Banxico Minutes – Hawkish tone as risks abound

- **Banxico published today the minutes of the meeting held last September 28, in which the board of governors unanimously decided to maintain the reference rate at 7%**
- **We perceived a more hawkish tone in today's minutes vs September's *communiqué*, where we highlight the following issues discussed at the meeting:**
  (1) Several members highlighted the possibility of making upward adjustments to the reference rate, given the greater likelihood of some of the inflation risks mentioned throughout the document materializing
  (2) One member highlighted that market's expectations of two rate cuts in 2018 are *"…not realistic and may be considered careless…"*;
  (3) However, most members stressed out that there has been a significant appreciation of the Mexican peso and an anchoring of inflation expectations, which *"...means that the main transmission channels of monetary policy are fully operating"*
  (4) The restrictive monetary policy implemented since 2015 will continue to influence inflation dynamics, allowing for an orderly adjustment in relative prices
  (5) The balance of risks for inflation deteriorated due to the impact of the uncertainty regarding an *"...adverse outcome of the NAFTA negotiations ..."*
- **In our view, Banxico will keep the reference rate unchanged for the remainder of the year, considering that we estimate that inflation has already reached its maximum level in August, and will maintain a downward trend during the rest of the year**
- **In this context, we believe that Banxico's board will change its current stance with Governor Carstens's exit in November**
- **In addition, it is our take that it's highly likely that the current complexities will fade away by 2H18, which in addition to CPI inflation converging to the target, could open up easing space for Banxico**
- **In this regard, we continue to anticipate a reduction of 100bps in the reference rate throughout 2H18, with a total easing cycle of up to 200bps taking place between years 2018 and 2019**

October 12, 2017

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Gabriel Casillas
Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes
Senior Economist, Mexico
Alejandro.cervantes@banorte.com

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX strategy team

Alejandro Padilla
Head Strategist - Fixed-Income and FX
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
FX Senior Strategist
juan.alderete.macal@banorte.com

Santiago Leal
Strategist, Fixed Income and FX
santiago.leal@banorte.com

From our fixed income and FX strategy team

- **Following the release, Mexico's yield curve is pricing-in -5bps of accumulated implied movements in the repo rate of -5bps by 1Q18, -12bps by 2Q18, -23bps in 3Q18 and -31bps in 4Q18. In our view the market is complacent about the easing cycle's kickoff, albeit with a conservative terminal rate by 2018-end**
- **The Mbonos curve held gains in the mid- and long-end of around 1-2bps, while the short-end was also broadly unchanged although losing about 3bps on average. We highlight that short maturities in the TIIE-IRS curve were pressured around 2-3bps, consistent with the more hawkish bias observed in this release**
- **In our view, volatility could result in higher risk and term premiums that could lead to better opportunities for long directional trades. In this context, we believe relative value tactical strategies are more convenient for now, especially steepeners in the TIIE-IRS curve such as 2s5s (currently at -5bps) and 2s10s (+22bps)**
- **The Mexican peso did not react strongly, trading 0.4% weaker today at 18.78 per dollar and still lagging EM peers. Banxico's more cautious tone signals that carry levels may remain as a positive factor for MXN for longer than expected by the market, particularly in relative terms**
- **Further increases in global volatility could keep weighing on MXN, particularly if some of the adverse scenarios due to idiosyncratic risks materialize. We maintain our recommendation of tactical USD/MXN longs even if it means a negative carry, targeting the 19.00-19.30 zone as its next potential target with an immediate resistance at the 200-day MA of 18.84 per dollar**

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates / Financials/ Mining / Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research Analyst – Airlines / Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454