

Banxico minutes – Hikes will end in February, albeit still uncertain about the next steps

- Banxico published the minutes of the decision held on December 15th, in which they hiked the reference rate by 50bps to 10.50%, with a dissenting vote from Deputy Governor Gerardo Esquivel
- In our view, the document reaffirms the less hawkish tone perceived in the statement
- The discussion centered on the end of the hiking cycle –which we think will happen in the next meeting– and the actions that will follow afterwards –albeit with greater divergence on the latter. Some factors related to this include:
 - (1) The likely magnitude of the next hike, which seems to be either 25bps or 50bps;
 - (2) The necessary period in which a restrictive monetary stance should be held; and
 - (3) The effects of inflation dynamics going forward on monetary conditions and the degree of restriction
- Considering our views on inflation, we still expect +50bps in February, with the rate reaching its terminal point of 11.00% in said meeting
- The market expects Banxico’s last hike in February (+50bps), in line with our call

Banxico minutes reaffirm a less hawkish tone. In our opinion, the document provided more details about the changes made in the [last monetary policy statement](#). In that occasion, the focus turned towards which will be the last hike in this cycle –perceiving some consensus that it will likely be in February– as well as its possible magnitude. Other important issues were addressed, highlighting: (1) The necessary period in which a restrictive stance should be held; and (2) the effects of inflation dynamics on monetary conditions. The explanation associated to the dissent from Deputy Governor Esquivel provided a relevant update on his views in what was his last decision as part of the Board, while comments from remaining members allowed us to evaluate the most important factors in their respective reaction functions.

The next hike will be the last one of this cycle. The statement was quite clear about the high likelihood of another increase in February. After this, they “...will assess if the reference rate needs to be further adjusted as well as the pace of adjustment...”. We interpret this as a signal that February will be the last move of this hiking cycle, despite lingering uncertainty about its magnitude. Specifically, we believe Governor Rodríguez and Deputy Governor Borja maintain that this will remain dependent on upcoming data and prevailing conditions (both local and foreign). Deputy Governor Heath argued that the synchronization with the Fed might continue, while Deputy Governor Espinosa remains more *hawkish* as she likely affirmed that the monetary stance must remain firm. In our view, inflation conditions will remain quite challenging, especially for the core in the short-term.

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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

Source: Banxico

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This is mainly due to potential pressures from higher costs for businesses and the latest [minimum wage hike](#), among other factors, with this already reflected in the prices of goods produced by some large corporates. Regarding the global backdrop, we expect the Fed to hike the *Fed funds* rate by 50bps in February, matching its previous decision. As such, we think Banxico will have to close its cycle with a relatively decisive adjustment, of the same magnitude. Nevertheless, we recognize the balance of risks seems to be tilting to a last increase of only 25bps, especially if inflationary dynamics [keep surprising to the downside](#), with the latest deviations explained by a better-than-expected performance of the non-core component.

Uncertainty prevails over the steps after reaching the terminal rate. It is our take that Deputy Governors Espinosa and Heath have been clearer on the steps after reaching the terminal rate. We believe the former emphasized once again that the central bank will need to stay restrictive for a more prolonged time and throughout the full forecast horizon. Moreover, larger adjustments to the rate might be needed, even tightening more than the Fed, given risks of a slower deceleration in inflation. Meanwhile, Deputy Governor Heath could have pointed that the terminal rate will have to prevail for some time. Nevertheless, he was more moderate by adding that “...neither a monetary easing is to be anticipated over the next months nor that the attained monetary tightening will prevail over the entire horizon in which monetary policy operates...”. The vies of the remaining members is more ambiguous, reiterating their high dependency to the data and prevailing conditions. Relatedly, we present our assessment of the main comments made by each member:

Banorte’s assessment on Board member’s comments in the December 15th minutes

Bias	Member	Order in the minutes	Relevant comments
 Hawkish	Irene Espinosa 	2	<p>“... there is now a greater risk that inflation will decline faster in the United States than in Mexico. He/she argued that this could imply larger increases in Banco de México’s reference rate for a longer-than-foreseen period.”</p> <p>“...a reduction in the pace of upward adjustments does not imply the beginning of an easing cycle...”</p> <p>“...it should also be acknowledged that signals of domestic inflationary pressures are becoming increasingly more evident, mainly those related to consumption...”</p>
	Jonathan Heath 	4	<p>“...monetary policy synchronization should continue as long as the trajectories of inflation are similar...”</p> <p>“...sound macroeconomic fundamentals could allow a marginal reduction of the spread in case the inflationary cycles diverge...”</p> <p>“... should highlight that the attained terminal rate will be maintained for some, still uncertain, amount of time...”</p>
	Galia Borja 	1	<p>“...looking ahead, both caution and flexibility will be required to adjust the monetary policy stance in line with the scenario that materializes...”</p> <p>“...whereas continuing to raise the reference rate implies that the environment remains complex, and that Banco de México will not be forbearing...”</p> <p>“...the nominal reference rate reached a level above observed inflation, placing it at a clearly restrictive level. He/she argued that a delicate balance is being confronted...”</p>
	Victoria Rodríguez 	5	<p>“...looking ahead, the ex-ante real interest rate is likely to continue increasing, while, at the same time, a greater tightening derived from the real exchange rate might be observed...”</p> <p>“...reaching an absolute monetary policy stance that would contribute to the convergence of inflation to its target, regardless of the relative monetary policy stance that this implies...”</p> <p>“...in the future, adjustments to the reference rate will have to be calibrated with caution, considering the monetary policy stance that has already been reached...”</p>
	Gerardo Esquivel 	3	<p>“...I believe a 25- basis point increase is appropriate. What is now needed is to allow the already attained restrictive policy stance to operate...”</p> <p>“...The restrictive policy stance already attained, together with easing inflationary pressures, suggests that further raising the reference rate is unnecessary...”</p> <p>“...as inflation expectations decrease, the level of monetary tightening is anticipated to continue increasing automatically as long as monetary easing does not begin...”</p>
Dovish			

Source: Banorte with information from Banxico

The Board's focus is on core inflation and expectations over the forecast horizon. All members recognized recent downward surprises in headline inflation. However, some highlighted that central trend measures kept rising as the decline has not been generalized; on the contrary, it is explained by: (1) Declines in a few generics –energy and agriculture–; and (2) mitigation of global shocks. In this sense, everyone agrees that core inflation remains under pressure –adding 24 consecutive months to the upside–, with food items as the main driver, in addition to recognizing recent pressures on some services. As in the previous minutes, most members consider that risks are still skewed to be upside, with cost increases associated with hiring conditions and/or wage revisions as a factor that could affect inflation in 2023. Regarding expectations, those in the short-term have been declining. Meanwhile, medium-term expectations are still above the target and in the long-term have not seen major changes. We also noted that at least two members agree that the degree of restriction –based on the ex-ante real rate– can increase indirectly in the future and without the need for additional tightening in the case of a fall in 12-month ahead inflation expectations.

We expect +50bps in February, taking the rate to 11.00%. As previously mentioned, we believe the adjustment in the next monetary policy decision will be the last of this cycle, leaving the terminal rate at 11.00%. Nevertheless, this would not mark the end of the monetary restriction as a moderation in inflation expectations would keep driving the ex-ante real rate higher. With 10.50% and 12-month inflation at 4.99% (taken from the latest central bank survey), said rate currently stands at 5.25%. Moreover, we estimate it will climb to 5.72% with +50bps in February. Lastly, an additional fall in inflation expectations is likely given what we have observed in the last two months, a factor that could contribute to an even higher rate.

From our Fixed income and FX strategy team

The market expects Banxico's last hike in February (+50bps), in line with our call. Today has been characterized by widespread pressures on sovereign yields, led by Treasuries. US data showed that the labor market remains strong, so the market recalibrated quickly towards +72bps of cumulative hikes to end the tightening cycle in June from +65bps yesterday. In this backdrop, the reaction of local rates to the minutes was mild. Long-term Mbonos and TIEE-28 derivatives went from losing 2bps to gaining 1bp, consistent with a less hawkish tone. Meanwhile, the curve continues pricing-in +50bps in February to reach a terminal rate of 11.00%; subsequently, it incorporates 140bps of accumulated cuts during 2H23. We recognize that volatility in fixed income will remain high, so we reiterate our preference for relative value positions. In FX, the USD strengthened on market expectations of a higher *Fed funds* rate at the margin. Nonetheless, the Mexican peso remained relatively stable, trading around its previous close of 19.38 per dollar. Even though MXN is the third strongest currency in EM with a gain of 0.6% so far this month, we consider that the room for further appreciation is limited. According to our models, the MXN trades with an 9.5% overvaluation. Despite being lower in magnitude relative to recent months, it remains quite high. We see the zone around USD/MXN 19.25 attractive for dollar longs, albeit only for tactical trading.

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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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