Banxico – Setting the stage to slow down the hiking pace

- **Today, Banxico's Board raised the reference rate by 75bps to 10.00%, in line with our call held since late September**
- **The vote was split, with Deputy Governor Esquivel favoring only +50bps**
- **In our opinion, the tone of the statement is less hawkish. We highlight:**
  (1) Mixed revisions to inflation forecasts, with the headline lower and more modest upward adjustments for the core;
  (2) On the forecasts, these are not seen as impacted further by additional shocks that would take more time to dissipate;
  (3) The balance of risks for inflation remains to the upside, although not "significantly", as in previous meetings;
  (4) Comments about global inflation were less pessimistic, while recognizing that international monetary conditions may tighten at a slower pace; and
  (5) Accumulated monetary tightening as a new factor to consider in upcoming decisions
- **We maintain our view of +50bps in December, with the rate at the end of the year reaching 10.50%. Hikes would continue, with a terminal point of 11.00% by the end of 1Q23 and with cuts materializing until the second half of next year**
- **The market expects a more modest hiking pace in December**

Banxico hikes 75bps for a fourth time in a row, while moderating the *hawkish* tone. In line with our forecast since September 29th and consensus expectations, the central bank raised the reference again by +75bps (see table on the right), taking the rate to 10.00%. The decision was not unanimous, with Deputy Governor Gerardo Esquivel supporting only +50bps. In our view, several changes make the statement's tone less hawkish (as detailed in the following paragraphs). The overall tone suggests that the tightening cycle will continue, albeit likely at a slower pace relative to the last four decisions, which were of +75bps each. This is consistent with our view of +50bps in December, taking the reference rate to 10.50% by the end of the year. For 2023, we reiterate our call of 25bps hikes each in February and March, which would result in an estimated terminal rate of 11.00%. In turn, this implies matching the moves that we anticipate for the Fed in the upcoming three decisions. In our opinion, this strategy would be influenced by the positive effects seen so far in terms of financial stability, among other factors. It would also help to reaffirm the central bank's prudent stance, which remains relevant as core inflation has stayed pressured and with no clear signs of moderating. This was reflected in Banxico's forecast adjustments today. In addition, it gives credence to the view that it will not be possible to decouple from the Fed for the rest of the hiking cycle. Meanwhile, we believe today's changes could induce a more heated debate about the possibility that Banxico could start cutting before the US monetary authority, and as soon as in 2023.

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Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Banxico's 2022 policy decisions

Date	Decision
February 10	+50bps
March 24	+50bps
May 12	+50bps
June 23	+75bps
August 11	+75bps
September 29	+75bps
November 10*	+75bps
December 15	--

*Minutes of the decision to be released on November 24th . Source: Banxico

In this backdrop, we reiterate our view that this decoupling could materialize in the second half of next year, anticipating 75bps in accumulated cuts from Banxico in the last three meetings (vs. only -25bps by the Fed), with the rate closing said period at 10.25%.

Notable changes in the statement, setting the stage for a more modest adjustment. We identified several points suggesting this. The clearest one is the dissent from Deputy Governor Esquivel, who had already telegraphed this possibility in his public presentations before the decision (podcast available only in Spanish). In addition, the description of global conditions suggests less pessimism as they mentioned that "*…there are signs that pressures on primary goods and disruptions in supply chains have started to mitigate…*". They don't speak of an accelerated monetary tightening globally and even noted lower-than-expected hikes by several central banks. On forward guidance, we believe the key addition was "*…the monetary policy stance already attained in this hiking cycle…*" as a factor that they will consider for monetary policy ahead. In our view, this was similar to a new comment by the Fed in its last decision, which we interpreted as a clear sign that the pace of hikes could moderate. Finally, we saw relevant changes regarding local inflation, which we detail next.

The path for headline inflation was adjusted lower, but the core increased. For the headline, the revision was to the downside –a situation not seen since February 2022–, with an average change of -23bps for the next four quarters (up to 3Q23), and the largest ones being of -30bps both for 4Q22 and 1Q23. On the contrary, they expect core pressures to continue, adjusting the path higher by 18bps on average for the next 12 months, remaining unchanged after that. We highlight that this is the smallest change since the forecasts are updated in the policy statement (August 2021). They didn't change the expected timing for the convergence to the target, still in 3Q24. We consider that these modifications are consistent with downward surprises in the three new inflation reports released since September's meeting, in which the headline moderated in annual terms, but the core kept climbing. We also note that: (1) The balance of risks remains tilted to the upside, albeit not "significantly" anymore; and (2) they did not mention that inflationary shocks have been higher than forecasted and that "*…they will take longer to dissipate…*".

CPI forecasts
% y/y, quarterly average

	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24
CPI										
Current	7.8*	8.5*	8.3	7.6	5.8	4.7	4.1	3.8	3.4	3.1
Previous	7.8*	8.5*	8.6	7.9	6	4.8	4	3.7	3.4	3.1
Difference (bps)	--	--	-30	-30	-20	-10	10	10	0	0
Core										
Current	7.3*	8.0*	8.3	7.5	6.4	5.2	4.1	3.6	3.2	3.0
Previous	7.3*	8.0*	8.2	7.3	6.2	5.0	4.1	3.6	3.2	3.0
Difference (bps)	--	--	10	20	20	20	0	0	0	0

Source: Banco de México. *Observed data

From our Fixed Income and FX strategy team

The market expects a more modest hiking pace in December. Local rates remained virtually unchanged after the decision, with the trading day characterized by a strong rally in the fixed-income market. This was driven by the positive surprise in US inflation. As a result, Treasuries printed a 20bps rally, mainly in the short end. In a similar fashion, Mbonos gained 35bps on average and TIIE swaps from the two-year term onwards rallied 40bps. In this sense, the market now sees with greater conviction a more modest pace in the hiking cycle, in tandem with the Fed. With this, the curve is fully pricing-in a 50bps hike in December and anticipates a terminal rate of 10.75%, below a previous level of 11.00%. Additionally, the market is pricing-in a decoupling at the start of an eventual easing in Mexico and the US, with cumulative adjustments of -220bps and -50bps, respectively, during the 2H23. This is consistent with our call that the debate in this front could intensify. In this current backdrop, we expect volatility in fixed income to stay high. Hence, we reaffirm our preference for relative value strategies instead of directional positions. In FX, the dollar had its worst day in over 10 years, with the BBDXY index falling 2.0%. The Mexican peso strengthened due to greater risk appetite, trading at 19.36 per dollar (+1.1%) from 19.55 before the US CPI release. In our view, the MXN has a limited room for further appreciation as our models signal an overvaluation that exceeds 12.00%. We suggest buying USD at current levels only for tactical positions.

Analyst Certification

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, Cintia Gisela Nava Roa, 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 Olivos 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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