

Banxico Minutes – How to follow the Fed

May 11, 2015

- This week (Thursday, May 14th), Banxico will publish the minutes of its April 30 monetary policy meeting, in which the board left the reference rate unchanged at 3%
- In our view, the tone of Banxico’s post-meeting statement will be quite similar to the last *communiqué*, mainly focused on two issues:
 - (1) The balance of risks for economic growth continues to be relatively weak, with no concerns regarding inflation; and
 - (2) The current market perception with respect to the timing at which the U.S. Fed will begin its hiking cycle
- Even though we believe the decision was unanimous, a dissenter would give a strong signal to the market one way or the other
- It will be interesting to see some discussion regarding the time gap between the FOMC and Banxico meeting schedules
- Looking ahead, we continue to believe Banxico will start a hiking cycle in July 2015, right after the Fed

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www.ixe.com.mx
@analisis_fundam

Gabriel Casillas

Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

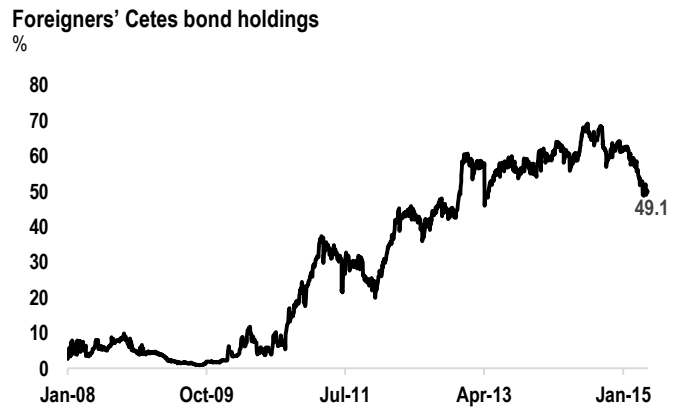
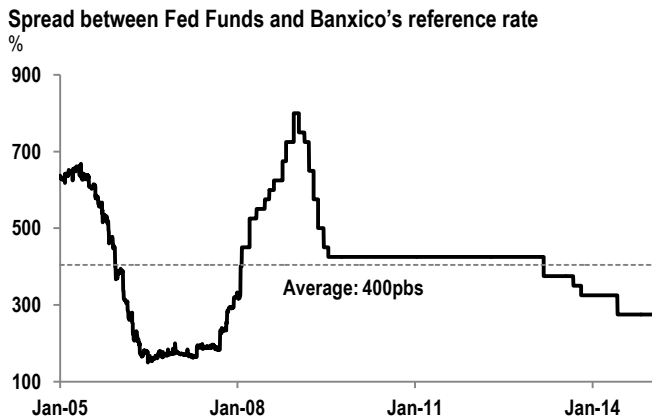
Alejandro Cervantes

Senior Economist, Mexico
alejandro.cervantes@banorte.com

Slightly more dovish minutes. This week (Thursday, May 14), Banco de Mexico will publish the minutes of its monetary policy meeting held back on April 30, in which the board decided to leave the reference rate unchanged at 3%, as it was widely expected. In our view, the tone of Banxico’s post-meeting statement will be quite similar to the last *communiqué*, mainly focused on two issues: (1) The balance of risks for economic growth continues to be relatively weak, with no concerns regarding inflation; and (2) the current market perception with respect to the timing at which the U.S. Fed will begin its hiking cycle.

Dovish tone in terms of economic growth... In terms of economic growth, we believe that Banxico’s tone within the minutes will as *dovish* as the *communiqué*. In the last monetary policy statement, even though the Board considered that the balance of risks for global economic growth has remained stable, Banxico stressed out that: “*The Mexican economy continued to show a moderate growth (...) Considering the above-mentioned factors, we believe that the balance of risks for growth still tilted to the downside ...*”.

The Fed’s next move and FX performance in the spotlight. Banxico stressed out that “...given that Mexico’s economy is highly integrated to the Global economy, in particular to the U.S., the Fed’s monetary policy could have a significant impact on the exchange rate, inflation expectations, and therefore the overall price dynamics in Mexico. Taking the above-mentioned factors into account, the Board will remain focused (...) on Mexico’s relative monetary conditions, particularly with respect to the U.S., as well as the performance of the exchange rate...”. As we have mentioned throughout our publications, Banxico does not manage the reference rate in absolute terms but, given the global influence of the U.S. monetary policy, it only sets the spread between Mexico’s rate and the U.S. federal funds rate (refer to the chart on the left). Thus, if the Federal Reserve decides to hike its rate in June, almost independently of Mexico’s economic cycle and inflation, Banxico “will have to maintain” the spread between the Fed Funds rate and Mexico’s reference rate, given the risks of capital outflows that could generate a disorderly depreciation of the Mexican peso against the dollar (refer to the chart on the right), threatening the country’s financial stability and inflation expectations.



Time gap between the FOMC and Banxico meeting schedules. Banxico’s last monetary policy statement was published one day after the Fed’s announcement (*i.e.* Fed’s announcement took place in April 29, while Banxico’s *communiqué* was published on April 30). As we have mentioned throughout our publications, the central bank is in no hurry to raise the reference rate, given Mexico’s moderate growth, inflation at 3%, and without any inflationary pressures on the horizon. If Banxico intends to “follow the Fed” it would be convenient for Banxico to “pay-to-see the Fed’s hand”. However, Banxico’s monetary policy meetings will take place between four and five weeks after the Fed meetings, which could qualify as an “eternal gap” for fixed-income and derivatives traders (refer to the table below). We believe that this could be a decisive factor that could trigger Banxico to raise rates in an intra-meeting fashion. Moreover, if the Fed begins to hike in December, Banxico will no longer have a regular monetary policy meeting scheduled this year after the Fed meeting.

We believe it would be advisable for the board to modify its calendar, so that the next monetary policy announcements could take place exactly one day after the FOMC. While this change could trigger some movements in the FX and TIE futures market, we believe that these movements will be non-disruptive, nor highly distortionary. Conversely, Banxico could remove a source of uncertainty.

Dates of the upcoming monetary policy decisions

	FOMC	Banxico	Difference (in days)
1	--	Thu 4-Jun	--
2	Wed 17-Jun	Thu 23-Jul	36
3	Wed 29-Jul	Thu 3-Sep	36
4	Thu 17-Sep	Thu 15-Oct	28
5	Wed 28-Oct	Thu 3-Dec	36
6	Wed 16-Dec	--	--

Source: US Fed and Banco de México

Possible delay in the Fed's hiking cycle. While Banxico mentioned that the market perception of a tighter monetary policy stance by the United States persists, the board stressed out that given the last monetary policy statement issued by the Fed, the market now considers it more likely that the initial upward movement in the Fed funds rate could be delayed.

We maintain our expectations that Banxico's next move will be a rate hike in mid-2015. It is our take that the Fed will raise the Federal funds rate (probably in June), we consider it highly likely that Banxico will also start a hiking cycle (in July), even though inflation in Mexico will be around its 3% target. In this regard, we believe that the hiking cycle will be supported by: (1) Greater concern for the pass-through effect of the depreciation of the peso against the dollar to inflation; and (2) the board will probably be more empathic in the next monetary policy announcements about Mexico's relative monetary conditions, in particular to the U.S., given that it is a key factor to decide Mexico's reference rate path.

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Livia Honsel	Economist, Europe	livia.honsel@banorte.com	(55) 1670 - 1883
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5004 - 1275
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 5004 - 1231
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 5004 - 1179
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 5004 - 1227
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 5004 - 1266
Valentín III Mendoza Balderas	Equity Research Analyst	valentin.mendoza@banorte.com	(55) 5268 - 9000 x 1267
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 5004 - 5262

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5004 - 1405
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 5004 - 1340
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 5004 - 1437

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Managing Director – Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Jorge de la Vega Grajales	Managing Director – Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Managing Director – Private Banking	lpietrini@ixe.com.mx	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Managing Director – Asset Management	pimentelr@ixe.com.mx	(55) 5268 - 9004
Ricardo Velazquez Rodríguez	Managing Director – International Banking	rvelazquez@ixe.com.mx	(55) 5268 - 9879
Victor Antonio Roldan Ferrer	Managing Director – Transactional Banking	vrolan@ixe.com.mx	(55) 5004 - 1454