

Banxico preview - A slightly more dovish wait for the Fed

October 26, 2015

- Banxico will announce its monetary policy decision this week (October 29) at 3:00pm (ET)
- We expect the monetary authority to remain on hold
- However, we do expect a slightly more dovish tone in the *communiqué* on two fronts:
 - (1) Express that the balance of risks for inflation has improved; and
 - (2) The higher probability that the FOMC will decide to delay the beginning of its normalization process
- All in all, we continue to believe board members will reiterate that in the absence of 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 start its hiking cycle once the Fed begins its own normalization of monetary policy, now in December 2015
- The minutes of this meeting will be published on November 12, and the next monetary policy announcement will take place on December 17

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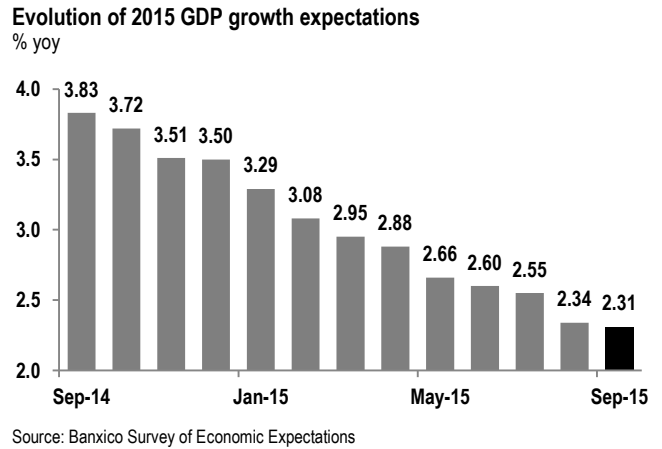
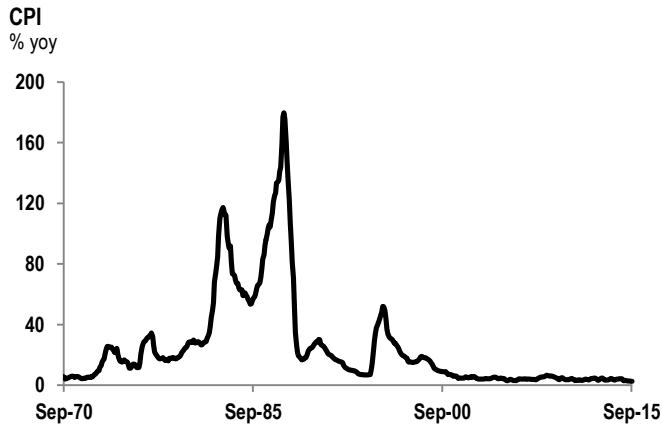
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A slightly more dovish wait for the Fed. This week, Banxico will hold its seventh monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (October 29) at 3:00pm (ET). We believe that board members will remain on hold, leaving the reference rate at 3%. However, we do expect a slightly more dovish tone in the *communiqué* on two fronts: (1) Express that the balance of risks for inflation has improved; and (2) the higher probability that the FOMC will decide to delay the beginning of its normalization process. All in all, we continue to believe board members will reiterate that in the absence of 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 start its hiking cycle once the Fed begins its own normalization of monetary policy.

Moderate growth and low inflation. Given Mexico's slow economic growth, the absence of inflationary pressures and the Fed's current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed begins its hiking cycle. Inflation is at historically low levels (refer to the chart on the left), and even though Mexico's economic growth has been higher in 2015, growth expectations have been continuously revised downwards (refer to chart on the right). Similarly, Mexico's economic outlook is not encouraging in 2016. 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%.

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We maintain our view that the central bank will continue to wait for the Fed to begin its own normalization of monetary policy. 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 will start its hiking cycle when the Fed begins its own normalization of monetary policy next December.

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