

Banxico preview – On hold... until September

- **Banxico will announce its monetary policy decision this week (July 30) at 2:00pm (EDT)**
- **We expect the monetary authority to keep the reference rate unchanged at 3%**
- **We believe that Banxico will maintain the tone of the last *communiqué* in which the main message was that in the absence of inflationary pressures and moderate growth, the board will focus on the time when the Fed will start its hiking cycle**
- **It is our take that the tone of the statement will provide support to our call (and consensus) that Banxico will begin a hiking cycle in September, right after the Fed's hike**
- **The recent change that Banxico made to its monetary policy meetings schedule reaffirms Banxico's commitment to Mexico's financial stability, given that it eliminated additional uncertainty to the volatility that might be generated after the beginning of the Fed's normalization**
- **The minutes of this meeting will be published on August 13, and the next monetary policy announcement will take place on September 21**

Same interest rate, same message. This week, Banxico will hold its fifth monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (July 30) at 2:00pm (EDT). We believe that board members will decide to leave the reference rate at 3%, as it is widely expected. Nonetheless, we believe that Banxico will maintain the tone of the last *communiqué* in which the main message was that in the absence of inflationary pressures and moderate growth, the board will focus on the time when the Fed will start its hiking cycle.

Moderate growth and low inflation. Even though Banxico has recognized that private consumption has shown a visible recovery, the board members still believe that the balance of risks for the Mexican economy continues to be negative given that GFI has shown a moderate recovery derived from the lower growth dynamics of the construction sector; and industrial production has been hampered by the reduction in Mexico's oil production, and the temporary slowdown in the U.S. economy, which resulted in a lower performance of manufacturing exports. In terms of inflation, the central bank has declared that the balance of risk has remained stable given that headline inflation will remain below 3% yoy in 2015.

July 27, 2015

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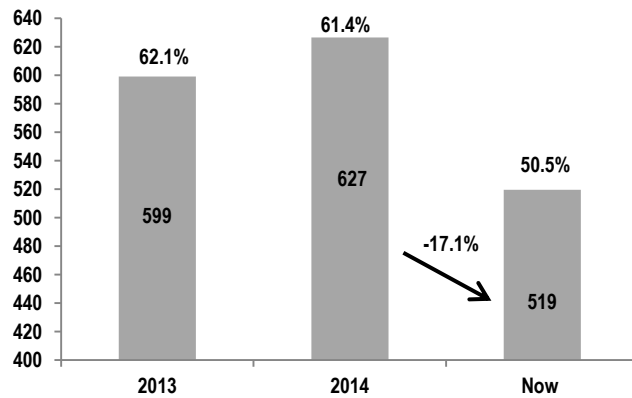
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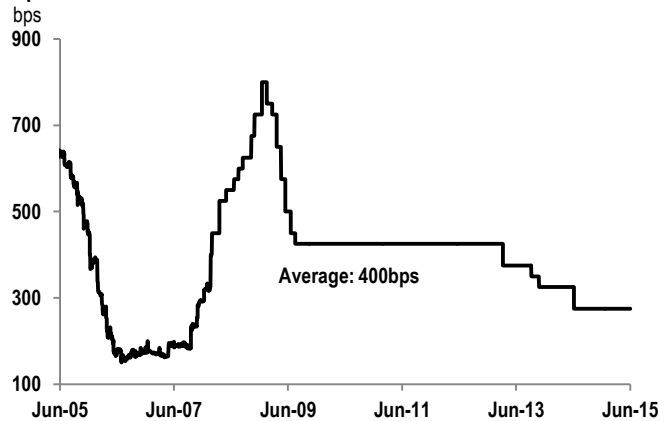
Waiting for the Fed: Rate hike in Mexico, despite sluggish activity and low inflation. As we have mentioned throughout our previous publications, we believe that an increase in the U.S. reference rate is a sufficient condition to trigger a rate hike in Mexico –despite the fact that economic activity has been sluggish and that inflation could converge to the 3% target this year-, given that the holdings of foreign investors in the short-end of the curve is elevated (refer to the following chart on the left), making even more relevant the spread between Mexico’s reference rate and the *Fed funds* rate, as shown in the chart on the right. Moreover, in the last monetary policy minutes published in May 14, most board members agreed that taking into account the recent fiscal adjustments and given that inflation expectations are well anchored, acting ahead of the Federal Reserve would have more costs than benefits to Mexico’s economic recovery.

Holdings of foreign investors in the short-end of the curve
MXN billions, %



Source: Banorte-Ixe, Banco de Mexico

Spread between Fed and Banxico reference rates



Source: Banorte-Ixe with data from Bloomberg

Changes to Banxico’s monetary policy meeting schedule for 2H15. Two weeks ago (July 1) Banxico just updated its monetary policy meeting schedule for 2H15. The aim of these changes was to synchronize monetary policy decisions in Mexico with those of the U.S. Fed, given the importance of the relative monetary policy stance between the two countries. The new dates will allow the Mexican monetary authority to have the latest information on U.S. Fed monetary policy decisions at the time of each meeting.

Modified monetary policy decisions schedule

2H15

Month	FOMC announcement	Banxico New Schedule	Banxico Previous
July	28-29	30	23
September	16-17	21*	3
October	27-28	29	15
December	15-16	17	3

Source: Federal Reserve

*This meeting will take place on Monday, instead of Thursday as it has been the case as of 2015

We maintain our view that the central bank's next move will be a hike, immediately after the Fed. While Banxico's central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico's next move will be a rate hike, immediately after the Fed starts its normalization of monetary policy in September 16-17. This implies that the Mexican central bank could be raising rates at its meeting on September 21. In our view, the change in the timing of monetary policy decisions is positive because it eliminates a factor of additional uncertainty to the volatility that might be generated after the Fed decides to start monetary policy normalization.

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