

Banxico Minutes Preview – Concerned about exchange rate performance

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- On Thursday, Banxico will publish the minutes of its February 4th monetary policy meeting, in which the board left the reference rate unchanged at 3.25%
- We believe the issues discussed in the meeting were:
 - (1) An increased concern about exchange rate pass-through amid the recent wave of volatility in international markets; and
 - (2) The factors behind the deterioration of the balance of risks to growth
- Even though our base case scenario is that the vote was unanimous, we believe there is a high probability that one of the members of the board voted in favor of a rate hike in January's meeting
- Looking ahead, we continue to believe Banxico will hike rates again right after the Fed does the same in June
- However, we cannot rule out the possibility of a preemptive hike before June (March or May)

Same message as in the last *communiqué*. Next Thursday at 10:00am EST, Banco de Mexico will publish the minutes of its monetary policy meeting held back on February 4th, in which the board decided to leave the reference rate unchanged at 3.25%, as it was widely expected. Even though our base case is that the decision was unanimous, we believe there is a high probability that one member of the board voted in favor of a rate hike in January, given the wave of high volatility at the beginning of the year. In addition, we expect discussions during the meeting to have focused on two issues: (1) An increased concern about exchange rate pass-through amid the recent wave of volatility in international markets; and (2) the factors behind the deterioration of the balance of risks to growth.

The balance of risks for growth deteriorated from the previous meeting. In our view, the tone of the statement with respect to growth was negative. Although Banxico confirmed the strength shown by private consumption – supported by higher employment and low inflation-, the central bank highlighted that exports have lost momentum on the back of the slowdown in external demand. In addition, the central bank recognized that investment has slowed. In this context, Banxico “...does not expect demand-side pressures on prices....” and considers that “...the balance of risks to growth has shown some deterioration compared to previous monetary policy decision...”.

Exchange rate and volatility, key to inflation. The central bank concluded its last monetary policy statement that cyclical conditions of the Mexican economy show weakness while the outlook for inflation in the short-term has deteriorated due to the base of comparison. Nevertheless, the monetary authority stresses that one of the main risks to the inflation scenario is the fact that “...*exchange rate depreciation could persist given the impact that global financial conditions has had on the exchange rate, contaminating inflation expectations and leading to increases in the prices of non-tradable goods ...*”.

We maintain our view that Banxico will continue its hiking cycle right after the Fed’s hike in June. 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 right after the Fed’s hike in June.

However, we do not rule out the possibility that Banxico could anticipate the Fed’s hike. Among the risks to be considered, the monetary policy statement highlighted the potentially pass-through to inflation from FX depreciation. In addition, the central bank also mentioned the risk of a disorderly decompression in the term-premium given the normalization of the Fed’s monetary policy. In fact, Banxico emphasized that in order to maintain the strong macro-fundamentals of the Mexican economy, it is necessary to consolidate public finances, continue the implementation of structural reforms, and modify Banxico’s monetary policy stance at an appropriate pace. In this regard, and given the recent performance in the FX -with the Mexican peso accumulating a 4.2% depreciation since February’s monetary policy statement-, we cannot rule out the possibility of Banxico acting preemptively in March or May.

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