Banxico Minutes – Signaling a rate hike in February

- **Banxico published today the minutes of the meeting held last December 14, in which the board of governors decided to increase the reference by 25bps at 7.25%**
- **We perceived a significantly more hawkish tone in today's minutes vs. December's *communiqué*, where we highlight the following issues:**
  (1) All members considered that the balance of risks for inflation has deteriorated given the recent supply-side shocks. In this context, one member commented that said balance is *"overwhelmingly negative";*
  (2) In addition, all board members emphasized that given the simultaneity and magnitude of the shocks, as well as the high inflationary levels, the main challenge for Banxico is to keep inflation expectations anchored in the medium and long term;
  (3) In this regard, one member mentioned that: *"…it is likely that given the high levels of inflation, its persistence and its inherent risks –depending on the behavior of prices and their outlook in the coming months–, it will probably be necessary to increase the reference rate again, possibly as soon as the next monetary policy meeting";*
  (4) Some members commented that under the actual environment: *"the current monetary policy stance is not congruent with a convergent trajectory of inflation towards the 3% target at the end of 2018"*; and
  (5) Another member also emphasized that the relative monetary stance between Mexico and the US should not be weakened, at least until certain risks –such as the renegotiation of NAFTA and the uncertainty around the 2018 electoral process– have dissipated
- **We consider that the minutes reaffirmed our view that the central bank will increase the reference rate by 25bps at the next monetary policy meeting (February 8)**
- **However, we believe that the significantly more hawkish tone alludes towards two additional 25bps rate hikes during the first half of 2018**
- **Looking ahead, and as volatility due to the above-mentioned factors starts to dissipate, it is likely that the central bank could cut rates by 50bps in the second half of 2018**

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From our fixed income and FX strategy team

- **Banxico's hawkish stance was reiterated with today's release of the minutes from its last policy meeting of 2017, stressing out significant concerns about external and internal factors that could result in a more complex backdrop for inflation in 2018. As of today, the market is fully pricing in a 25pb rate hike for the central bank's next meeting on February 8th and an additional increase in the 2Q18**
- **In the aftermath of the recent assessment from Banxico we remain bearish in terms of local bonds and continue recommending defensive strategies in floating-rate bonds (Bondes D) and in long-term UMS (10-year tenor)**
- **In the FX market, the Mexican peso continues depicting a volatile performance, assimilating several conditions that could result in a weaker currency during the first half of 2018. This situation could steer a more hawkish tone from several board members despite a modest improvement in the adjusted carry embedded in the MXN. More details in our research note "USD/MXN 2018 - *A roller coaster ahead, but with a favorable outcome*" <pdf>, published on December 18th, 2017**
- **Overall, we reaffirm our neutral stance on the currency in a short-term horizon, however acknowledging the likely increase in risk premium by mid-2018**

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