

Banxico's 50bps rate hike – Is it safe?

- Banxico just announced its monetary policy decision, in which the board decided to increase by 50bps the reference rate to 5.25%, below our 5.5% forecast
- We believe that the moderate increase in Banxico's reference rate was explained by the high uncertainty surrounding the effects of the US election on the Mexican economy, and was aimed to strengthen Mexico's macroeconomic framework
- However, Banxico did acknowledge that despite today's 50bps hike inflation will stand above their 3% target in 2017
- Looking ahead, Banxico will focus on:
 - (1) The pass-through effect of FX depreciation to prices; and
 - (2) Mexico's relative monetary stance –particularly with the US-, and the evolution of the output gap
- Looking ahead, we continue to forecast a highly volatile exchange rate market, given:
 - (1) If Trump's fiscal stimulus does materialize, inflation might be higher and the Fed's hiking cycle could be faster than our base-case scenario
 - (2) Trump's future comments regarding *NAFTA* and the bilateral trade relation; and
 - (3) Oil price volatility
- Moreover, we expect a 25bps hike from the Fed in December
- In this context, we believe that Banxico will increase the reference rate by 25bps in their next monetary policy meeting on December 15 (vs our previous 75bps hike call)
- However, we do not rule out a 50bps hike if FX volatility increases. In fact, Banxico could increase the reference rate in an extraordinary meeting before December's scheduled meeting
- The minutes of today's meeting will be published on the 1st of December

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From our fixed income and FX strategy team

- **Strong gains in local rates along the Mbonos and Udibonos curves, concentrated in the short-end at around 10-20bps in both cases. Despite of the latter, we maintain a cautious stance waiting more stable conditions for long directional positions, mainly in the short- and long-end of the Mbonos curve. In our view, risks remain that local rates will continue affected by higher interest rates in the U.S., a wider country risk premium, volatile FX dynamics, and the possibility of another 25-50bps rate hike in December, less than what the market had already priced-in. We believe that markets will continue pushing upward inflation expectations for 2017, most likely resulting in greater preference for inflation-linked securities**

- **The Mexican peso is falling 1% on the day to 20.40 per dollar from around 20.20 before the communique. We stay without directional positions for now albeit with a long dollar bias, believing that this rate increase will not be enough to stabilize the currency as volatility is likely to remain very high, with a strong support at the 20.00 psychological level. We still think that the peso's appreciation potential will be limited at least until Inauguration Day in the US on January 20, 2017**

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