Banxico – One more and done

- **Today, Banxico's Board raised the reference rate by 50bps to 10.50%, in line with our call held since late September**
- **The vote was split, with Deputy Governor Esquivel favoring only +25bps**
- **In our view, the tone of the statement is less hawkish, noting:**
  (1) Changes to the forward guidance, providing certainty about another hike in the upcoming meeting, but assessing if additional adjustments will be necessary;
  (2) A more constructive tone over the current backdrop, especially on the degree of uncertainty and the tightening of financial conditions;
  (3) A more favorable view surrounding global inflation, particularly because of recent dynamics of energy and food items; and
  (4) Mixed adjustments on inflation forecasts, still with caution on the core component
- **After this adjustment, we modify our expected path for the reference rate. We now anticipate +50bps in February and no adjustments in March (previous: 25bps hikes in both meetings). As a result, our forecast for the terminal rate remains at 11.00%, albeit reaching it a bit sooner**
- **Local assets had already priced-in Banxico's decision**

Banxico hiked 50bps, moderating the pace of increases and its *hawkish* tone. With this, the reference rate reached 10.50%, in line with our forecast since September 29th and consensus expectations. The decision was split once again, with a dissent from Deputy Governor Esquivel in favor of only +25bps. We noted relevant changes in the statement that lead us to believe that the central bank is signaling that the end of the hiking cycle is near. In our opinion, this was clearly reflected in the changes made to the forward guidance. Specifically, they explicitly stated that a hike will be needed in the upcoming meeting. At the same time, they opened the possibility of no more adjustments by arguing that they will assess if these are necessary. In this context, changes to inflation forecasts –at least for the headline– and the delayed impact of accumulated hikes on the economy would also support this scenario. Nevertheless, as the balance of risks for the core remains to the upside, we believe one more adjustment from the monetary authority is the most prudent action. Therefore, we modify our expected path for the reference rate. We now expect +50bps in February, matching the Fed. However, said move would be Banxico's last in the current tightening cycle, not expecting one more in March (previous: 25bps hikes both in February and March). If this happens, it implies a decoupling from the monetary authority in the US given that we still see +25bps in the latter case for the third month of the year. As a result, our forecast for the terminal rate remains at 11.00%, albeit reaching it a bit sooner than we previously expected.

Relevant changes to the forward guidance, signaling that the end of the tightening cycle is very close. We consider that these adjustments were the most relevant part of the statement. They added that "*…The Board considers it will still be necessary to raise the reference rate in its next monetary policy meeting…*".

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

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Banxico's 2022 policy decisions

Date	Decision
February 10	+50bps
March 24	+50bps
May 12	+50bps
June 23	+75bps
August 11	+75bps
September 29	+75bps
November 10	+75bps
December 15*	+50bps

*Minutes of the decision to be released on January 5th. Source: Banxico

In our opinion, this provides greater certainty about the next move of the central bank and states that the tightening cycle has not ended. However, its also key the statement in which they now say that they will assess the *need* for further adjustments and their corresponding magnitude; previously, it was only mentioned the magnitude in *upcoming meetings*. These changes suggest that decisions will be made on a meeting-by-meeting basis starting in early 2023, in turn suggesting that the end of the hiking cycle is quite close. Despite of the latter, the central bank kept the option of increasing the rate further if necessary, recognizing that uncertainty prevails by repeating that decisions will be based on prevailing conditions at the time.

Caution remains on core inflation, albeit with a better outlook for the headline. The core component remains on the Board's spotlight. This is reflected in: (1) Higher forecasts; and (2) the language inside the announcement. Regarding the former, the average upward increase is larger than in the previous decision, up by 18bps vs 9bps. On the latter, we highlight small changes, such as including the adjective "greater" when referring to cost pressures. Meanwhile, the view on headline inflation looks more constructive. Specifically, they noted declines in energy and food prices, a trend that allowed to eliminate the word "greater" within the risks related to price pressures in them. In addition, the mention of shocks related by the geopolitical conflict and the pandemic was suppressed, noting these were present in the previous statement. As a result, the path for headline inflation had moderate and mixed adjustments, with an average change of 0bps throughout the forecast horizon. In more detail, downward revisions of 20bps and 10bps were included for 4Q22 and 1Q23, respectively. For the remainder of 2023, they expect only 10bps higher, mainly driven by the core. Finally, they did not change the date expected for the convergence to the target, remaining in 3Q24.

CPI forecasts
% y/y, quarterly average

	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24
CPI										
Current	8.5*	8.1	7.5	5.9	4.8	4.2	3.8	3.4	3.1	3.0
Previous	8.5*	8.3	7.6	5.8	4.7	4.1	3.8	3.4	3.1	--
Difference (bps)	--	-20	-10	10	10	10	0	0	0	--
Core										
Current	8.0*	8.5	7.8	6.7	5.5	4.3	3.7	3.2	3.0	3.0
Previous	8.0*	8.3	7.5	6.4	5.2	4.1	3.6	3.2	3.0	--
Difference (bps)	--	20	30	30	30	20	10	0	0	--

Source: Banco de México. *Observed data

From our Fixed Income and FX strategy team

Local assets had already priced-in Banxico's decision. The local fixed-income market reaction was mild as this 50bps hike was widely expected. Short-term Mbonos lost 3bps, while long-term tenors trading virtually unchanged. The market foresees that the end of the restrictive cycle is near, already incorporating an additional adjustment of +41bps next year to reach a terminal rate close to 11.00%. Subsequently, it prices-in the beginning of an accommodative cycle in May. It is worth noting that expectations about accumulated rate cuts in 2023 have increased to -200bps from -183bps a month ago, driven by heightened concerns of a global recession.

Given the uncertainty that prevails about terminal rate levels and the time they will remain there, as well as the eventual start of accommodation, we recognize that volatility in fixed income markets will be persistent and elevated. In this backdrop, we reaffirm our preference for relative value trades, avoiding directional positions. In FX, the session was characterized by USD gains and widespread losses in developed and emerging markets amid a risk-off sentiment. In particular, the Mexican peso was stable after Banxico’s decision around 19.73 per dollar (-0.5%). Whit this, it accumulates a 2.4% loss in December. However, it is still one of the few currencies in positive territory so far this year (+4.0%). In this context, we prefer to wait for better entry levels in USD longs.

Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, and Daniel Sebastián Sosa Aguilar 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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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
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