

Banxico Minutes – Monetary policy still tied to the U.S. Fed

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- On Thursday, August 13, Banxico will publish the minutes of its July 30 monetary policy meeting, in which the board left the reference rate unchanged at 3%
- In our view, Banxico's minutes will confirm the monetary authority's focus on the U.S. Fed's hiking cycle
- In particular, we believe that the market will pay close attention to the discussions regarding the exchange rate and the relative monetary conditions, particularly vs. the U.S.
- Even though we believe the decision was unanimous, a dissenter would give a strong signal to the market one way or the other
- Looking ahead, we continue to believe Banxico will start a hiking cycle right after the Fed

Same message as in the last *communiqué*. This week (Thursday, August 13), Banco de Mexico will publish the minutes of its monetary policy meeting held back on July 30, in which the board decided to leave the reference rate unchanged at 3%, as it was widely expected. In our view, discussions during the meeting were focused on two issues: (1) The assessment of the balance of risks for growth and inflation; and (2) the exchange rate and relative monetary conditions, particularly vs. those in the United States.

Marginally more negative tone in terms of growth. In our opinion, the tone of the statement regarding the growth was marginally more negative than in June's statement. While the central bank considers that the balance of risks for the global economy has not changed since the last meeting, Banxico highlights that the non-car manufacturing sector, mining and construction performance is weak. Moreover, despite some pick up in domestic demand indicators, they consider that slack in the market is still large, so they do not expect demand-side pressures on prices. In this context, the monetary authority considered that the balance of risks for inflation "*...improved in the short term, although there are some significant upward risks...*".

In our view, relative monetary conditions and exchange rate remain the most important factors in Banxico's decision making process. The monetary authority concluded that cyclical conditions of the Mexican economy show weakness while inflation will remain below the target in 2015. Nevertheless, as it was abovementioned, board members warned that: "*...the Fed's actions could have additional repercussions on the exchange rate and inflation expectations...*". In this context, Banxico's board of governors will pay particular attention to "*... the evolution of the exchange rate, the relative monetary conditions between Mexico and the United States, and the evolution of the slack in the economy...*".

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We maintain our view that the central bank's next move will be a hike, immediately after the Fed. 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's next move will be a rate hike, immediately after the Fed starts its normalization of monetary policy in September 16-17. This implies that the central bank could be raising rates at its next regular meeting on September 21. Recent measures taken by the *Foreign Exchange Commission* give Banxico some leeway to wait for the Fed to hike rates.

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