

Banxico – Confirming that a prudent easing cycle is the best way to go

December 19, 2019

www.banorte.com
@analisis_fundam

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

Juan Carlos Alderete, CFA
Senior Economist, Mexico
juan.alderete.magal@banorte.com

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

Fixed income and FX Strategy

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

Santiago Leal
FX Senior Strategist
santiago.leal@banorte.com

Leslie Orozco
Fixed Income and FX Strategist
leslie.orozco.velez@banorte.com

Document for distribution among public

- Banxico decided today to cut the reference rate by 25bps to 7.25%, in line with our call and market expectations
- The decision was again split. Nevertheless, there was only one vote in favor of a 50pbs cut, instead of two, as was in the last two decisions
- In our view, the tone of the communique was dovish, although slightly less so than in the previous statement, given that:
 - (1) One member changed his vote in favor of a 25bps cut instead of -50bps, assuming that all members were present in the decision
 - (2) Banxico was more explicit about upside risks to inflation because of wage increases above productivity gains, highlighting the minimum wage hike for 2020; and
 - (3) The need to be prudent as they added a risk factor for financial stability, namely possible contagion from emerging markets, mainly Latin America
- Our linguistic analysis showed a renewed importance of “risks”, matching “inflation” as the most mentioned word. In addition, “outlook” and “Latin America” appeared, in our view related to prevailing uncertainty
- We expect Banxico to continue the easing cycle. In particular, we expect three consecutive 25bps cuts in the decisions to be held in February, March, and May
- Moreover, we reiterate our view that the central bank will cut the reference rate by an accumulated 125bps in 2020, reaching 6.00% by year-end. Nevertheless, our conviction has diminished, as we perceived higher concerns about the outlook for inflation
- The minutes of this meeting will be released on January 2nd, 2020
- Sell-off in local rates, with the short-end depicting a less appealing valuation

December 19th, 2019 Statement Word Cloud



Source: Banorte with data from Banxico

November 14th, 2019 Statement Word Cloud



Source: Banorte with data from Banxico

Banxico cuts the reference rate by 25bps, to 7.25%. The decision was in line with our call and market expectations. Nevertheless and assuming all members were present in the policy decision, it should be noted that four would have voted for a 25bps cut, instead of three in the last two decisions, while only one (previously: two) favored a 50bps cut. We believe this likely surprised the market on the hawkish side. In this respect, we argued [in our preview](#) that one of the dissenters (which, in the previous two meetings, were Deputy Governors Esquivel and Heath) could have shifted their vote in favor of only -25bps, believing that the economy will improve in 2020.

In our view the tone remains dovish, but slightly less so. In this respect, the central bank reaffirmed the economy remains in a weak spot, arguing that the output gap will continue to widen in 4Q19, with the balance of risks for growth still tilted to the downside. Global risks are also skewed downwards despite some positive developments such as lower trade tensions between US and China, results from the UK General Election, and stronger signals of activity from soft data indicators (*e.g.* global PMIs). The latter, in tandem with the [agreement on changes to USMCA](#), has resulted in higher risk appetite and diminished financial stability risks, which in turn led to an appreciation of the Mexican peso –reducing pass-through risks to inflation–. Moreover, they added that short-term inflation expectations have moderated.

Nevertheless, we believe it is less dovish based on important changes to the balance of risks for inflation. The most important had to do with changes related to the [minimum wage increase](#), which remains as the second most important upside risk to watch going forward. In particular, they provided additional details on the possible impact that this announcement could have, including higher wages in other segments of the population (the so-called “lighthouse effect”), and impacts on formal employment (based on recent [research by the central bank](#)) and prices. This was relevant enough that Banxico suggested this will likely lead to upward revisions to their inflation forecasts for 2020 (see table below). We also noted the addition of a new risk for financial stability, namely possible contagion from other emerging economies, mainly from Latin America due to idiosyncratic factors. All in all, and as we also perceived in the latest minutes, a prudent approach is necessary in a context in which the outlook for inflation is still highly uncertain.

Banxico: CPI forecasts

% yoy, quarterly average

	2019		2020				2021		
	III	IV	I	II	III	IV	I	II	III
CPI									
QR - 3Q19	3.3*	3.0	3.5	3.1	3.1	3.0	2.8	2.9	2.9
QR - 2Q19	3.3	3.2	3.4	3.1	3.1	3.0	2.9	3.0	--
Core									
QR - 3Q19	3.8*	3.6	3.6	3.2	3.1	2.9	2.8	2.9	2.9
QR - 2Q19	3.7	3.5	3.4	3.1	3.0	2.9	2.9	3.0	--

Source: Banco de México, 3Q19 QR; *Observed data

Banxico to continue with the easing cycle. We stress that this is the first cut since 2014 by the central bank in which the Fed had not previously acted in the same direction, confirming that Banxico has started to deviate from US monetary policy. Moreover, we believe that the slight shift in relative positions in terms of members' votes suggests the case for a prudent stance has strengthened, meaning also that our expectation of -25bps steps in each meeting will likely remain for the rest of the cycle. In this context, we reiterate our view that the central bank will cut the reference rate by an accumulated 125bps in 2020, reaching 6.00% at year-end. In the short-term, we see three consecutive 25bps cuts in the decisions to be held in February, March and May.

Nevertheless, our conviction about the total magnitude of the current cycle has diminished. This is based on our perception of greater concerns regarding the outlook for inflation within the Board, which may be driven more by structural rather than temporary factors. In this sense, we are looking forward to the minutes of the meeting, expecting that they will provide additional and valuable information about the stance on the balance of risks for inflation. Last but not least and although some financial stability risks have waned, we think the central bank sees fit to remain prudent as the risk of a reversal higher in volatility remains elevated. This could be due to global and domestic factors, staying as a potential source of pass-through to core inflation, particularly as the carry advantage of the currency erodes gradually.

From our fixed income and FX strategy team

Sell-off in local rates, with the short-end depicting a less appealing valuation. Consistent with our interpretation of Banxico's tone today, the local fixed-income market sold-off on a widespread basis, averaging a +11bps adjustment in the Mbonos curve and 12bps loss in TIEE-28 swaps, focused in mid-term maturities. As a consequence, the market is currently pricing in close to 113bps of implied rate cuts for year-end 2020, from 139bps as of yesterday's close. In our view, the Mexican yield curve current valuation, combined with the communiqué's bias, suggests that the short-end will remain unappealing. Moreover, and in line with our most recent views, we consider appropriate to wait for better levels and market conditions for new long positions in long-term Mbonos, stressing out Mbono Nov'47.

In the FX market, the Mexican peso depicted a fairly limited reaction to the decision, more evident when comparing to the reaction experienced by local rates. The currency held a trading range between 18.93 and 18.97 per dollar in the aftermath, closing today's session at 18.93 (+0.2%). The peso rests near its strongest level since July, currently trading with a 3.8% YTD appreciation. [We have recently updated](#) our 2019 and 2020 year-end forecasts to USD/MXN 19.30 and 20.20, respectively, evaluating levels close to current price action for new USD long positions.

Disclaimer

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato, Eridani Ruibal Ortega and Leslie Thalia Orozco Vélez, 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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

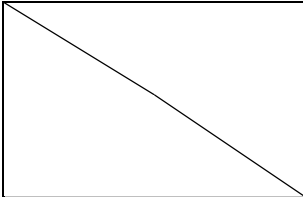
Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY HOLD SELL	When the share expected performance is greater than the MEXBOL estimated performance. When the share expected performance is similar to the MEXBOL estimated performance. When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V., since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

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 Godínez	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
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Luis Leopoldo López Salinas	Analyst, Global Economist	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
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
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalia Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Víctor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 – 4000 x 2755
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	Manager, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
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 Corporate Banking	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 Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454