

## Banxico – Rate hike confirms the restrictive cycle, despite a divided Board

- In a majority decision (3-2), Banxico decided today to hike the reference rate by 25bps to 4.50%, in line with our call and consensus expectations
- In our view, the statement maintains a hawkish tone given prevailing concerns on inflation, in turn also reflected in the significant upward move in the central bank’s forecasts after recent communication changes
- Within the statement, we highlight that:
  - (1) The convergence of inflation to the target was delayed to 1Q23, longer than the 3Q22 that had been signaled in the last decision;
  - (2) Deputy Governors Galia Borja and Gerardo Esquivel voted again to keep the reference rate on hold; and
  - (3) They expect Mexico’s recovery to continue for the remainder of the year despite persisting risks due to the increase in contagions
- We maintain our call of three additional 25bps hikes for the rest of 2021, taking the reference rate to 5.25%. For 2022, we see two more hikes of the same magnitude at the start of the year and one at the end, closing at 6.00%
- The split decision triggered a positive reaction in local rates

**Banxico hikes 25bps, in line with expectations.** The rate increased to 4.50%, in line with expectations after the surprise hike in the last decision. In our view the tone of the statement remains hawkish, with the Board still concerned about inflation. Moreover, we had new information following [recent changes to the communication strategy](#). These include: (1) The vote’s direction of all members, with Deputy Governors Galia Borja and Gerardo Esquivel dissenting in favor of keeping the rate unchanged; and (2) updated inflation forecasts for the next eight quarters, shown in the table below. In the latter, we note the convergence to the target was delayed even further than they expected in the previous meeting (3Q22), now seeing it until 1Q23. It is our take that forecast changes and the overall tone confirm that Banxico has already started a hiking cycle. However, its extension and magnitude remain uncertain given data dependency and, especially, as we had a split decision again. Nevertheless, we maintain our call of three additional 25bps hikes for the rest of 2021, taking the reference rate to 5.25%. For 2022, we see two more hikes of the same magnitude at the start of the year and one more at the end, closing at 6.00%.

CPI forecasts  
% y/y, quarterly average

|                  | 2021 | 3Q21 | 4Q21 | 1Q22 | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 |
|------------------|------|------|------|------|------|------|------|------|------|
| CPI              |      |      |      |      |      |      |      |      |      |
| Current          | 6.0* | 5.6  | 5.7  | 5.2  | 3.9  | 3.2  | 3.4  | 3.1  | 3.1  |
| Previous         | 5.8  | 4.5  | 4.8  | 4.3  | 3.0  | 3.1  | 3.1  | 2.9  | --   |
| Difference (bps) | +20  | +110 | +90  | +90  | +90  | +10  | +30  | +20  | --   |
| Core             |      |      |      |      |      |      |      |      |      |
| Current          | 4.4* | 4.7  | 5.0  | 5.1  | 4.4  | 3.6  | 3.3  | 3.1  | 3.0  |
| Previous         | 4.3  | 3.9  | 3.9  | 3.9  | 3.3  | 3.2  | 3.2  | 3.2  | --   |
| Difference (bps) | +10  | +80  | +110 | +120 | +110 | +40  | +10  | -10  | --   |

Source: Banco de México. \*Observed data

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### Banxico's 2021 policy decisions

| Date                        | Decision |
|-----------------------------|----------|
| <a href="#">February 11</a> | -25bps   |
| <a href="#">March 25</a>    | 0bps     |
| <a href="#">May 13</a>      | 0bps     |
| <a href="#">June 24</a>     | +25bps   |
| August 12                   | +25bps   |
| September 30                | --       |
| November 11                 | --       |
| December 16                 | --       |

Source: Banxico

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**Strong upward adjustment on inflation forecasts.** Globally, they seem to recognize a more complex backdrop, saying that inflation “...continued increasing significantly...”, given pressures in commodities’ prices, as well as “multiple” bottlenecks in production (supply shocks). Therefore, and as signaled last week, the institution revised their quarterly inflation forecasts strongly to the upside. Given that they still consider most shocks as transitory, the largest changes were made in the one-year horizon period. Nevertheless, due to dynamics already seen and these changes, the convergence to the 3% target was delayed until 1Q23. We should remember that, in the previous statement, this was expected in 3Q22, in turn one quarter later than in the last *Quarterly Report*. For the core, adjustments were also meaningful. Regarding the balance of risks, we consider especially relevant that: (1) It remains skewed to the upside, even when forecasts were adjusted in the same direction; and (2) factors to the upside and downside were practically unchanged relative to the previous decision. All in all, we believe that this information supports a more hawkish stance by the institution and is consistent with a tightening cycle.

**The recovery will continue despite higher contagions.** We saw few changes about the economy, affirming that global activity kept recovering. We noted the warning that some AEs monetary stimulus remains in some AEs, although a withdrawal is already expected, while several EMs have already reduced it. For Mexico, they mentioned that the recovery continued through the second quarter and that they expect it to maintain this trend for the remainder of the year despite risks prevailing because of the increase in COVID-19 cases. Therefore, we think Banxico remains quite optimistic on growth despite the ‘delta’ variant and its potential impact, both globally and locally.

**We maintain our call of more hikes in coming months.** Considering the strong adjustments to inflation forecasts and the statement’s tone, we reiterate our view that the hiking cycle has begun and will continue in the near future. Moreover, we think the global trend has become less accommodative at the margin, reducing the room to leave the rate unchanged. Specifically: (1) We now see the Fed’s *tapering* announcement in September and the start in December, slightly earlier than previously; and (2) the inflation outlook has also become more difficult in several countries, with several emerging markets (*e.g.* Brazil, Chile, Russia, Hungary) also hiking rates. On the other hand, uncertainty remains high about the effect on prices from supply shocks and the recent introduction of price ceilings to LP gas. Nevertheless, we still anticipate some resistance to the downside at the core level (above 4.0% at least until 3Q22, and above Banxico’s forecasts) and healthy economic performance (despite new highs in terms of daily COVID-19 cases because of ‘delta’). Hence, we think it is necessary to continue the hiking cycle to avoid a potential impact from currently high inflation into expectations. Specifically, we maintain our call of three additional 25bps hikes for the rest of 2021, taking the reference rate to 5.25%. For 2022, we see two more hikes of the same magnitude at the start of the year and one at the end, closing at 6.00%. However, an ample debate is likely to continue about the total magnitude of the cycle given the bank’s data dependency mode, but especially because: (1) The Board remains very divided; and (2) there will be changes in its composition at the start of next year.

*From our fixed income and FX strategy team*

**The split decision triggered a positive reaction in local rates.** The Mexican yield curve adjusted sharply to Banxico's decision reversing previous losses in the session that accumulated a sell-off as strong as 7bps in TIEE-28 swaps. From its weakest point in the day, these adjustments resulted in a net rally of ~7bps for Mbonos and of ~12bps in TIEEs, mainly focused in mid-term tenors. Given the communiqué's tone and CPI forecasts, this performance suggests a market interpreting the split decision in a less hawkish tone relative to expectations. Moreover, gains focused in mid-term maturities reflect some uncertainty regarding a more restrictive policy stance for next year. This support will probably endure for the next sessions benefiting local rates and will result in a temporal steeper slope. However, short- and mid-term rates' rally is limited to the market's repricing for Banxico, which is already factoring a feasible monetary stance. In this sense, the yield curve prices in additional hikes for close to 75bps in 2021, consistent with our estimate of the reference rate closing December at 5.25%. Moreover, we hold a view of Treasuries trading at higher levels this year, a situation that will also limit a further rally in local rates. Under this context, we wait for better market conditions for directional strategies.

In the FX market, the Mexican peso sold-off from USD/MXN 19.86 to 19.97, closing fairly unchanged vs yesterday's close at 19.93. The pesos' reaction reflects the sensibility the currency will hold for the carry effect, a factor we still see as supportive for a defensive performance in the following months amid a structural USD strengthening. We hold a bias favoring USD purchases in dips, with first attractive levels at USD/MXN 19.80.

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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, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Álvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Juan Barbier Arizmendi, 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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