

## Banxico – A more hawkish tone suggests the hiking cycle will continue

- In a majority decision (4-1), Banxico’s Board decided today to hike the reference rate by 25bps to 4.75%, in line with our call and consensus expectations
- In our view, the statement had a more hawkish tone given the tally of the Board’s voting –with Gerardo Esquivel as the only dissenter– and changes to the inflation outlook, including the convergence to the target and about expectations
- Regarding the latter, we highlight:
  - (1) Important revisions to the upside on inflation forecasts for this and next year, both for the headline and core indices;
  - (2) Convergence of inflation to the target was delayed “...by the end of the forecast horizon...” (3Q23) from 1Q23 previously; and
  - (3) They included more precise comments about risks of higher inflation expectations, while the balance is still skewed to the upside
- We reiterate our call of two additional 25bps hikes for the rest of 2021, taking the 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%. In addition, we believe risks have increased of Banxico needing to accelerate the pace of hikes in an upcoming meeting
- The market eased rate pressures after the decision, although it is still discounting a restrictive stance

**Banxico hikes 25bps, with a more hawkish tone.** The rate increased to 4.75%, in line with our call and market expectations. In our view, the tone of the statement was more hawkish than in the previous decision. Specifically, we highlight: (1) The 4-1 vote, with Gerardo Esquivel as the only dissenter and Galia Borja now supporting the hike; (2) upward adjustments of inflation forecasts and the signal about an additional delay of the convergence towards the target, despite still considering shocks as transitory (please see table below); and (3) more precise comments about risks of higher inflation expectations, while the balance is still skewed to the upside. Based on this outlook and a more challenging financial and global monetary policy backdrop, among other factors, we reiterate our view of two additional 25bps hikes for the remainder of 2021, to 5.25%. For 2022, we still expect two more of the same magnitude at the start of the year and one at the end, closing at 6.00%. Lastly, we believe risks have increased of Banxico needing to accelerate the pace of hikes in an upcoming meeting.

CPI forecasts  
% y/y, quarterly average

	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
CPI									
Current	5.8	6.2	5.6	4.3	3.5	3.4	3.3	3.2	3.1
Previous	5.6	5.7	5.2	3.9	3.2	3.4	3.1	3.1	--
Difference (bps)	+20	+50	+40	+40	+30	0	+20	+10	--
Core									
Current	4.8	5.3	5.4	4.8	4.0	3.4	3.1	2.9	2.8
Previous	4.7	5.0	5.1	4.4	3.6	3.3	3.1	3.0	--
Difference (bps)	+10	+30	+30	+40	+40	+10	0	-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
<a href="#">August 12</a>	+25bps
September 30	+25bps
November 11	--
December 16	--

Source: Banxico

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**Important changes to the inflation outlook...** Similar to recent decisions, it is our take that the most relevant adjustments were in this front. On top of those already mentioned above about inflation forecasts and the convergence to the target, we highlight other comments. Globally, they recognize that it has kept increasing, although removing the word “considerably”, and adding as a driver “...*stimulus spending and its rebalancing towards merchandises...*”. Locally, we note greater caution because of the possible effect stemming from high and persistent levels of actual inflation. In this front: (1) They added that expectations for the headline and core rose once again, not only for 2021 but for the next 12 months and 2022; (2) they stated that the magnitude and nature of the shocks to inflation, as well as the time they have being on effect, could not only impact the price formation process, but also expectations, even though they are transitory. Lastly, factors that could influence the inflation path, both to the upside and the downside, were unchanged; however, the balance of risks remains skewed higher despite new forecast adjustments. In our opinion, all of these suggest that the hiking cycle is still in an early stage and could extend further than expected before this decision.

**...but few on growth.** The Board mentioned that the global economy keeps recovering, albeit “...*at a slower pace...*”, which was not mentioned in the previous meeting. Overall, global risks remain unchanged. On Mexico, they stated that the country still recovered in 3Q21 and this is expected to continue in 2022. Although the latter is new, it is consistent with estimates in the last [Quarterly Report](#) and does not signal changes to their expectations. In a relevant manner, they also eliminated the risk of an increase in contagions and still expect slack and differences at the sector level.

**We reiterate our call of an extension of the hiking cycle.** We believe local and global conditions for thinking about a pause in the current hiking cycle have worsened. The main one is the inflation outlook –as reflected in forecast revisions–, without ruling out further adverse shocks. In addition, the room to maneuver has diminished because of: (1) The Fed’s strong signal that the tapering will begin this year and the pace of reductions could be faster than expected, with net purchases reaching zero by mid-2022; (2) additional hikes by other emerging markets (*e.g.* Brazil, Russia, Chile, Colombia, etc.) that translate to less space for a pause; and (3) the possibility of financial stability because of China (*e.g.* Evergrande’s situation), reflected in higher asset volatility (including the MXN, as recognized by Banxico), which could in turn affect growth prospects and induce more financial outflows. Therefore, we reiterate our call of two additional 25bps hikes for the rest of 2021, taking the rate to 5.25%. Moreover, we believe the change in Galia Borja’s vote supports our view for 2022, seeing two more hikes of the same magnitude at the start of the year –which will be with a new Board composition, likely led by Arturo Herrera. After this, we still see an additional one at the end of said year, with the rate closing December at 6.00%. Lastly, and although not our base case, this environment and the more hawkish tone suggest risks of Banxico needing to accelerate the pace in an upcoming meeting, especially if there is an additional deterioration in inflation, the MXN or financial market conditions.

*From our fixed income and FX strategy team*

**The market eased rate pressures after the decision, although it is still discounting a restrictive stance.** Following the decision, local rates rallied, suggesting that the market, although with a slight conviction, anticipated a more aggressive adjustment to the reference rate. Moreover, this price action also likely reflected some profit-taking to a positioning capitalizing on recent pressures on local rates. In this sense, today's decision took place during a session that has extended the volatility of the last few days where we have seen strong pressures that have resulted in a steepening of nominal curves in tandem to Treasuries. The Mbonos' curve ended the day with an appreciation of 2bps, on average, with gains of up to 5bps in the mid-end. Specifically, the 10-year benchmark, Mbono May'31, closed at 7.35% (-3bps) after reaching levels of up to 7.40% yesterday, its highest since April 2020. As for TIIE-28 IRS, short-term securities outperformed with gains of 7bps, while the long-end adjusted -4bps. The latter have accumulated since Thursday of last week 26bps sell-off, on average. The market received Banxico's decision with a cumulative pricing this year of +87bps (including today's fully priced-in 25bps hike) and currently holds additional +56bps for 2021 and +84bps for the mid-2022. For the time being, this view is mostly in line with our 2021 estimate and is more aggressive for 2022, reason why it is our take that current market conditions and the complex inflation dynamics will hold discussions around the central bank's hawkish stance rather active. In terms of strategy, current Mbonos' valuations look attractive to consider inciting short-term tactical long positions in long-term securities; however, UST's performance and other risk premiums joining tilt us for a more cautious bias and to wait for better entry levels. Moreover, the market is likely to calibrate its expectation for the central bank as it factors-in the details for this voting when the minutes are released.

In the FX market, the USD/MXN weekend as rates moderated recent pressures moving from 20.54 to 20.68, its weakest level since June. Later, the currency stabilized at 20.63, equivalent to a 0.5% sell-off and scoring its fifth negative session, locating among the weakest currencies in the EM universe. Its recent performance has been affected by a widespread USD strengthening, following the more hawkish stance from the Fed. In our view, the carry attractiveness of the MXN will play a partial equilibrium role; however, we expect the USD strength to endure in a structural fashion given the US relative monetary policy stance against other developed countries. Given this situation, we continue favoring USD purchases in dips, where in the shortest-term view the 20.35 looks attractive.

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We, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalia 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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