

Banxico's monetary policy decision

Hawkish communiqué but not enough for a December hike

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- Banxico just announced its monetary policy decision
- As expected, the board unanimously decided to maintain the reference rate at 7%
- We believe that Banxico's communiqué was more hawkish, where we highlight the following points:
 - (1) The board members emphasized on the relative monetary stance between the Fed and Banxico;
 - (2) The balance of risks for inflation deteriorated with an upward bias in the horizon in which monetary policy acts, as a result of greater volatility of the exchange rate in response to a possible US exit from NAFTA and an adverse market reaction of the Fed's monetary policy normalization process
 - (3) The change in Mexico's GDP base year yields a higher GDP growth within the last three years, which implies that the output gap was marginally positive in 2Q17; and
 - (4) The contraction of Mexican economy in the third quarter was mainly explained by the impact of the earthquakes on September's economic figures; hence, the Central Bank's economic growth outlook remained unchanged from the previous statement
- Our linguistic analysis of Banxico's monetary policy announcement shows a greater weight on "inflation", while "output gap" was mentioned three times in today's *communiqué* vs 1 time in September
- Although we recognize that the probability of a rate hike in December has increased, we believe that Banxico will maintain its monetary stance unchanged for the remainder of the year
- However, we now believe that Banxico will reduce the reference rate by 50bps in the second half of the year vs. our previous -100bps forecast

Word cloud of November's statement

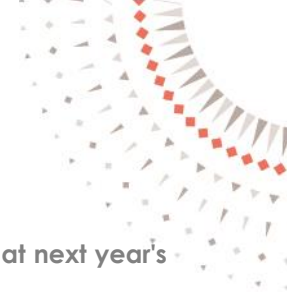


Source Banorte with Wordle

Word cloud of September's statement



Source Banorte with Wordle

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- The change in our forecast comes as a result of:
 - (1) Four of the five current board members will be present at next year's monetary policy meetings;
 - (2) The Fed's normalization process will continue in 2018; and
 - (3) Mexico's CPI will be measured using a new methodology, which will likely increase headline and core inflation's annual variation in the second half of 2018
 - The market depicted an indulgent reaction despite a hawkish bias within Banxico's *communiqué*, which highlighted several factors that has deteriorated the current balance of risks for inflation
 - We hold a cautious stance in terms of the Mexican fixed-income market, expecting an additional increase risk and term premiums embedded in the local yield curve, resulting in a possible steepening of the yield curve between the mid- and long-ends. Overall, we believe that relative value tactical strategies are more convenient, especially targeting steepeners in the TIE-IRS curve such as 2s5s and 2s10s
 - Regarding the currency, we believe Banxico showed relatively more concern about recent dynamics, warning about the possibility of additional pressures due to risks from NAFTA's renegotiation and the Fed's normalization process, among others
 - Even after the hawkish tilt, we reiterate our short-term recommendation of buying USD/MXN on dips, expecting higher appetite for dollar longs in case of a drift below the 19.00 psychological level at least until we have more definition about a series of external and internal risks that the economy will face in upcoming months

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