

Banxico minutes – Dovish tone, ready to follow the Fed

- Banxico published today the minutes of its monetary policy meeting held on March 30, in which the board decided unanimously to increase the reference rate by 25bps to 6.50%
- The discussions focused on the following topics:
 - (1) Banxico hiked 25bps on the back of the Fed's 25bps increase, and also in order to prevent shocks to other price-formation processes;
 - (2) Headline and core inflation continued to show an upward trend as a result of the exchange rate depreciation and the adjustment in energy prices, although the Board considered that the balance of risks for inflation has not further deteriorated;
 - (3) Inflation expectations in the short-term have increased considerably, while medium-term expectations have only edged up moderately, as the impact of supply-side shocks are seen as temporary;
 - (4) The balance of risks for growth marginally improved, mainly as a result of the lower probability that the most extreme adverse external scenarios materialize; although uncertainty around growth prevails;
 - (5) Given the simultaneity of the adverse economic environment and temporary shocks in relative prices, the main challenge for the monetary authority is to prevent second-round effects on inflation and on medium and long-term inflation expectations; and
 - (6) The fiscal actions take special relevance given that a solid fiscal stance is essential to reduce Mexico's risk perception
- Nevertheless, there was some divergence among some board members about the future rate path, evidenced by three comments:
 - (1) One board member mentioned that in absence of further negative shocks, a foreign rate hike might not be matched by Mexico;
 - (2) Another participant considered that given the adverse environment coupled with inflation above Banxico's target, further rate hikes in the following months are necessary for inflation to converge towards the goal; and
 - (3) Finally, another member mentioned that given the manufacturing cycle in both the US and Mexico, as well as the recent performance of the services sector, there is not much space to deviate from the Fed's monetary policy stance
- In this context, we consider that the central bank will increase the reference rate by another 50bps in 2017. We believe Banxico will hike twice in line with the Fed in September and December

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From our fixed income and FX research team:

- **Mexican bonds validated the rally started before the minutes registering a modest 1-3bps appreciation after several days pressured. Moreover low liquidity conditions prevail in local trading due to upcoming holidays. In strategy terms, we hold a positive view regarding the Mbonos curve, though with a much limited space for further appreciation after the performance witnessed during 1Q17, still acknowledging that the most attractive valuation remains in the 5- and 7-year area (Jun'22, Dec'23 and Dec'24)**
- **In FX, the Mexican peso had no meaningful reaction to the minutes, trading 0.25% stronger than yesterday's close at 18.73 per dollar despite the generalized risk aversion mode. We remain without any directional position in USD/MXN although we still believe the currency will hold a positive bias in the short-term, watching a key support in the USD/MXN 18.46-18.50 area. It is worth mentioning that geopolitical risks are still present suggesting a potential correction if negative surprises were to emerge**

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