



Banxico's monetary policy decision

Hawkish hike amid a risky and uncertain backdrop

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www.banorte.com
@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

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Alejandro Padilla
Head Strategist - Fixed-Income and FX
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
FX Senior Strategist
juan.alderete.macal@banorte.com

Santiago Leal
Strategist Fixed Income and FX
santiago.leal@banorte.com

- Banxico's board announced today its unanimous decision to hike in 25bps the reference rate leaving it at 7.75%
- In our opinion, the statement suggests that the monetary authority has left the door open to further hikes going forward, especially if the exchange rate depreciates significantly
- We now expect Banxico to maintain the reference rate at the current level over a 18-months period
- This implies a change vs. our previous view, in the sense that we no longer think that the central bank will have leeway to cut rates
- Nevertheless, we recognize that there is a high level of uncertainty in the scenario going forward so we do not have enough elements to forecast another hike, amid an expectation of inflation ending the year around 4.3% while we expect the USD/MXN to rally after the election process
- The linguistic analysis of the communiqué supports our view as it shows a significant increase in the use of the words "risks" and "uncertainty" to describe the scenario

June 21, 2018 Statement Word Cloud



Source Banorte

May 17, 2018 Statement Word Cloud



Source Banorte

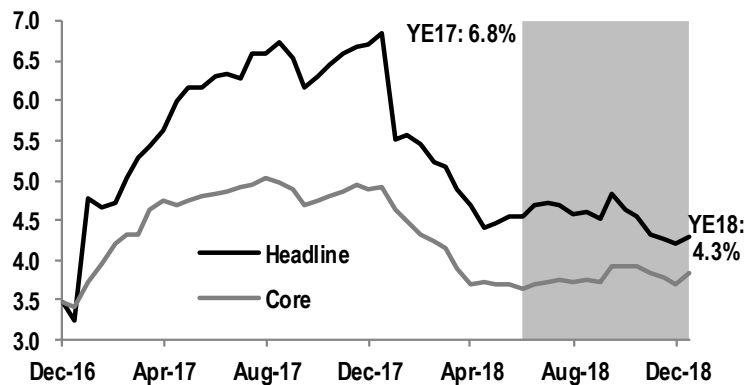
- As it has been the case in recent press releases, the monetary authority maintains the main factors to which it will remain vigilant in the future in order to adjust monetary policy. The evaluation of such factors is as follows:
 - (1) Potential pass-through from exchange rate fluctuations: When talking about the upside risks to inflation "... the peso exchange rate continues to be under pressure due to an environment of higher external interest rates and U.S. dollar strength, and uncertainty associated with both the NAFTA renegotiation and Mexico's elections..."
 - (2) Relative monetary stance between Mexico and the United States: "...In the U.S., economic activity is expected to grow at a stronger pace, partly in response to the fiscal stimulus implemented, which, under conditions of reduced slack in the economy, may lead to greater inflationary pressures..:"
 - (3) Conditions of slack in the economy: Banxico recognizes that dynamism in 1Q18 economic activity "...caused some tightening in the economy's slack conditions..."

- Regarding the balance of risks, the Board highlighted the uncertainty surrounding the scenario, which implies that, for growth, risks continue to be biased to the downside, while for inflation they consider that "...the risk of inflation converging to its target at a slower rate than that forecasted has increased..."

- Although 12-month inflation has come down from 6.8% at the end of 2017 to 4.5% in May, we expect it to pick up in the next few months given the increase in the prices of gasoline due to the driving season, as well as the depreciation of the MXN. However, as the reference price falls we anticipate that inflation will continue to converge towards the target, ending the year at 4.3%.

Inflation forecast for 2018

% yoy



Source: INEGI; Banorte



From our fixed income and FX strategy team

- The yield curve flattened in the aftermath of Banxico's decision to increase its reference rate by 25bps with a hawkish tilt within its communiqué. The market is modestly pricing in a modest probability of an additional rate hike this year
- In terms of strategy, we hold our trade idea of long positions on floating-rate Bondes D. In addition, we have changed our assessment about the Mbonos and TIE-IRS curves, having a more optimistic view in the long-end as we acknowledge the strong likelihood of an additional flattening bias
- The Mexican peso is gaining 0.7% today to 20.21 per dollar, second best in EM and with five straight days appreciating, reacting positively to the communiqué as it traded around 20.30 before the release. In our view, expectations of additional moves in the reference rate due to the vigilant stance by Banxico in case of further gains or losses in the currency would help reduce volatility, but would not be enough to change its overall direction
- We remain without trading or directional positions for now, waiting for better entry levels –around 21.00 per dollar- to assess MXN longs given a significantly improved valuation after the 10% loss accumulated this quarter and a more favorable technical positioning. Nevertheless, we are waiting stronger signs of stabilization in emerging markets, apart from cautiousness ahead of the Presidential Election as short-term vols have indeed picked up but do not signal very significant concerns about the event

Disclaimer

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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
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Analyst, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@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 Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist 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) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugo.a.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebaldos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldán Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454