

Banxico preview - A neutral stance, until the Fed hikes in June

- Banxico will announce its monetary policy decision this week (March 18) at 3:00pm (EDT)
- We highlight that this will be the first monetary policy meeting after Banxico's Board of Governors decided to increase by 50bps the reference rate in an extraordinary meeting held back in February 17
- We expect the monetary authority to remain on hold
- However, we expect a neutral tone in the *communiqué* given that:
 - (1) The 50bps hike in the reference rate during Banxico's extraordinary meeting should not be taken as a sign of a tightening cycle; looking ahead, Banxico's monetary policy will be subject to both external and domestic factors
 - (2) The Mexican economy continues to show weakness
 - (3) The balance of risks for inflation in the short term remains slightly negative; and
 - (4) The higher probability that the FOMC will hike the interest rate range once again in June
- All in all, we continue to believe board members will reiterate that in the absence of significant inflationary pressures and moderate growth, the board will continue to monitor the relative monetary conditions vs. the U.S.
- It is our take that the tone of the statement will provide support to our call that Banxico will continue its hiking cycle after the Fed's hike in June
- The minutes of this meeting will be published on the 1st of April, and the next monetary policy announcement will take place on the 5th of May

A neutral stance. This week, Banxico will hold its second regular policy meeting of the year. The monetary policy *communiqué* will be published on Friday (March 18) at 3:00pm (EDT). We highlight that this will be the first monetary policy meeting after Banxico's Board of Governors decided to increase by 50bps the reference rate in an extraordinary meeting held back in February 17. We believe that board members will remain on hold, leaving the reference rate at 3.75%. However, we expect a neutral tone in the *communiqué* given that: (1) The 50bps hike in the reference rate during Banxico's extraordinary meeting should not be taken as a sign of a tightening cycle; looking ahead, Banxico's monetary policy will be subject to both external and internal factors; (2) the Mexican economy continues to show a weak growth; (3) the balance of risks for inflation in the short term remains slightly negative; and (4) the higher probability that the FOMC will decide to delay its normalization process until June.

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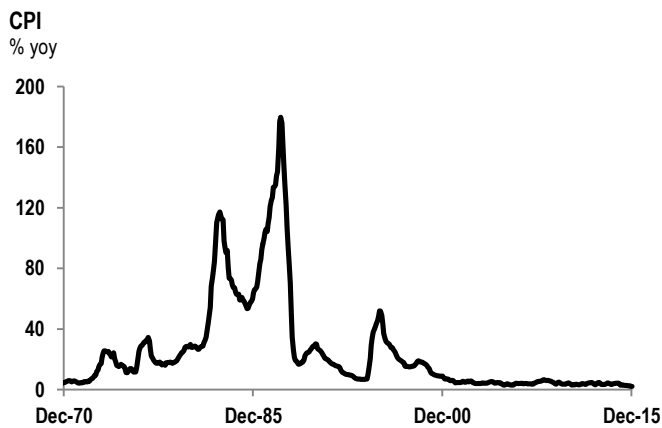
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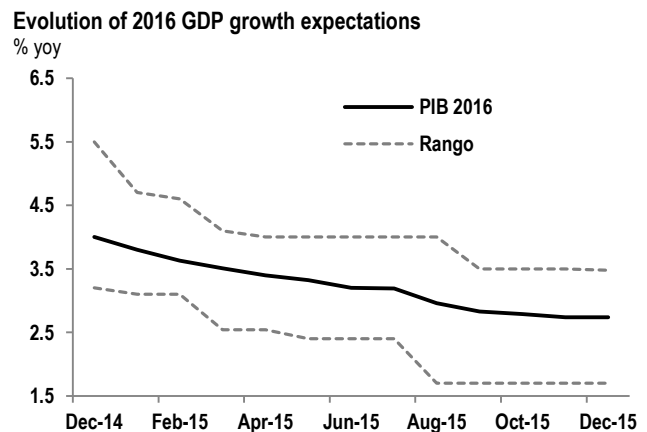
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Lower growth and moderate inflation. In their last *Quarterly Inflation Report* (QIR), Banxico highlighted, among other things, that the Mexican economy maintained a moderate growth during the last quarter of 2015. In particular, Banxico mentioned that Mexico’s economic growth was supported by the upward trend in private consumption. In particular, the central bank said that the recovery in consumption was explained by the better growth dynamics in labor markets, low inflation, higher banking credit, and the recent growth in remittances inflows. However, the monetary authority mentioned that there were several factors that could affect Mexico’s economic growth such as: (1) A delay in the recovery of the U.S. industrial sector; (2) a further decline international oil prices, which could lead to an additional fiscal cut; (3) new episodes of volatility in financial markets derived from China’s economic growth and the uncertainty regarding the Fed’s next hike. In addition, Banxico mentioned that headline inflation will increase this year given the following factors: (1) The fading of favorable supply shocks that took place in 2015; (2) price adjustments given the depreciation of the Mexican currency; (3) the change in the MoF’s policy of the determination of gasoline prices, which implies higher prices during the second and third quarters, but lower during the first and fourth quarters.

Given Mexico’s slow economic growth, the absence of significant inflationary pressures and the Fed’s current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed continues its hiking cycle. Inflation is contained (refer to the chart on the left), and Mexico’s economic growth expectations for 2016 have been continuously revised downwards (refer to chart on the right). Moreover, the current situation of low crude oil prices given Mexico’s heavy dependence on oil revenue (~25%), the government’s commitment to reduce the fiscal deficit to 0.5% of GDP in 2016, and the new fiscal regulations that will affect the accounts of Mexico’s federal entities and municipalities, will translate into a lower public spending, hindering 2016 GDP’s growth below 3%.



Source: INEGI



Source: Banxico Survey of Economic Expectations

The FOMC to hike again in June. In today's FOMC releases, the US Fed decided not to change its monetary stance in order to keep the Fed Funds rate between 0.25% and 0.50%. In the statement, as well as in the economic projections, and in the comments made by the Fed's Chair Janet Yellen during the press conference following the FOMC monetary policy announcement, we perceive a neutral tone, in which even though economic activity seems to be expanding at a moderate pace, there are still some downside risks to inflation while financial conditions are still a risk to consider. In this context, we continue to believe that the Fed's next hike will be in June.

We maintain our view that the central bank's next move will be a 25bps rate hike, immediately after the Fed in June. In our opinion, Banxico's latest QIR maintained the tone we have already discussed previously, in the sense that after Banxico's 50bps rate hike, the central bank is tied to the U.S. Fed actions. In this regard, we believe that Banxico's next move will be a rate hike, immediately after the Fed continues its normalization of monetary policy in June 15. This implies that the central bank could be raising rates at its next regular meeting on June 30.

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