Banxico minutes – Additional actions needed amid a challenging local and global backdrop

February 24, 2022

www.banorte.com
@analisis_fundam

Alejandro Padilla
Chief Economist and Head of Research
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
Executive Director of Economic Research and Financial Markets Strategy
juan.alderete.macal@banorte.com

Francisco Flores
Director of Economic Research, Mexico
francisco.flores.serrano@banorte.com

Fixed income and FX Strategy

Manuel Jiménez
Director of Market Strategy
manuel.jimenez@banorte.com

Leslie Orozco
Senior Strategist, Fixed Income and FX
leslie.orozco.velez@banorte.com

- **Banxico published the minutes of the decision held on February 10th, in which they hiked the rate by 50bps to 6.00%, in line with our call**
- **The document maintains a clear restrictive bias, highlighting greater concerns about core inflation dynamics and the probable volatility stemming from the tightening of global monetary conditions**
- **In our opinion, the comments attributable to Victoria Rodriguez suggest a center-hawkish stance, highlighting the need for monetary policy to remain focused on consolidating an environment of low and stable inflation, risks to expectations, and strengthening the commitment to uphold the central bank's mandate**
- **Discussions about inflationary pressures continue to stand out. Among the main issues, we note:**
  (1) A greater conviction that inflation is generalized, elevated and persistent, especially at the core component;
  (2) Growing concerns about the impact of high inflation on expectations and the price formation process; and
  (3) Rising risks to markets and financial stability due to a more restrictive monetary stance in advanced economies
- **We reiterate our call of a 25bps hike in March, followed by increases of the same magnitude in May, June, September and December. However, recent events have once again raised the probability of an additional 50bps hike in the next decision**
- **We maintain our trade idea of paying 2-year TIIE-IRS**

Banxico minutes point to the need of acting further amid a difficult situation on several fronts. In our opinion, the document maintains a clear restrictive bias. Although we had already identified this in repeated occasions, we believe the tone about inflation dynamics shows renewed concerns, especially on core inflation. In addition, it is our take that Russia's invasion of Ukraine –announced last night– deteriorates the balance of risks – which was already characterized as tilted to the upside– due to its upward impact on commodities, the exchange rate and risk premiums. On the other hand, we perceive in greater detail the need to be prudent because of monetary normalization in advanced economies, which could induce greater financial instability in Mexican markets. It was also very important to identify the comments made by Governor Victoria Rodríguez, as this was her first meeting. In our view, she showed an institutional stance by reaffirming the importance of strengthening the commitment with fulfilling the bank's mandate in a highly complex environment with elevated inflationary pressures. She also mentioned that the social and economic costs of high inflation affect people with lower incomes the most, and that expectations could continue to be affected. Considering the latter, we place the Governor at the center-hawkish position relative to other members.

Banxico's 2022 policy decisions

Date	Decision
February 10	+50bps
March 24	--
May 12	--
June 23	--
August 11	--
September 29	--
November 10	--
December 15	--

Source: Banxico

Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Document for distribution among the general public

A challenging backdrop remains, considering inflation and the relative monetary stance. We consider that, for most members, the inflationary outlook and its effects on expectations remains as the main argument to continue with the hiking cycle. However, the relative monetary stance has gained more importance relative to the previous decision given expectations about the start of the Fed's restrictive cycle. It is also very important that we had the first comments from Governor Victoria Rodríguez, which we identify with a center-hawkish bias. Specifically, we attribute to her the mention that "*...in the current scenario, the central bank's commitment to fulfilling its mandate should be strengthened...*", reinforcing the importance of inflation in her decision-making process. She added that "*...the outlook for monetary policy has become more complex, given the outlook for a faster withdrawal of monetary stimulus around the world...*", consistent with the overall message about the relative monetary stance. As such, we believe she will favor prudent actions in upcoming meetings, extending the hiking cycle. On the remaining members, we detail the most relevant comments that we believe were made by each of them, in order of appearance:

- Gerardo Esquivel: "*...the concern is whether to raise it by 25 or 50 basis points. He/she questioned the arguments for accelerating the monetary tightening...*". The stance from the Deputy Governor could be less dovish at the margin, although he maintains a series of arguments, mainly related to activity, of why adjustments should be smaller. He reiterated that accelerated actions could have adverse effects on the recovery.
- Galia Borja: "*...it is still necessary to strengthen the downward trajectory of inflation, given that pressures have not dissipated...*". This Deputy Governor seems to maintain a relatively hawkish stance. Although most immediate conditions may have improved, the institution must make sure that this materializes. On the Fed, she mentioned that the current relative stance is solid, with the spread between rates close to highs of the previous cycle. This could suggest that upcoming adjustments might be of a lower magnitude.
- Irene Espinosa: "*the dilemma is between maintaining the current pace of increase at 50 basis points or raising it to 75 basis points*". In our opinion, she remains as the most hawkish member, quoting three factors: (1) High inflation; (2) imminent interest rate increases by the Fed; and (3) adverse cyclical conditions of the economy. In this context, we think she might be the main proponent of more significative increases in upcoming meetings, representing an upside risk for our expected path.
- Jonathan Heath: "*…the appropriate pace at which to reduce monetary stimulus must be assessed to ensure an orderly convergence to the target...*". His comments suggest concerns about inflation, especially the core, even with the possibility of having to maintain elevated rates. In addition, he added that the widening of slack conditions does not justify a moderation in the monetary stance. Broadly speaking, we think that if the outlook for prices keeps deteriorating, he could support a more substantial hike.

Inflation is a generalized phenomenon, centered at the core. The Board recognized current inflation is *"...a generalized phenomenon",* with one member pointing out that *"...the arguments of price increases being due to seasonal factors or comparison base effects are no longer valid...".*

Moreover, they pointed out that the non-core has driven headline inflation down from November to January, but that it could well be reversed. In that sense, the bigger concerns remain on core inflation, with some members highlighting that *"…it has risen in each of the last 14 months…"* and both in goods and services. Individual contributions on its dynamics include one member affirming that *"…this not only responds to temporary external pressures…"* and other predicting that *"…the shocks that have affected core inflation are expected to continue at least until the second half of 2022…"*. Finally, everyone highlighted that expectations for the rest of 2022 and 2023 increased again. We believe this discussion shows growing concerns about price dynamics, its expectations, and the price formation process.

Greater risks due to global monetary policy. Even if the statement did not include many references to this, the minutes provided further details of its importance. Specifically, they mentioned the accelerated pace of reduction in global monetary stimulus, including advanced economies on top of EMs. On the Fed, they noted the possibility of a higher-than-anticipated pace and magnitude of hikes. Despite of the desire of being gradual and not to surprise markets, the forward guidance is fewer about how the normalization will be done. As such, this entails risks for markets, including capital flows, fixed income, and EM currencies, with a member stating that the balance of risks for financial stability has deteriorated. Overall, we perceived that most recognize the importance of closely following markets in an environment of policy normalization, which in turn could influence future decisions about the reference rate.

Unchanged call of a 25bps hike in March, albeit with higher risks of +50bps. We reiterate our view of accumulated increases of 125bps this year, with steps of 25bps each in March, May, June, September, and December. With this, the reference rate would reach 7.25% by year-end. Nevertheless, we believe one of the main risks is that the Fed hikes more aggressively, forcing Banxico's hand to increase at least by the same magnitude. Nevertheless, even if the Fed goes for 25bps in March, risks of a more sizable adjustment from Banxico have increased at the margin. Specifically, we had increasing concerns about the price outlook even before the last deterioration in energy prices, FX depreciation and higher risk premia because of the conflict between Russia and Ukraine. Hence, a new 50bps increase is not completely off the table. Apart from the evolution of the conflict and markets in coming days, we believe updated commentaries in the *Quarterly Report* (to be released next Wednesday) will be very important to recalibrate potential changes in the opinions of the Governing Board.

From our Fixed income and FX strategy team

We maintain our trade idea of paying 2-year TIIE-IRS. The escalation in geopolitical tensions between Russia and the US over Ukraine has increased appetite for safe haven assets. With this, local nominal rates are losing 7bps on average despite Treasuries seeing broad gains, implying a widening in spreads. On the other hand, the reaction to Banxico's minutes was modest. Moreover, the market: (1) Is already pricing-in implied hikes of +201bps for the remainder of the year vs +189bps last Friday; and (2) assigns a high probability of 50bps hikes at least in the next two decisions, in March (+48bps) and May (+41bps).

This scenario looks high compared to our call for year-end 2022 at 7.25% (+125bps). However, we maintain a more hawkish stance for 2023 relative to the market, seeing +100bps. In the current backdrop and given higher risk premia, we maintain our trade idea of paying 2-year TIIE-IRS (26x1) with an entry level of 7.40% and target at 8.10%. This security currently trades at 7.94% (+8bps); which is +2σ of its 90-day MA. In the FX market, higher risk aversion has strengthened the dollar, with the DXY and BBDXY gaining 1.5% and 1.2%, respectively. G-10 and EM currencies reflect widespread losses, with EUR reaching its lowest since June 2020 and RUB as today's weakest currency (-7.3%). Meanwhile, the MXN depreciates 2.4% to 20.73 per dollar after reaching its best intraday level since October 2021 yesterday at 20.16. We reiterate our view of additional dollar strength ahead of the start of the Fed's hiking cycle in a backdrop of heightened inflation uncertainty and geopolitical tensions.

Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, José Luis García Casales, Yazmín Selene Pérez Enríquez, José Itzamna Espitia Hernández, Carlos Hernández García, Paola Soto Leal, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Daniela Olea Suárez, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez and Gerardo Daniel Valle Trujillo, 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

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., *through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.*

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

The information contained hereby has been obtained from sources that we consider to be reliable, but we make no representation as to its accuracy or completeness. The information, estimations and recommendations included in this document are valid as of the issue date, but are subject to modifications and changes without prior notice; Grupo Financiero Banorte S.A.B. of C.V. does not commit to communicate the changes and also to keep the content of this document updated. Grupo Financiero Banorte S.A.B. of C.V. takes no responsibility for any loss arising from the use of this report or its content. This document may not be photocopied, quoted, disclosed, used, or reproduced in whole or in part without prior written authorization from Grupo Financiero Banorte S.A.B. of C.V.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Alejandro Padilla Santana	Chief Economist and Head of Research	alejandro.padilla@banorte.com	(55) 1103 - 4043
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research			
Juan Carlos Alderete Macal, CFA	Executive Director of Economic Research and Financial Markets Strategy	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Director of Economic Research, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Director of Economic Research, Global	katia.goya@banorte.com	(55) 1670 - 1821
Yazmín Selene Pérez Enríquez	Senior Economist, Mexico	yazmin.perez.enriquez@banorte.com	(55) 5268 - 1694
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Leslie Thalía Orozco Vélez	Senior Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Carlos Hernández García	Senior Strategist, Equity	carlos.hernandez.garcia@banorte.com	(55) 1670 – 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Paola Soto Leal	Analyst	paola.soto.leal@banorte.com	(55) 1103 - 4000 x 2755
Corporate Debt			
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Quantitative Analysis			
Alejandro Cervantes Llamas	Executive Director of Quantitative Analysis	alejandro.cervantes@banorte.com	(55) 1670 - 2972
José Luis García Casales	Director of Quantitative Analysis	jose.garcia.casales@banorte.com	(55) 8510 - 4608
Daniela Olea Suárez	Senior Analyst, Quantitative Analysis	daniela.olea.suarez@banorte.com	55) 1103 - 4000
Miguel Alejandro Calvo Domínguez	Senior Analyst, Quantitative Analysis	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5004 - 1282
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 5140
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8173 - 9127
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5249 - 6423
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Osvaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5004 - 1051
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 1670 - 1899