

Banxico' Minutes – Restricting cycle comes to an end while opening the door to rate cuts in the medium term

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- Banxico published today the minutes of the meeting held last June 22, in which the board of governors decided to increase the reference rate by 25bp to 7%
- It is worth mentioning that this decision was not unanimous, as one member voted in favor of maintaining the reference rate unchanged
- There were a lot of discussions on the most pressing issues, but at the end, the majority of the board agreed that: *"... there could be a pause in the tightening cycle ..."*
- We consider that this was based on the discussions particularly on the following topics:
 - (1) The inflation balance of risks have turned neutral, while several members considered that the monetary policy implemented since December 2015: *"... will continue to influence the behavior of inflation over the following quarters ..."*
 - (2) The conclusion that while the current relative monetary stance vs. the US Fed should be maintained, looking ahead, the domestic yield curve will contribute to an orderly adjustment of domestic financial markets over the Fed's normalization process; and
 - (3) Although most members pointed out that the Mexican economy showed some weakness at the beginning of 2Q17, all members agreed that the slack in the Mexican labor market has disappeared, but there are no significant inflationary pressures from the demand side
- In addition, they discussed the possibility of cutting rates in the short term, prevailing the view that the monetary authority should maintain a prudent approach to policy amid a highly uncertain backdrop
- 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

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From our fixed income and FX strategy team

- **Market participants are digesting neutral minutes with a modest hawkish glance in contrast with the expectations for a dovish document, resulting in an 8bps sell-off in short-term securities, while longer tenors are depreciating nearly 4bps amid a negative performance in global sovereign bonds. This situation could suggest a stable reference rate for longer and no cuts in the short-term horizon (maybe until the 2H18) *vis-à-vis* a yield curve pricing in a lower reference rate as soon as 2017-end**
- **In terms of strategy, we suggest waiting for better market conditions after we recommend profit taking on the strategy of long positions in Mbonos Jun'20 and Jun'22 yesterday previous to the release of the minutes from the Federal Reserve**
- **MXN did not react strongly to the report, losing 0.3% on the day to 18.36 per dollar, with a brief gain to 18.30 as an immediate reaction. We believe that consensus about maintaining a prudent monetary policy stance suggests that carry levels in MXN longs will remain attractive when compared to other EM**
- **Given higher risk aversion, the recent fall in oil prices and increase in US rates that have provided some support to the dollar against EM currencies, we are waiting for the US payrolls report tomorrow to assess new tactical positions in the currency market**

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