



Banxico's monetary policy decision

A more dynamic monetary policy for a volatile year

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- Banxico just announced its monetary policy decision
- As expected, the board decided to increase the reference rate to 7.25% from 7%
- It is worth mentioning that the decision was not unanimous, given that one Board member voted for a 50bps hike
- We now believe that Banxico will increase the reference rate by 25bps at the first meeting of next year (February 8, 2018), leaving the door open for further increases if needed
- We consider that Banxico's *communiqué* was more hawkish, where we highlight the following points:
 - (1) The board members emphasized that the inflation outlook has become more complex given the pressure on the Mexican peso as a result of a pickup in uncertainty regarding NAFTA renegotiation and the Fed's 25pbs hike in the Fed Funds rate;
 - (2) Banxico's rate hike looks to anchor inflation expectations both in the medium and long-term as well as to reinforce its path towards the target
 - (3) If upside risks for inflation increase, Banxico's Board may take further actions to anchor expectations; and
 - (4) The Central Bank mentioned that there are no signs of slack in the economy, as evidenced by both the output gap and labor market conditions
- Our linguistic analysis of Banxico's monetary policy announcement shows a smaller weight on "inflation", while "prices" gained a greater importance in December's *communiqué* (refer to the graphs below)
- In this context, we recognize that year-end inflation for 2017 will close at 6.7% (previous: 6.5%), and will remain above Banxico's target during 2018

Word cloud of December's statement



Source Banorte with Wordle

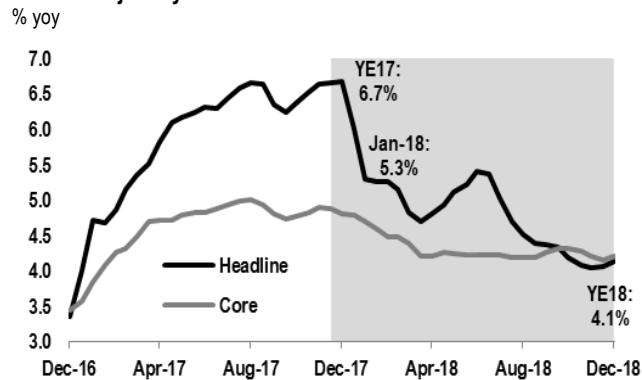
Word cloud of November's statement



Source Banorte with Wordle

- As a result, we now believe that Banxico will hike rates by 25bps in February 8. In addition, we do not rule out further increases in a case of heightened volatility and a bleaker inflation outlook
- The change in our forecast comes as a result of:
 - (1) Inflation will stand around 200bps above Banxico's target in January; and
 - (2) We expect more volatility of the Mexican peso as a result of the uncertainty regarding NAFTA renegotiation and 2018's electoral process

Inflation trajectory 2017-18



Source: Banorte with data from INEGI

- Looking ahead, and as volatility due to the before-mentioned factors starts to dissipate, it is likely that the Central Bank could cut rates by 50bps in the second half of 2018

From our fixed income and FX strategy team

- Banxico delivered a hawkish hike today, stressing out the strong concerns about the current inflation backdrop and several events that could result in a weaker MXN ahead, despite the effect of slack in the economy observed recently. In the aftermath of this scenario, local rates sold off nearly 4bps, mainly in the short- and mid-end
- Following the central bank's hawkish rhetoric we remain bearish in terms of local bonds and continue recommending defensive strategies in floating-rate bonds and in long-term UMS
- In FX, the Mexican peso has reversed its gain from 19.05 per dollar to a session high of 18.98 after the decision, giving them back to stabilize around 19.12 at the time of writing, depreciating 0.6% from yesterday's close
- In terms of strategy, Banxico's hawkishness helps reaffirm our neutral stance on the currency after taking profits in USD/MXN longs on Wednesday morning at 19.20 per dollar, just before the Fed decision. Despite the potential support stemming from the possibility of additional rate hikes, today's reaction keeps us reticent of adding MXN longs

Disclaimer

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