

Banxico preview – We expect a 25bps rate hike

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- **Banxico will announce its monetary policy decision tomorrow at 2:00pm (EST)**
- **We expect a 25bps rate hike, taking the reference rate to 5.5%**
- **We believe that the key variable for Banxico's decision will be the 25bps increase that the Fed announced today**
- **However, we cannot rule out completely a 50bps increase given the deterioration in inflationary expectations generated by:**
 - (1) **The higher pass-through effect from the depreciation of the Mexican currency to prices; and**
 - (2) **The potential impact of the 9.6% increase in the minimum wage to the price dynamics.**
- **The minutes of this meeting will be published on the 29th of December and the next monetary policy announcement will take place on the 9th of February**

We expect a 25bps hike in Banxico's reference rate. On Thursday, Banxico will announce its monetary policy decision at 2:00pm (EST), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 5.5% from 5.25%. We believe that the key variable for Banxico will be the 25bps increase that the Fed implemented today, given that Banxico's rate hike will take place tomorrow. We believe that the Board will justify the increase, given the importance of Mexico's relative monetary conditions, particularly with the U.S., despite Mexico's low economic growth. However, we can't rule out completely a 50bps increase given the deterioration in inflationary expectations generated by: (1) The higher pass-through effect from the depreciation of the Mexican currency to prices, and (2) the potential impact of the 9.6% increase in the minimum wage to the price dynamics.

Inflationary risks rise due to FX volatility. Even though Mexico's headline CPI index has remained below Banxico's 3% target, we believe that the balance of risks for inflation has deteriorated as a result of the higher pass-through effect from the depreciation of the MXN to prices. In addition, the depreciation of the MXN since Donald Trump's victory could generate additional pressure not only on the consumer price index, but on medium and long-term inflation expectations.

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Minimum wage will increase 9.85%. On December 1st, the National Commission of Minimum Wages (*CONSASAMI*), announced an increase in minimum wages for 2017. With this revision, the minimum wage will amount to MXN 80.04 per day, which implies a 9.9% increase. In this regard, the central bank will probably mention within the monetary policy *communiqué* that next year's inflation will partly reflect the increase in the minimum wage, although it will probably not have an impact on medium and long-term inflation expectations.

Banxico will hike *in tandem* with the Fed. While Banxico's central scenario seems to be of lower economic growth, the prospects of a depreciated currency in Mexico coupled with higher rates in the United States pose a significant risk to inflation levels and expectations in Mexico. Looking ahead, we believe that Banxico will follow the Fed in its monetary tightening cycle. In this context, we expect Banxico and the Fed to hike 50bps in 2017, with Banxico's reference rate ending next year at 6%.

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