

Banxico minutes – Board remains predominantly hawkish

- Banxico published today the minutes of its monetary policy meeting held on February 9, in which the board decided unanimously to increase the reference rate by 50bps to 6.25%
- The discussions focused on the following topics:
 - (1) Banxico hiked 50bps on the back of the deterioration in both the current outlook and inflation expectations
 - (2) Headline and core inflation showed an upward trend as a result of the exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–, which implies that the balance of risks for inflation has deteriorated;
 - (3) Inflation expectations in the short, medium and long-term have increased as a result of the negative impact of supply-side shocks, among which the central bank highlighted the increase in gasoline prices, and the recent hike in agricultural goods prices;
 - (4) The balance of risks for growth deteriorated, mainly as a result of the economic policies that the new administration in the U.S. might implement, and its subsequent impact on the Mexican Economy
 - (5) Given the simultaneity of the adverse economic environment and temporary shocks in relative prices, the main challenge for the monetary authority is to prevent second-round effects on inflation and on medium and long-term inflation expectations; and
 - (6) The fiscal actions take special relevance given that a solid fiscal stance is essential to reduce Mexico's risk perception
- Nevertheless, some Board members also mentioned that given the preventive hikes already implemented, the central bank now has more leeway to implement monetary policy relative to the Fed's policy
- As a result, we now believe that Banxico has larger margin not to hike by 50bps as a response to a 25bps Fed hike
- In this context, we consider that the central bank will increase the reference rate by another 100bps in 2017. Given the FEC's announcement, the central bank now has more room to execute monetary policy due to fewer inflationary pressures derived from the reduced volatility of the exchange rate coupled with lower energy prices. In addition, the implementation of the exchange rate hedge program is also likely to lead to lower short-term inflation expectations
- Since the minutes does not incorporate the information from the FEC's FX hedge program announced two days ago, we believe that Banxico's QIR (*Quarterly Inflation Report*), to be released on March 1st, will be particularly relevant given that it will provide additional information regarding the monetary stance to be implemented

February 23, 2017

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- In addition, the trajectory of gasoline prices –and its subsequent impact on the price formation process– will provide additional information to assess the possibility of the central bank hiking the reference rate as soon as the next monetary policy meeting (to be held on March 30)
- Mexican bonds remain with a positive bias, with investors still assimilating FEC’s important announcement last Tuesday, and also benefited by a rally in global sovereign securities, despite the *hawkish* tone inside the minutes (as expected). More details in our research note “*Reassessing our rates and peso forecasts after the FEC’s new mechanism*” <[pdf](#)>, published on February 21st, 2017. The local yield curve is currently pricing in 73bps of implied cumulative hikes by year-end. Taking into account current conditions, we remain positive in terms of the belly of the yield curve, but not so constructive with respect to the long-end, especially after the recent rally and flattening bias. As a result, we hold our trade idea opened on February 15th, 2017 of a 5y10y steepener position in TIE-IRS (long/receive 5y TIE-IRS (65x1) and short/pay 10y TIE-IRS (130x1)) with an entry level of 28bps, target of 43bps, stop-loss of 18bps, and currently trading at 31bps. More details in our research note “*Trade Idea: 5y10y TIE-IRS steepener*” <[pdf](#)>.
- In FX, the Mexican peso stabilized around 19.70 per dollar, 1% stronger on the day albeit with no meaningful reaction to the minutes. We believe the most relevant parts for the currency are those related to greater macroeconomic risks faced by the Mexican economy that could result in additional currency losses, and therefore to inflation, given greater signs of pass-through effects. In this respect, the FEC’s decision could be interpreted as a measure to diminish inflation risks due to peso weakness. Given Banxico’s tone, the risk-on mood for EM, low volatility, headwinds for the dollar, and the potential delay of fiscal measures in the US, appetite for carry trades could remain strong. We reiterate our recommendation of peso longs on an intraday basis, with a support in the 19.50-19.55 zone, near the convergence of the 200-day MA (19.51) and a Fibonacci level (19.54).

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