

## Banxico – A 50bps intra-meeting cut

- **Banxico announced today, in an intra-meeting decision, a 50bps cut in the reference rate, bringing it down to 6.50%. We expected a reduction of this magnitude next week, while we had not ruled out completely an unscheduled adjustment, given the global and domestic market conditions**
- **It should be noted that this decision replaces the one originally scheduled for March 26<sup>th</sup>, and that the vote was not unanimous, with one of five Board members favoring only a 25bps reduction**
- **The central bank also announced additional measures, some in conjunction with the MoF, to bolster market liquidity**
- **We now expect the reference rate at 5.50% by year-end 2020 (previous: 6.50%), with a 50bps rate cut in the next meeting. We do not rule out another intra-meeting decision, as there are no meetings scheduled until mid-May**

**Banxico cut the reference rate by 50bps, to 6.50%.** In an out of calendar meeting, the central bank cut the reference rate by 50bps to 6.50%. While the magnitude was [in line with our expectation](#), the timing was a bit early, while we also had not ruled out entirely given global and domestic market conditions. It should be noted that the statement mentions that this decision replaces the one scheduled for March 26<sup>th</sup>. The decision was not unanimous, with one member voting for a 25bps cut.

**Responding to the COVID-19 outbreak and the shock in the oil market, as part of a global easing wave.** This is a direct response to material changes to the outlook stemming from the coronavirus’ impact, similar to the actions undertaken by other global central banks. In this respect, so far in March, 47 of them, including Banxico, have cut their reference rates. Specifically, they expect a strong deterioration of GDP growth, resulting in an even wider output gap, with “...risks significantly biased to the downside...”, as both domestic and external demand will be hit. In this respect, we have [updated our macroeconomic framework](#), expecting now a GDP contraction of 3.5% y/y in 2020, followed by a 1.0% rebound in 2021. Regarding inflation, the central bank said the balance of risks is even more uncertain than before. On one hand, a more negative output gap –leading to lower demand-side pressures– and plunging oil prices could insert a downward bias. On the other, this could be outweighed by higher prices due to the passthrough effect from the depreciation of the Mexican peso. Banxico stated that inflation is likely to continue with its downward trend towards the target, albeit in a slower fashion. This is similar to our view, maintaining our year-end inflation forecast at 3.6% y/y.

### Measures to provide liquidity and to improve the functioning of domestic markets

#### Measures announced

1. Reduction of the Monetary Regulation Deposit (DRM) by 50 billion pesos (US\$ 3 billion)
2. Adjustments to the interest rate on the Ordinary Additional Liquidity Facility
3. US dollar auctions using the Swap line with the Fed as a financing mechanism
4. Collaboration with the Ministry of Finance to strengthen the Primary Dealers Program

Source: Banxico

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### **Banxico’s 2020 monetary policy decisions**

Date	Decision
February 13	-25bps
March 20 (out-of-calendar)	-50bps
May 14	--
June 25	--
August 13	--
September 24	--
November 12	--
December 17	--

Source: Banxico

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**In addition to the rate cut, Banxico also announced several measures to provide liquidity and ensure the proper functioning of domestic markets.** The central bank posted the following actions: (1) A \$50 billion reduction in the monetary regulation deposits (locally known as DRM) held by commercial and development banks in order to improve their liquidity positions and bolster their capacity to grant credit and maintain or expand their credit lines, taking effect on April 1<sup>st</sup>, 2020 (Banxico will sterilize the monetary impact of this action); (2) a lower cost of the Ordinary Additional Liquidity Facility, from a range of 2.0-2.2 times Banxico's target for the overnight interbank interest rate, to 1.1 times (also entering into force on April 1<sup>st</sup>, 2020); (3) US dollar auctions among credit institutions funded by the swap line with the Federal Reserve announced yesterday, with a total amount of US\$60 billion; and (4) a combined effort with the MoF to strengthen the Primary Dealers Program, with changes that will take place starting in April 1<sup>st</sup>, 2020. A summary table is presented above.

**We expect the reference rate at 5.50% by year-end 2020.** Given the current backdrop of extreme market uncertainty, which continues to be fought with almost unprecedented easing efforts by global central banks, we now expect Banxico to cut the reference rate to 5.50% by year-end (previous: 6.50%). Moreover, we believe the central bank will cut again by 50bps in the next meeting, to 6.00%. Also similar to today, we do not rule out another intra-meeting cut, as there are no meetings scheduled until May 14 (see table above, right). Moreover, we also think it is very positive that the bank deployed a series of measures to cope with the market's volatility, which will help ensure appropriate dollar liquidity in the domestic market. In our view, this will contribute to mitigate financial stability risks, with the possibility that additional mechanisms are implemented if needed. Uncertainty about the economic outlook is very high for all economic agents, so we believe it is key that the central bank keeps reacting forcefully, in a timely manner, and with high conviction. Simultaneously, Board members will likely maintain a prudent approach, judging on a daily basis the new developments on the horizon and risks to the outlook. In our view, this combination will foster a successful adjustment in financial markets and the economy at the least possible cost.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Jorge Antonio Izquierdo Lobato and Eridani Ruibal Ortega, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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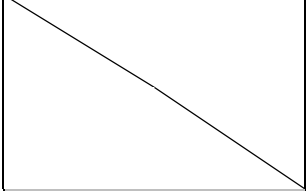
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