

Banxico Minutes – Caution prevails regarding inflationary risks

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- Banxico published today the minutes of the meeting held last August 10, in which the board of governors unanimously decided to maintain the reference rate at 7%
- We highlight the following issues discussed at the meeting:
 - (1) The balance of risks for inflation remained unchanged; however, most board members acknowledged that: “...*considering that slack in the labor market has been narrowing, the evolution of labor unit costs could eventually impact on inflation dynamics...*”
 - (2) The monetary stance implemented by Banxico since December 2015, given that: “...*Mexico has been one of the countries with the strongest tightening cycles in recent years ...*”;
 - (3) In this context, the majority of members also recognized that monetary policy has a lagging effect on inflation;
 - (4) However, one member mentioned that, given the prevailing uncertainty, “...*monetary policy should be cautious...*” and that “...*the possibility of further increases in the interest rate should not be ruled out...*”;
 - (5) In this regard, most members also agreed that: “...*the central bank will remain vigilant to maintain prudent monetary policy in a way that strengthens the anchoring of medium-term and long-term inflation expectations...*”; and
 - (6) The balance of risks for growth has become neutral, given a lower probability of a deteriorating in trade relations between Mexico and the United States, as well as a strengthening of macroeconomic fundamentals
- In our view, we expect Banxico to remain on hold for the remainder of the year, as we estimate that inflation will peak in August at 6.5% yoy to then converge to our 5.7% in year-end
- Looking ahead, we believe that Banxico could start an easing cycle in the second half of 2018 (August) as inflation will start to converge towards the 3% and most of the uncertainty of the scenario will be significantly reduced by then
- We believe that Banxico has room to reduce the reference rate between 150-200bps over the next two years from which 100bps could take place in 2018

From our fixed income and FX strategy team

- **The minutes released today depicted a cautious central bank given current inflation dynamics and financial markets pricing a benign scenario ahead. The yield curve remained pressured (1-2bps sell-off) following a higher than expected CPI print in tandem with a prudent tone inside Banxico's minutes. Following these events, we continue acknowledging a favorable valuation in the short-end of the curve. Moreover, we hold our trade idea of long positions in the Udibono Dec'20 with entry of 3.05%, target of 2.90% and stop-loss of 3.15%, currently at 3.06%. For details, please refer to: *"We recommend long positions in the 3-year Udibono Dec'20"* <[pdf](#)>, published on August 9th, 2017**

- **Banxico's prudent signal suggests MXN will remain supported by attractive carry levels as long as volatility stays low, with three-month carry/vol now above other relevant flow competitors in EM such as RUB, ZAR and BRL. We maintain a neutral stance in MXN for directional positions but with a positive bias for trading purposes, with 17.50 as adequate for profit taking**

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