

Banxico's minutes – Monetary policy should decisively face shocks to the economy

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- Banxico just published the minutes of the meeting held on May 17th, in which the board of governors decided to keep the reference rate unchanged at 7.5%
- In our opinion, the document adds little additional information to the discussions already observed in the *Quarterly Report* released yesterday
- In this context, we perceive the same *hawkish* tone in the minutes that we have been mentioning, on the back of the discussions among the members of the board of governors on the following topics:
 - (1) The balance of risks for growth in the short term has improved, with limited slack observed in the economy;
 - (2) The balance of risks for inflation remains on the negative side amid high levels of uncertainty, and despite the improvement it has presented so far;
 - (3) Inflation expectations, while relatively anchored, remain above the Banxico's target;
 - (4) They pointed out the persisting risk to the scenario: the renegotiation of the NAFTA, the electoral process, the fiscal reform in the US, as well as the volatility in international financial markets and an adverse socio-political environment; thus
 - (5) The objective of monetary policy in a complex environment must be *"...to achieve the convergence to the target, decisively addressing any shock while preserving the central bank's credibility ..."*, this could lead, in the opinion of one of the members *"... to further adjustments to the rise in the benchmark interest rate, even in the near future ..."*
- Today's minutes support our expectation that Banxico will raise the benchmark rate by 25pbs at its monetary policy meeting on June 21
- Looking ahead, Banxico's board argued that there is the possibility that the period of uncertainty may be further extended, and therefore, *"... the scope of action required goes far beyond monetary policy ..."*
- We highlight two important changes to the structure of the minutes, in line with the improvements to the central bank's communication already announced:
 - (1) The discussions during the meetings are presented in the first place and, as an annex, the analysis from Economic Research and Operations of the Central Bank, when in the past this was the other way around; and
 - (2) For the first time, the direction of the vote of each member of the board of governors is presented, which on this occasion was unanimous

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From our fixed income and FX strategy team

- **Local assets are trading on the negative side. Mexican bonds are selling off nearly 6bps while the Mexican peso is the second worst performer in EM today, falling 1.4% to 20.01 per dollar as the US confirmed tariffs to aluminum and steel exports beginning tomorrow**
- **The market reaction following today's minutes was modest, as the tone of the document was slightly hawkish, in tandem with the previous communiqué**
- **In our view, the central bank remains cautious ahead of several risks that could result in higher volatility in the Mexican peso, with consequences for inflation in terms of the pass-through effect. In the aftermath of today's minutes, the market is pricing-in a 15bps of implied cumulative rate hikes for 2Q18, 33bps for 3Q18 and 36bps for 4Q18**
- **As Banxico's current assessment is consistent with our defensive strategies, we hold our trade idea of long positions in floating-rate securities with positive carry (e.g. Bondes D), while waiting for better market conditions to enter once again in Mbonos**
- **We highlight the recognition of peso weakness since the previous meeting on April 12th, attributed mainly to broad USD strength but also to uncertainty about NAFTA negotiations and, to a lesser extent, to the typical political uncertainty during local electoral processes. In this respect, we agree with the central bank's ranking of the factors that have recently driven currency performance**
- **As a result, we maintain a defensive stance in the peso but recommend taking profits of USD/MXN longs at the current level, waiting for a better entry to re-engage in these positions for short-term trading purposes, with its next resistance on a break higher of this technical level around the 20.21 figure (Dec-16 low at the close)**

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