

## Banxico preview –Still waiting for the Fed

- **Banxico will announce its monetary policy decision next week (September 21) at 2:00pm (EDT)**
- **We expect that the monetary authority to remain on hold**
- **We believe that Banxico will highlight that in the absence of inflationary pressures and moderate growth, the board will continue to monitor relative monetary conditions vs. the U.S.**
- **It is our take that the tone of the statement will provide support to our call that Banxico will start its hiking cycle once the Fed begins its own normalization of monetary policy, now in December 2015**
- **The minutes of this meeting will be published on October 5, and the next monetary policy announcement will take place on October 29**

**Still waiting for the Fed.** Next week, Banxico will hold its sixth monetary policy meeting of the year. The monetary policy *communiqué* will be published on Monday (September 21) at 2:00pm (EDT). We believe that board members will remain on hold, leaving the reference rate at 3%. We believe that Banxico will highlight that in the absence of inflationary pressures and moderate growth, the board will continue to monitor relative monetary conditions vs. the United States. It is our take that the tone of the statement will provide support to our call that Banxico will start its hiking cycle once the Fed begins its own normalization of monetary policy.

**Moderate growth and low inflation.** Given Mexico's slow economic growth, the absence of inflationary pressures and the Fed's current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed begins its hiking cycle. Inflation is at historically low levels (refer to the chart on the left), and even though Mexico's economic growth has been higher in 2015, growth expectations have been continuously revised downwards (refer to chart on the right). Similarly, the current situation of low crude oil prices given Mexico's heavy dependence on oil revenue (~25%), the government's commitment to reduce the fiscal deficit to 0.5% of GDP in 2016, and the new fiscal regulations that will affect the accounts of Mexico's federal entities and municipalities, it is likely that public spending will face major cuts, hindering 2016 GDP's growth below 3%.

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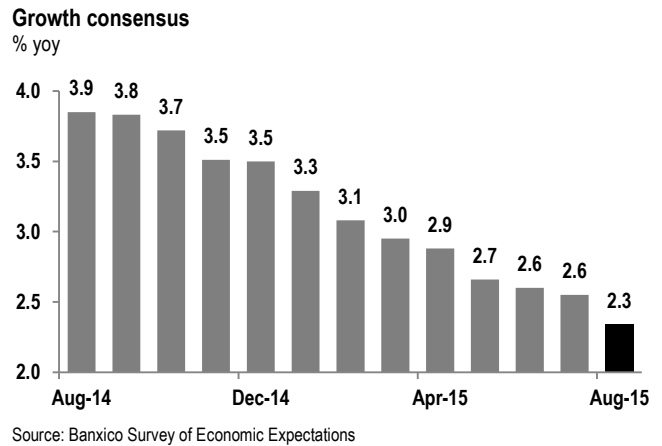
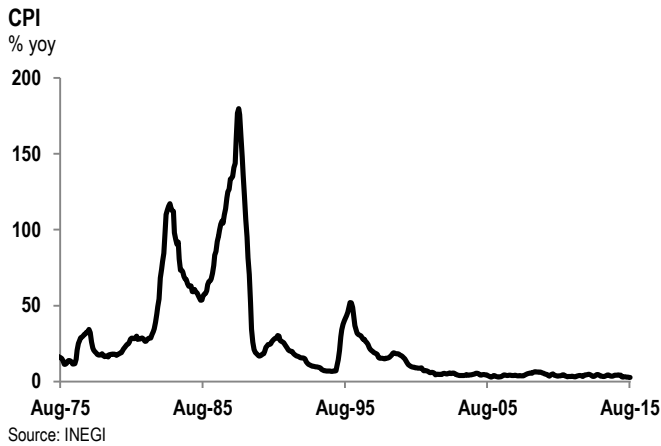
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**FEC will keep the US dollar auctions unchanged.** Even though FX policy is not in hands of the central bank only –as it is the Foreign Exchange Commission (FEC) who handles it with participation of the MoF-, it is our take that the FEC will also announce –similar to Banxico’s last meeting-, that they will keep the US dollar daily auctions as they are: (1) US\$ 200 million with no minimum price; and (2) US\$ 200 million if the peso depreciates one percent with respect to the last trading day fix.

**We maintain our view that the central bank will continue to wait for the Fed to begin its own normalization of monetary policy.** While Banxico’s central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico will continue its hiking cycle when the Fed begins its own normalization of monetary policy.

*From our fixed income and FX strategy team*

**We hold our positive view on short-term securities on the back of an appealing valuation.** The short-end of the yield curve remains highly attractive *vis-à-vis* other EM, taking into consideration implied cumulative rate hikes priced in for the following 12 months. The likelihood for Banxico staying put next Monday has increased in a significant fashion after (1) the Federal Reserve decided today to leave its monetary stance unchanged, and (2) the MXN has observed a relief rally throughout September. In this regard, we hold our trade idea of receiving the 9-month TIE swap (9x1) with entry level of 3.85%, target of 3.65% and stop-loss of 4.00% (currently trading around 3.80%). This position implies an expected return of 11bps per month (carry + roll-down). For more details see: “*Trade Idea: Receive nine-month TIE-IRS (9x1)*” <[pdf](#)> published on September 3. In the aftermath of today’s policy decision in the U.S. this security is currently trading at 3.70% (-10pb).

**In the FX market and after the Fed’s decision, we switch once again to a neutral stance in the peso and buying USD/MXN on dips for intraday purposes from a selling bias before the event.** Based on the latter, we see at least two important consequences that could have some impact in the currency in the short term. On one hand and as already mentioned, the market cut strongly the probability of a Banxico rate hike as soon as next Monday and has significantly reduced the implied cumulative hikes going into year-end. In our view, this factor had some supportive effect on the currency in the last few weeks, so the fall could be negative for the peso at the margin. On the other and in our base-case scenario that Banxico does not increase its reference rate on September 21, the extension of the uncertainty period due to the Fed will likely tilt the Foreign Exchange Commission to prolong the daily US\$ auctions with and with no-minimum price past September 30, 2015. It is our take that the MXN is not likely to rally strongly if the auctions are extended as this scenario is likely already discounted; nevertheless, a reduction in either of these two mechanisms could send a negative short-term signal and increase the exchange rate’s volatility, which we do not believe is desirable for the authorities given the already highly complex external environment. Overall, we see the prospects skewed in favor of continued peso weakness, at least in the short term.

#### **Disclaimer**

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