanwhile, the Mexican peso was stable, trading slightly below 19.80 per dollar and reaching up to 19.76 after Banxico's minutes. The peso has traded defensively compared with EM peers, accumulating an appreciation of 3.7% year-to-date. This is only behind BRL (+16.5%), RUB (+16.3%) and PEN (+9.5%). However, given the current situation, we maintain our view of USD structural strength on a more hawkish tone from the Fed and the market's risk-off mood. Given a more aggressive stance by Banxico, we do not rule out further peso gains in the short term. This is possible even if we see limited space for a strong appreciation beyond the 19.70 congestion zone, especially as our models suggest a 7.9% overvaluation. Regardless of the juncture, we see the current range of 19.70-19.80 as sufficiently attractive to buy USD for short-term tactical trading positions..

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivios Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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