

## Banxico preview – We expect a 25bps rate hike

March 29, 2017

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- **Banxico will announce its monetary policy decision tomorrow at 23:00pm (EDT)**
- **We expect a 25bps rate hike, taking the reference rate to 6.5%**
- **We believe that the key variable in Banxico's decision process will be the recent hike in the Fed Funds rate**
- **In addition, we believe that the central bank will mention that the balance of risks for inflation has deteriorated as a result of:**
  - (1) **The increase in energy prices; and**
  - (2) **The higher pass-through effect from the depreciation of the Mexican currency to prices**
- **Nonetheless, we expect a *dovish* communiqué, mentioning the recent appreciation trend of the Mexican peso**
- **The minutes of this meeting will be published on the 12<sup>th</sup> of April and the next monetary policy announcement will take place on the 18<sup>th</sup> of May**

**We expect a 25bps hike in Banxico's reference rate.** Tomorrow, Banxico will announce its monetary policy decision at 3:00pm (EDT), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 6.5%. We believe that the key variables for Banxico will be: (1) The Fed's own 25bps hike; (2) the recent upward trend in inflation as a result of the increase on gasoline prices along with the pass-through effect of the depreciation of the Mexican currency to prices; (3) and the deterioration of inflation expectations. Nonetheless, we expect a *dovish* communiqué, mentioning the recent appreciation trend of the Mexican peso.

**Fed's own 25bps rate hike.** We believe that the recent hike in the Fed funds rate is a sufficient condition to trigger a rate hike in Mexico –despite the fact that domestic economic activity has been sluggish-, given that the holdings of foreign investors in the short-end of the curve is still relatively high. In this regard, given that Mexico continues to be a small and open economy, Banxico does not manage the reference rate in absolute terms, but –given the global influence of the U.S. monetary policy-, it sets the spread between Mexico's rate and the U.S. *Fed funds* rate. Thus, after the Fed's 25bps hike, almost independently of Mexico's economic cycle and inflation, Banco de Mexico “*will have to maintain*” the differential between the interest rates in both countries.

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**Inflationary risks rise due to energy prices and FX volatility.** In the second case, Banxico will also justify the 25bps hike in order to limit the inflationary impact generated by the increase in gasoline prices and the changes in relative prices of goods with respect to services, as a result of the pass-through effect of the depreciation of the Mexican currency to prices, although Banxico will probably recognize that the latter effect will be lower as a result of the recent appreciation of the Mexican currency. Finally, the increase will also be justified by the deterioration of inflation expectations in the short and medium term, following the increase in inflation resulting from the gradual liberalization of gasoline prices.

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