

Banxico – We now expect a 25bp hike in March

- We maintain our forecast of 100bp hike in Banxico’s reference rate throughout 2017. However, we now believe we have more information to provide an estimated path
- Fed Chair Yellen, gave a speech in Chicago where she reaffirmed the hawkish tone we have perceived from other FOMC members’ speeches, so we now consider that Banxico will increase the benchmark rate in line with the Fed by 25bp in March
- We consider that the Foreign Exchange Commission’s announcement has given the central bank more room to be less aggressive in its hiking cycle (for further information see “*Reassessing our rates and peso forecasts after the FEC’s new mechanism*” <pdf>)
- Moreover, Banxico did acknowledge in its *Quarterly Report* that the balance of risks for inflation depend mainly on:
 - (1) The shocks stemming from the direct and indirect impact of the gradual liberalization of gasoline prices in Mexico and possible further pass-through effect of FX depreciation to prices; and
 - (2) An additional deterioration of inflation expectations stemming from future depreciations of the Mexican currency as a result of the uncertainty regarding the external environment
- Looking ahead, we believe Banxico will increase the reference rate again by 25bp in September and December, in tandem with the Fed
- Moreover, we think the Central Bank will increase an additional 25bp throughout the year due to different risk factors, which we believe are:
 - (1) Inflationary pressures derived from a greater passthrough effect or significantly higher energy prices;
 - (2) Geopolitical risk events, such as the Presidential elections in Europe, particularly France; and
 - (3) Uncertainty related to 2018’s political process
- The short- and mid-end of the yield curve should have a better performance vis-à-vis longer tenors after recent price actions and current market conditions. The yield curve is pricing in 69bps of implied cumulative hikes for the rest of 2017. All in all, we hold our trade idea opened on February 15th, 2017 of a 5y10y steepener in TIE-IRS (long/receive 5y TIE-IRS (65x1) and short/pay 10y TIE-IRS (130x1)) with an entry level of 28bps, target of 43bps, stop-loss of 18bps, currently trading at 26bps. More details in our research note “*Trade Idea: 5y10y TIE-IRS steepener*” <pdf>

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