



Banxico's monetary policy decision

NAFTA, elections & exchange rate

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- Banxico just announced its monetary policy decision in which, as expected, the Board decided to maintain the reference rate at 7.50%
- It is worth noting that it was an unanimous decision, being the first time Banxico publicly released the vote of each Board member
- We consider that Banxico's *communiqué* was marginally more hawkish, where we highlight the following points:
 - (1) Board members emphasized that while most EM currencies have shown a depreciation, the Mexican peso was also affected by internal factors;
 - (2) Even though the Board reaffirmed that inflation is in line with its expectations as published in the latest Quarterly Report, the balance of risks for inflation maintains an upward bias within a "highly uncertain environment" (i.e. NAFTA renegotiations and the electoral process)
- In this context, Banxico commented that should an adjustment to the real exchange rate be necessary given a paradigm shift (i.e. a failed NAFTA renegotiation or a deterioration of fiscal balances), the institution will act in such a way that it occurs in an orderly manner;
- Even though Banxico released the *communiqué* in both English and Spanish for the first time, we still conducted our linguistic analysis with the Spanish version, given that it is the first time the institution has done so and the base of comparison is still the Spanish version. The result of this analysis reaffirms our view of a hawkish *communiqué*, given the appearance of the word "uncertainty" and a greater weight on "risks". On the contrary, we highlight the lesser importance of the word "prices" vs. April's statement
- In this context, we continue to expect a 25bps increase 2Q18, which will occur at the June 21 meeting, considering the uncertainty related to the NAFTA renegotiations and the electoral process. We also maintain our expectation that the reference rate will end the year at 7.25%

May 17, 2018 Statement Word Cloud



Source Banorte

April 12, 2018 Statement Word Cloud



Source Banorte



From our fixed income and FX strategy team

- Banxico left the reference rate unchanged with a more hawkish tone, albeit less than expected by the market. As a result, TIE-IRS rallied 6-7bps on average along the curve. In spite of the latter, the door remains open for another rate hike in June, which is positive for our cautious stance and recommendations in the local fixed-income market
- This rhetoric is mainly explained by recent pressures in the Mexican peso (-8.8% from the April 17th YTD high of 17.94 per dollar to 19.68) which could extend further in the rest of the summer. Moreover, international energy prices have increased (e.g. oil and gasoline), with both factors as upside risks for inflation going forward
- On the other hand, the Fed has shifted to a more hawkish bias, with the possibility of three more hikes the rest of this year instead of two. Although the high real interest rate spread between Mexico and the US gives Banxico room to not follow the Fed, they will likely remain prudent due to the potential impact of a more restrictive Fed in global markets. On a more positive note, inflation has surprised to the downside, resulting in a faster convergence towards Banxico's variability range. In particular, 6 out of 8 bi-weekly inflation prints released so far in 2018 have been lower than consensus estimates
- In this context, we stay on the sidelines in the Mbonos market, waiting for better conditions and entry levels for new trade ideas. We reiterate our recommendation of sticking with defensive strategies in floating-rate securities (e.g. Bondes D). For details, see: "*Fixed-Income and FX Weekly*", [pdf](#), May 14th, 2018
- The Mexican peso gained slightly, from 19.70 to 19.68 per dollar. With a less hawkish tone than expected by the market, the potential of a strong relief from here and due to the decision is low.
- We are neutral on USD/MXN at the current level, waiting for better entry levels for new dollar longs for short-term positions. We see the current risk premium as modest considering the uncertainty about NAFTA and the Presidential Election, with most of the recent move because of the generalized re-pricing higher of the dollar

Disclaimer

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