Banxico's Minutes – Still waiting for the Fed

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www.banorte.com
www.ixe.com.mx
@analisis_fundam

Gabriel Casillas
Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes
Senior Economist, Mexico
alejandro.cervantes@banorte.com

- **Tomorrow (Thursday, April 9), Banxico will publish the minutes of its March 26 monetary policy meeting, in which the board left the reference rate unchanged at 3%**
- **In our view, the tone of Banxico's post-meeting statement was slightly more *dovish* given that:**
  - **(1) The board stated that the market perception regarding the Fed's next hike could be delayed; and**
  - **(2) The balance of risks for economic growth has deteriorated**
- **However, we believe that the minutes will stress out that the most relevant factors to be considered regarding their monetary policy stance will be:**
  - **(1) Mexico's relative monetary conditions, particularly with respect to the U.S.; and**
  - **(2) The performance of the exchange rate**
- **In our view, investors will pay close attention to the Board's views regarding these subjects**
- **Even though we believe the decision was unanimous, any dissenter would be a strong signal**
- **Looking ahead, we continue to believe Banxico will begin a hiking cycle in July 2015**

Slightly more *dovish* minutes. Tomorrow (Thursday, April 9), Banco de Mexico will publish the minutes of its monetary policy meeting held back on March 26, in which the board decided to leave the reference rate unchanged at 3%, as it was widely expected. In our view -and in line with the last statement- the tone of the minutes will be slightly more dovish, particularly given that: (1) The board stated that market's perception regarding the Fed's next rate hike could be delayed; and (2) the balance of risks for economic growth has deteriorated.

Possible delay in the Fed's hiking cycle. While Banxico mentioned that the market perception of a tighter monetary policy stance by the United States persists, the board stressed that given the last monetary policy statement issued by the Fed, the market now considers it more likely that the initial upward movement in the Fed's fund rate could be delayed.

***Dovish* tone in terms of economic growth...** In terms of economic growth, we believe that Banxico's tone within the minutes will as *dovish* as the *communiqué*. In the last monetary policy statement, even though the Board considered that the balance of risks for global economic growth has remained stable, the Board believes that the balance for growth in Mexico has deteriorated. In particular, they highlighted that: *"The Mexican economy has had a rather weak performance. Mexico's oil production platform continues to fall, which has contributed to a slower growth in industrial production... Considering the above-mentioned factors, we believe that the balance of risks for growth has deteriorated ..."*

However, we continue to believe that the Fed's monetary policy and FX performance will be Banxico's main focal points. Banxico in their last monetary policy statement stressed out that "*...the Board will remain attentive to the evolution of all the inflation determinants, and market's expectations, but particularly they will be focused in Mexico's relative monetary conditions, particularly with respect to the U.S., as well as the exchange rate performance of."* As we have mentioned throughout our publications, Banxico does not manage the reference rate in absolute terms but, given the global influence of the U.S. monetary policy, it only sets the spread between Mexico's rate and the U.S. federal funds rate. Thus, if the Federal Reserve decides to hike its rate in June, almost independently of Mexico's economic cycle and inflation, Banco de Mexico "*will have to maintain*" the differential between the interest rates in both countries. Particularly given that not doing it could trigger a significant depreciation of the Mexican peso against the dollar.

We maintain our expectations that Banxico's next move will be a rate hike in mid-2015. Given that economic activity in Mexico will expand at a higher rate this year (*vis-à-vis* last year), and that the Fed will raise the federal funds rate (probably in June), we consider it highly likely that Banxico will also start a hiking cycle (in July), even though inflation in Mexico will be around its 3% target. In this regard, we believe that the hiking cycle will be supported by: (a) A much more optimistic outlook for the U.S. economy, especially in light of the recent economic data, and growth momentum given the lower gasoline prices (in that country); (b) greater concern for the pass-through effect of the depreciation of the peso against the dollar to inflation; and (c) Banxico's board will probably be more empathic in the next monetary policy announcements about Mexico's relative monetary conditions, in particular to the U.S., given that it is a key factor to decide Mexico's reference rate path. In this context, we acknowledge that given the global deflationary environment, there is a chance that the U.S. Fed might postpone the beginning of its hiking cycle. If this is the case, then we would change our Banxico monetary policy call as well.

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Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Julieta Alvarez Espinosa	Assistant	julieta.alvarez@banorte.com	(55) 5268 - 1613
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Julia Elena Baca Negrete	Economist, U.S.	julia.baca.negrete@banorte.com	(55) 1670 - 2221
Livia Honsel	Economist, Europe	livia.honsel@banorte.com	(55) 1670 - 1883
Miguel Alejandro Calvo Dominguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5004 - 1275
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 5004 - 1231
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 5004 - 1179
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 5004 - 1227
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 5004 - 1266
Valentín III Mendoza Balderas	Equity Research Analyst	valentin.mendoza@banorte.com	(55) 5268 - 9000 x 1267
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 5004 - 5262

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5004 - 1405
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 5004 - 1340
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 5004 - 1437

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Managing Director – Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Jorge de la Vega Grajales	Managing Director – Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Managing Director – Private Banking	lpietrini@ixe.com.mx	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Managing Director – Asset Management	pimentelr@ixe.com.mx	(55) 5268 - 9004
Ricardo Velazquez Rodríguez	Managing Director – International Banking	rvelazquez@ixe.com.mx	(55) 5268 - 9879
Victor Antonio Roldan Ferrer	Managing Director – Transactional Banking	vroldan@ixe.com.mx	(55) 5004 - 1454