

Banxico preview – We expect a 50bps rate hike

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- **Banxico will announce its monetary policy decision tomorrow at 2:00pm (EST)**
- **We expect a 50bps rate hike, taking the reference rate to 6.25%**
- **We believe that the key variable for Banxico's decision will be the recent upward trend in inflation and the deterioration of inflation expectations**
- **In addition, we believe that the central bank will mention that the balance of risks for inflation has deteriorated in the short and medium run, as a result of:**
 - (1) **The 16% increase in the still regulated price of gasoline; and**
 - (2) **The higher pass-through effect from the depreciation of the Mexican currency to prices**
- **The minutes of this meeting will be published on the 23th of February and the next monetary policy announcement will take place on the 30th of March**

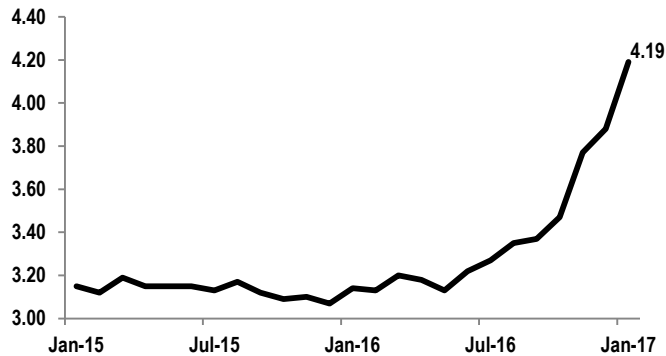
We expect a 50bps hike in Banxico's reference rate. Tomorrow, Banxico will announce its monetary policy decision at 2:00pm (EST), where we expect a 50bps rate hike. Thus, the new reference rate will stand at 6.25%. We believe that the key variable for Banxico will be the recent upward trend in inflation and the deterioration of inflation expectations. In addition, we believe that the central bank will mention that the balance of risks for inflation has deteriorated in the short and medium run, as a result of: (1) The 16% increase in the still regulated price of gasoline; and (2) the higher pass-through effect from the depreciation of the Mexican currency to prices.

Adjustment in gasoline prices. On December 27, the Ministry of Finance published the new methodology for determining the maximum prices of gasoline in January. While the MoF's proposal was part of the Federal Government's efforts to foster free markets and impose a second-best scheme before the complete liberalization of the gasoline market, the consumer price index rose 1.51% 2w/2w as a result of this measure. In addition, inflation expectations climbed right after this price adjustment (refer to the charts on the next page). It is our take that the central bank will decide to increase the reference rate by 50bps in order to contain the upward trend in inflation and anchor expectations.

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Inflation expectations for 2017

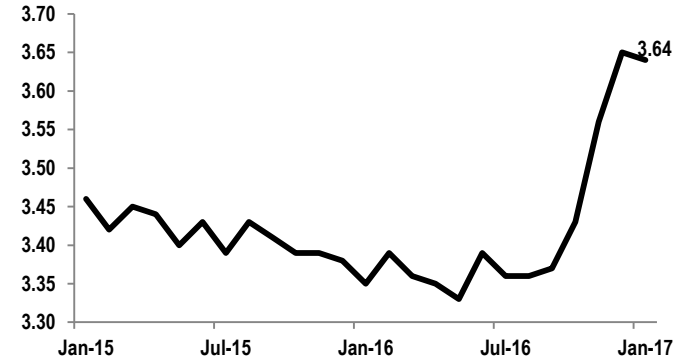
% yoy, mean



Source: Banxico's monthly survey of economic expectations

Inflation expectations in the next four years

% yoy, mean



Source: Banxico's monthly survey of economic expectations

Inflationary risks rise due to FX volatility. We believe that Banxico's board will also highlight that the balance of risks for inflation has further 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 has generated additional pressure not only on the consumer price index, but on medium and long-term inflation expectations.

Banxico will continue its hiking cycle throughout the year. While Banxico's central scenario seems to be of lower economic growth, the prospects of a significantly higher inflation coupled with a depreciated currency and higher rates in the United States pose a significant risk to inflation levels and expectations in Mexico. Looking ahead, we believe that Banxico will implement an additional 50bps hike in March trying to anchor inflation expectations. In addition, we continue to believe that Banxico will follow the Fed in its monetary tightening cycle. In this context, we expect an additional 50bps hike in June and December (right after the Fed's hikes), with Banxico's reference rate ending at 7.75% in 2017. The minutes of this meeting will be published on the 23th of February.

Disclaimer

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