

## Banxico – It's all about the FX

- Banxico just announced its monetary policy decision, in which the board decided to hike by 50bps the reference rate, leaving it at 4.25%, above our 25bps forecast
- In an unprecedented event, we believe that the reason behind the 50bps hike was the significant depreciation of the Mexican currency during the year, despite two very relevant reasons that did not call for a hike:
  - (1) It is very likely that the Fed will delay the normalization of its monetary policy, the BoE will likely cut its reference rate, and we expect further monetary easing from the ECB and the BoJ;
  - (2) We anticipate that inflation will remain below 3% in 2016, and the absence of any demand-side pressures, given that the Mexican economy will probably decelerate in the second half of the year
- After today's rate hike, we also expect that market participants will pressure Banxico to raise the reference rate in the event of a significant depreciation of the exchange rate...
- ...and in order to achieve any reaction in the local markets, from now on Banxico will need to hike 50bps
- Looking ahead, we continue to forecast a highly volatile exchange rate market, given the geopolitical risks in the second half of the year. In this context, we anticipate that the central bank will increase the reference rate 50bps in September, and again in December, leaving it at 5.25 % by year-end
- The minutes of this meeting will be published on July 14, and the next monetary policy announcement will take place on the 11<sup>th</sup> of August
- Important market reaction in the aftermath of Banxico's decision, with the short-end of the yield curve observing a 14-16bps sell-off, while longer tenors rallied 3-4bps. In the FX market, the peso appreciated 1.2% following two consecutive sessions of a relief rally, finishing the day as the best performer in the EM spectrum
- We hold our view for a further flattening of the yield curve, still acknowledging an attractive relative valuation in 10- and 20-year Mbonos
- The peso is likely to assimilate Banxico's policy action in coming days, however with a limited space given a highly uncertain external environment

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