

Banxico minutes signaled a bias towards a more restrictive monetary policy

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- Banxico published today the minutes of the meeting held last February 8, in which the board of governors decided to increase the reference by 25bps at 7.5%
- We highlight that February's decision was unanimous, unlike the one taken in December, where one member voted for a bigger increase than the one finally decided (50bp vs. 25bp), which alludes to a slightly less hawkish attitude on this occasion
- Nevertheless, we perceived a generalized hawkish tone in today's minutes that reaffirmed our monetary policy view (a 25bps rate hike in April 12 following a 25bps Fed hike on March 21; in addition, we do not rule out a further increase if uncertainty persists before the presidential elections)
- In addition, most members agreed that there is no slack in the economy. In this regard, one member emphasized that current cyclical conditions are a factor that can reduce the rate of convergence of inflation towards the target
- Regarding inflation, some members emphasized that *"...[the board] can't be certain about a clear downward trend, in the short term ..."* and *"...[the Mexican economy] still faces an uncertain environment with various risk factors, in which the economy could face additional inflationary pressures in the coming months ..."*
- With this, the Board commented that the balance of risks for inflation maintains an upward bias in an environment of high uncertainty, fostered by the renegotiation of NAFTA, the electoral process and the pressures that said events will exert on the exchange rate
- In this regard, one member pointed out the credibility of the central bank arguing that long-term inflation expectations have remained above 3.5%, which could generate market participants to consider an inflation target of between 2 and 4% , unlike Banxico's 3% target
- Most members stressed the need to consider the more restrictive monetary conditions expected in the US;
- In this regard, one member commented that *"...if the outlook for stable relative monetary stance between Mexico and the US materializes, the need for a new adjustment of the monetary policy stance in Mexico during April would have to be evaluated in light of the behavior of inflation and its expectations..."*
- In addition, Banxico's Board decided to change the order of one of the most relevant factors on which it will focus forward: the monetary stance relative to the United States, which ranked second while in the November and December's releases it was the first factor to consider

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- **In this context, we emphasize that the hawkish tone of these minutes does not reflect the tone we have perceived in recent speeches by some board members, which introduces some uncertainty about our monetary policy forecast**
- **As a result, Banxico's QR (to be published on February 28) could offer additional insight into Banxico's hawkish bias**

From our fixed income and FX strategy team

- **The yield curve is pricing in one 25bps hike coming from Banxico for the rest of the year following today's minutes, suggesting a downside risk (especially for short-term rates) given the hawkish tilt confirmed today. It is our take that a "hawkish hike" from the Federal Reserve on March 21st and the other risks enlisted by the central bank could result in tighter monetary conditions in Mexico in the 1H18. All in all, we hold our trade idea of long positions in 5-year Bondes D as a defensive strategy with a very attractive carry. For more details please refer to our "*Fixed-Income and FX Weekly*" <pdf>, released last Monday**
- **The MXN is up 1% today from 18.84 to 18.65 per dollar, supported by lower-than-expected inflation and the minutes. For FX, we highlight the "conditionality" of monetary policy to a series of risks given its potential currency impact, and therefore its pass-through effect to inflation. The majority warned repeatedly about the possibility of higher volatility, suggesting that keeping wide interest rate spreads remains a priority. Even considering the likely support for MXN due to this factor, we maintain USD/MXN directional longs since January 19th, believing the peso's risk premium will increase ahead of the Presidential election in a more challenging and volatile market environment as a result of rising interest rates**

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