

Banxico's farewell to 2016: An additional 50bps hike

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- Banxico just announced its monetary policy decision, in which the board decided to increase the reference rate by 50bps to 5.75%, above our 5.5% forecast
- We believe that Banxico's 50bps rate hike was mainly explained by the deterioration of short and medium-term inflation expectations, coupled with the uncertainty surrounding Mexico's economic environment
- Banxico did acknowledge that the balance of risk for inflation deteriorated as a result of:
 - (1) The pass-through effect of FX depreciation to prices;
 - (2) The impact of the 9.9% increase in Mexico's minimum wage to prices which will be implemented on January 2017; and
 - (3) The effect of the gradual liberalization of gasoline prices in Mexico
- As we mentioned in our previous reports, we believe that after the 50bps hike in both February's extraordinary meeting and June's ordinary meeting (just a week after *Brexit*), Banxico preconditioned market participants to expect minimum 50bps hikes in order to achieve any market reaction
- Banxico also mentioned that the preventive increases throughout the year will be reflected in the economy and inflation will eventually converge to the central bank's 3% target in 2018
- In this context, we believe that Banxico will increase the reference rate by at least 100bps throughout 2017, although we can't rule out additional hikes if the FX volatility increases
- The minutes of today's meeting will be published on the 29th of December, while Banxico's next meeting will take place on February 9
- In the aftermath of Banxico's decision, the yield curve observed an 8bps sell-off in short-term securities, 3bps losses in the mid-end, but a 4bps rally in longer tenors. On the other hand, CPI-linked Udibonos curve observed a more defensive performance, with gains in several securities in the short- and mid-ends
- Taking into consideration the concerns on inflation depicted by Banco de Mexico today in tandem with several risk factors that we have stressed out recently, we hold our trade recommendation of long positions in Udibonos Jun'19, Dec'20 and Jun'22
- The Mexican peso reversed its losses on the day on the surprise announcement, strengthening 0.6% from 20.51 to 20.38 per dollar. We believe the likelihood of a better performance of the Mexican peso before Inauguration Day on January 20 has increased
- We maintain our view that USD/MXN will not breach the 20.00 psychological level at least for the rest of the year. Nevertheless, we recommend selling remaining USD longs maintained since December 6 when the cross breached 20.50 at a basically unchanged level based on a then-entry of 20.39

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