

# Banxico – Closer to easing, but not quite there yet

March 28, 2019

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

**Juan Carlos Alderete, CFA**  
Senior Economist, Mexico  
juan.alderete.mactal@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

**Santiago Leal**  
FX Senior Strategist  
santiago.leal@banorte.com

**Leslie Orozco**  
Fixed Income and FX Strategist  
leslie.orozco.velez@banorte.com

Document for distribution among public

- Banxico’s Board announced today its unanimous decision to maintain the reference rate at 8.25%, in line with our expectations and consensus
- In our opinion, the tone was more dovish when compared to the previous communiqué and similar to that of the latest *Quarterly Report*, but less than markets were expecting
- In terms of growth, the central bank said activity kept showing low dynamism at the start of the year, in line with their previous assessment that the moderation at the end of 2018 could extend further
- Regarding inflation, the central bank maintained that the balance of risks is still skewed to the upside, even if acknowledging that some of the downside risks have intensified
- As expected, the central bank also addressed the recent dovish shift of the Fed and the prevalence of some risks factors, such as those related to Mexico’s and Pemex credit rating
- In this regard, the linguistic analysis show a higher relative weight about “risks” and “conditions”, while “prices” took a less prominent role
- We continue to expect that Banxico will start an easing cycle on its June 27th meeting with a 25bps rate cut. In addition, we believe that cumulative cuts during 2019 could amount to 50 or 75bps
- Local rates adjustment with Banxico’s tone coming less dovish than market expectation

March 28th, 2019 Statement Word Cloud



Source: Banorte with data from Banxico

February 7th, 2019 Statement Word Cloud



Source: Banorte with data from Banxico

**Reference rate unchanged at 8.25%, as expected.** The central bank announced its decision to keep the reference rate unchanged at 8.25%, in line with our expectations and consensus. As in the previous meeting, the decision was unanimous. More importantly, we consider that the tone of the statement was more dovish when compared to the previous communiqué but similar to the latest *Quarterly Report*; however, it was less than what markets were pricing-in.

**Banxico recognizes the Fed's dovish shift.** Regarding the international context and as expected, Banxico recognized the recent dovish shift by the Fed in terms of its forward guidance (*dot-plot* showing no expected hikes for this year) and the balance sheet normalization strategy. This led to higher risk appetite and financial inflows to emerging markets. Moreover, they stated that global growth and headline inflation have decline in major developed economies and some EM, so among the main external risks is a steeper-than-expected deceleration, along trade tensions, *Brexit* and geopolitical risks.

**The balance of risks to growth remains to the downside.** Broadly speaking, the tone regarding economic activity remained unchanged, confirming that the soft patch from the end of 2018 has extended to the beginning of this year. It is worth noting that the central bank had already anticipated this, while saying that slack conditions had relaxed further in the first months of 2019. As a result, the balance of risks remains skewed to the downside.

**Still cautious on core inflation.** In our view, Banxico remains relatively cautious on the outlook for inflation and its expectations, although they recognized the strong decline in the non-core component. Regarding this, they warned that some of the factors that have led to the steep decline in the headline index have started to revert, particularly energy prices. In addition, core inflation remains the main concern, maintaining that it keeps showing resistance to the downside. In this context, it is worth mentioning that the Board referenced core inflation expectations for the first time (as far as we know), stating that mid-term expectations have increased from 3.42% to 3.50% while long-term measures picked up from 3.30% at the end of 2018 to 3.40%. As a result, they said that: “...*Although there has been an intensification of some of the downside risk factors, there are still others that might put upward pressure on inflation in greater magnitude and make it deviate from its foreseen path. For this reason, the balance of risks for the forecasted trajectory for inflation still remains to the upside, in an environment of high uncertainty...*”.

**Some macroeconomic risks still on the horizon.** After stating in the previous communiqué that Fitch had downgraded Pemex's credit rating, the central bank said that among the noteworthy risks factors still in the horizon for Mexico's economy are those related to the oil company's and even the sovereign credit rating. Among others, this has led to an additional discount or risk premium for domestic assets, even if more favorable conditions prevailed in international financial markets that contributed to the positive performance of local markets.

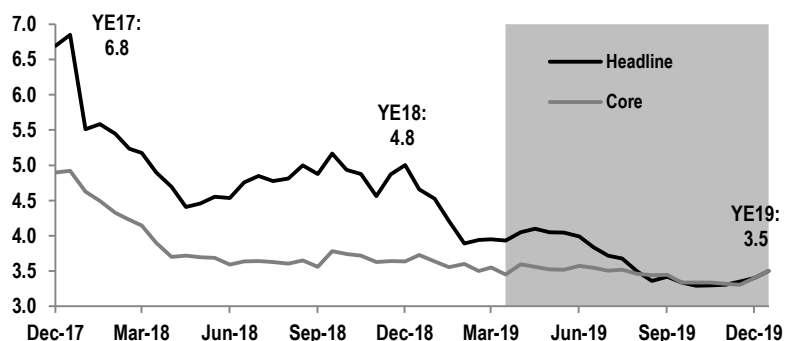
**We continue expecting Banxico to start an easing cycle on its June 27<sup>th</sup> meeting with a 25bps rate cut.** In our view, Banxico’s attention remains on three issues: (1) The outlook for economic growth; (2) the path of inflation; and (3) the financial stance of Pemex and its implications for both the company and the sovereign credit rating.

On the first two factors our base-case contemplates a further moderation in economic activity, while price dynamics will continue to be favorable, particularly for the non-core index. Regarding the former, we expect that the impact from recent supply shocks will materialize with greater strength in February (as suggested by trade balance figures), taking into account that January’s IGAE did not show a meaningful deceleration (+0.2% m/m). On top of this, the recent downturn in global economic activity supports our expectation that growth will be more moderate in comparison with 2018.

On inflation, our forecast contemplates a downward path towards the target, ending the year at 3.5% (refer to the chart below). In this respect, it is very relevant to take into account the new energy pricing policy that aims to maintain prices constant in real terms. In this context, we have already seen the policy in action, with the renewed fiscal stimulus to fuel excise taxes (IEPS) starting in early March and that could start to show results as soon as in the second half of the month. With core inflation stable and headline inflation declining in a context of lower demand-side pressures due to the deceleration of growth, it is our take that price dynamics will also allow the central bank to cut rates.

**Inflation forecasts**

% yoy, biweekly frequency



Source: INEGI, Banorte

Although these two factors would be enough to start cutting rates in the near future, we recognize there are still some lingering concerns, highlighting the recent revision to the country’s credit outlook by *S&P Global Ratings*, as suggested in the communiqué. Nevertheless, we maintain our view that the new federal administration will maintain healthy public finances, willing to adjust its spending policy if risks arise that compromise the fulfillment of its targets. This would help ease concerns about the sovereign credit rating, which we see standing at BBB+ (or equivalent) for the rest of the year.

Moreover and equally important, on Pemex we think that the partial use of the stabilization fund as well as the capitalization program announced earlier in the year are steps in the right direction to address the company's financial challenges, which will eventually lead to a less uncertain outlook in terms of idiosyncratic risks. For details, see: "*Partial use of the Stabilization Fund – Another step to strengthen Pemex*", <[pdf](#)>, March 22, 2019.

As we expect these risks to be tacked in the near future, it is our take that the central bank will start an easing cycle in the June 27th meeting with a 25bps cut to 8.00%, with room for a cumulative 50-75bps reduction in the reference rate during 2019.

*From our fixed income and FX strategy team*

**Local rates adjustment with Banxico's tone coming less dovish than market expectations.** Banxico stayed put today, in line with our expectations, depicting a similar bias in respect to its last communications but less dovish than the market's positioning. In this sense, it held a balance of risks for growth skewed to the downside and pointed that upward risks for inflation persist. On the other hand, the central bank stressed out the change in rhetoric from the Federal Reserve towards loose monetary conditions going forward, giving strong leeway in terms of the relative monetary policy between both countries (*i.e.* the spread between short-term ex-ante real rates hovering around 394bps, with nearly 100bps of additional premium). As a consequence, Mexican rates depicted a significant reaction, registering a 1-3bps sell-off for Mbonos which were trading with a rally up to 4bps before the decision. Moreover, TIEE-28 swaps also reverted the appreciation seen before Banxico which reached up to 4bps, then averaging a 7bps sell-off. As of today, the yield curve is pricing-in -16bps of implied cumulative cuts in 2Q19, -26bps in 3Q19, and -51bps for the entire 2019. In a two year horizon, the market is discounting a repo rate 108bps lower by 2020-end. We acknowledge that current conditions are favorable for interest rates worldwide and this backdrop will be beneficial for the Mexican yield curve. This will result in market participants that will hold a significant exposure in local bonds. Nevertheless, we see a valuation for local assets that has become more expensive. As a result, we suggest waiting for better entry levels for new directional long positions in Mbonos, with greater preference in the 10- and 20-year area.

Regarding the FX market, the Mexican peso depicted a moderate reaction to today's decision holding a price action fairly close to 19.35 per dollar (+0.1%). The cross has recently underperformed on the back of pressures focused on the EM spectrum coupling to some recovery in the USD. In this context, yesterday we closed our short-term trade recommendation on USD longs, with an entry level of USD/MXN 18.89 having reached its target at 19.35. For more details please consult: "*Mexico: Profit taking in our long USD short term tactical trade idea*", <[pdf](#)>, released yesterday.

#### **Disclaimer**

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

## Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Francisco Duarte Alcocer, Jorge Antonio Izquierdo Lobato and Leslie Thalia Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. de C.V. for the provision of our services.

## Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

## Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte Ixe and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

## Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

## Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

## Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

## Guide for investment recommendations.

Reference	
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

## Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V., since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

**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
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Francisco Duarte Alcocer	Analyst, Global Economist	francisco.duarte.alcocer@banorte.com	(55) 1103 - 4000 x 2707
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
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

**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
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
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.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Manager, 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.cebillos@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
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454