

Banxico minutes – Still in a hiking cycle, but with the pace mostly up to the Fed

- Banxico published the minutes of the decision held on March 24th, in which they hiked the rate by 50bps to 6.50% unanimously, in line with our call and consensus
- Similar to the statement, the document maintains a hawkish tone, with higher concerns about inflation once again, especially because of external factors
- In this sense, we highlight:
 - (1) The renewed deterioration of the balance of risks for prices due to the conflict in Ukraine, on top of the core component’s upward trend;
 - (2) The additional delay in the expected moment of convergence of inflation to the target; and
 - (3) The deterioration of medium-term inflation expectations (from analysts) and even those for the long-term (market implied)
- In addition, we perceived different positions about the potential response from the central bank to a more restrictive policy from the Fed. Meanwhile, all agreed that the conflict in Ukraine has increased global inflationary pressures
- The document reinforces our call of a 50bps hike on May 12th. After this, we maintain our view of consecutive 25bps rate increases each in the meetings from June to December. Nevertheless, given the difficult global backdrop, the risk that Banxico needs to maintain a 50bps hiking pace looks high
- We see higher value in the belly of the Mbonos curve

Minutes reinforce the hawkish tone from the statement. In our opinion, the document provides relevant details about Board members’ opinions, mainly on three fronts: (1) The outlook and risks for inflation, with a balance of risks that deteriorated once again; (2) the possible response from Banxico to global monetary tightening, but especially from the Fed; and (3) implications of the war in Ukraine, with all members considering that, despite high uncertainty, has increased global inflationary pressures. Specifically, on the second point we perceived no clear consensus among members regarding the optimal response, which in turn will depend on Fed decisions. For the remainder of the year, the latter’s meetings will always take place before those by Banxico, with a time difference between them ranging from one day up to two weeks. Considering our short-term inflation expectations and the likely path of the Fed’s monetary stance, we expect Banxico to extend its hiking cycle. Specifically, we forecast a 50bps hike in the reference rate on May 12th, followed by five consecutive 25bps hikes each in the remaining decisions of the year. Nevertheless, given the complex global backdrop, the risk that Banxico needs to maintain a 50bps hiking pace looks high.

April 7, 2022

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Banxico’s 2022 policy decisions

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

Source: Banxico

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Consensus on the risks from the conflict in Ukraine, albeit with greater divergence regarding the response to the Fed. All members agreed that the conflict in Ukraine represents a shock and higher risks to inflation. This, along other risks (see following section), helped to tilt the balance towards a unanimous vote, unlike in previous meetings. On the other hand, we perceived more differences in opinions about the best response to the Fed’s tightening. Specifically, actions from Banxico could be more modest, the same or even larger than those of said monetary authority. Despite of the latter, we believe consensus is skewed more heavily to a hawkish bias, at least matching the moves from the Fed and maintaining a prudent stance. On specific comments, we detail the most relevant ones that we think were made by each of them, in order of appearance:

- Gerardo Esquivel: “...*interest rate levels anticipated by both private sector analysts and market traders are too high, considering the level of deviation of inflation from its target, and the slack conditions in Mexico relative to other economies...*”. Along other comments that keep giving a high weight to economic conditions –impacted by rate hikes–, we believe he might revert to supporting hikes of only 25bps, even if the Fed is more aggressive.
- Galia Borja: “...*if the ex-ante real interest rate needs to be above the range estimated as neutral, a balanced relative monetary policy stance must be maintained...*”. In addition, we noted arguments regarding the need to maintain a robust stance to consolidate the balance of risks for inflation as neutral. We consider that this Deputy Governor might argue that following the Fed’s pace would be enough, despite concerns of an adverse backdrop.
- Jonathan Heath: “...*greater tightening than that of the Federal Reserve could be required when the outlook for domestic inflation so demands...*”. He also suggested some willingness to take the real rate from neutral to restrictive given current issues. He also added the importance of the expectations channel and underestimated –at the margin– the possible impact through the credit channel. We think he remains as one of the most hawkish members and is likely to continue supporting adjustments of a larger magnitude in upcoming decisions.
- Irene Espinosa: “...*it is necessary to analyze more extensively whether front loading the pace of adjustment of the reference rate would curb inflationary inertia more firmly...*”. This was bundled with several comments that signal greater concerns about the inflationary backdrop, even talking of a systematic underestimation of inflation. We believe that it is almost a fact that she Governor would support hikes of at least 50bps in the short-term.
- Victoria Rodríguez: “...*He/she considered it imperative that, given the aforementioned challenges, the monetary policy response be clearly consistent with the convergence of inflation to the target within the forecast horizon...*”. On top of this, we must add concerns over the social cost of inflation. As such, the Governor seems to maintain a *hawkish* tone, in line with the Board’s consensus, albeit without a clearer signal about the possible response.

Once again, greater concerns about inflation, the price formation process, and medium- and long-term expectations. Concerns about price dynamics were a consensus issue, especially regarding the core component. Some highlighted that “...reflects the persistence of the shocks that have affected it...”, and another one that “...it has grown significantly above its historical pattern and is influencing the upward trajectory followed by headline inflation...”. There is some debate about the relative importance of the factors that are having an impact –internal or external–, although they agree that those associated with the pandemic (of a global nature) remain important. Additionally, the Governing Board reflected on inflation expectations, where everyone mentioned that they increased again for 2022 and 2023, with the convergence towards the target postponed again. They also stated that analysts' views increased both for the short- and medium-term, while long-term expectations remained stable and still above target. In contrast, market expectations have increased, including for the latter period. In line with the above, the majority affirmed that the risks to the price formation process have increased. One member said that “...the price formation process [has] continued to deteriorate and that, without the expectations channel functioning properly, monetary policy's transmission mechanisms will be limited...” Based on all of the above, we believe anchoring inflation expectations will continue to be a decisive factor in future monetary policy decisions.

Given a more complicated environment, the hiking cycle will continue and could be even more aggressive. We maintain our +50bp call for the upcoming decision (May 12th), followed by 25bp hikes in the remaining five meetings of the year. Thus, the reference rate would reach 8.25% in December. In current conditions, we think the minutes suggest that one member could favor hiking by the same or less magnitude than the Fed, two at the same pace, and the remaining two even faster. In our opinion, the risk is tilted towards a faster tightening than what we currently expect, with 50bp hikes lasting longer than expected. The main factor would be the Fed's position. For the latter case, the possibility of a more accelerated tightening—as evidenced in yesterday's minutes— and of a potentially adverse market impact due to balance sheet reduction remains. All in all, Banxico could maintain a more prudent stance, still on the look over: (1) Signals and decisions from the Fed, as well as the market reaction; (2) the evolution of the price of commodities due to the conflict in Ukraine; and (3) the development of local conditions, with the persistence of higher inflation also supporting this.

From our Fixed income and FX strategy team

We see higher value in the belly of the Mbonos curve. Local rates showed a limited reaction, still discounting a scenario consistent with the hawkish tone of the statement and minutes. The Mbonos' curve maintained its flattening bias, with pressures of 6bps in short- and mid-term securities and +4bps in long-term tenors. Meanwhile, TIE-IRS maintained pressures of 6bps on average. In this context, the market is pricing-in accumulated hikes of +238bps by year-end, assigning a high probability of 50bps hikes in the decisions to be held in May, June, August, and September. This suggests a front-loaded cycle, just as one Board member suggested. Nevertheless, it looks elevated compared to our call of a year-end rate at 8.25% (+175bps).

In contrast, we maintain a more hawkish view for 2023 vs the market, with a +100bps spread. Hence, we see a hiking cycle at a slower pace, but longer duration. Considering this, we see higher value in mid-term securities, particularly Mbono Mar'26 (and to a lesser extent, Mbono Mar'27), following the sharp adjustment accumulated during 1Q22 in this segment of the curve and the prevailing flattening and inversion pressures both in the US and Mexico.

In FX, the Mexican peso oscillated between gains and losses in a range of 20.10 to 20.19 per dollar. The currency is currently at 20.17 per dollar, practically the same level as the previous close. The USD remains bid with a modest 0.1% advance in the DXY and BBDXY. In our view, the MXN has little room for additional gains. In addition, we keep our call of further USD strength. Therefore, we favor buying USD below the 20.00 per dollar psychological 20.00, albeit only tactically due to its negative implied carry.

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