Banxico – Hawkish surprise with another 50bps, seeing now a terminal rate of 11.50%

- **Today, Banxico's Board raised the reference rate by 50bps to 11.00%, higher than our call and consensus expectations**
- **The decision was unanimous, with this being the first meeting of Deputy Governor Omar Mejía Castelazo**
- **The tone of the statement was quite hawkish. We noted that:**
  (1) The forward guidance signaled another hike in March, albeit leaving the door open for a reduction in the pace;
  (2) The Board remains very cautious on inflation, especially for the core, as reflected in a very sizable upward revision to their forecasts;
  (3) The expected convergence to the target was delayed by one quarter, to 4Q24; and
  (4) The balance of risks to prices remains skewed to the upside, with possible pressures from China's reopening
- **After the surprise, we now expect two more 25bps rate hikes each, in March and May, with the terminal rate estimated at 11.50% (previous: 11.00%). Nevertheless, risks are tilted to the upside given that the inflation outlook remains complex (especially for the core) and with the Fed possibly extending its cycle more than currently expected**
- **The market increased its view of the terminal rate, now close to 11.50%**

Banxico hiked 50bps, surprising us and consensus. This was higher than the +25bps that we expected, taking the reference rate to 11.00%. Contrary to last December, the vote was unanimous. This was the first meeting attended by Deputy Governor Omar Mejía, replacing Gerardo Esquivel –who at the time dissented for +25bps. Within the statement, we highlight that "*…The Board considers that, given the monetary policy stance already attained and depending on the evolution of incoming data, for its next policy meeting, the upward adjustment to the reference rate could be of lower magnitude…*". This replaced the previous guidance that "*…The Board considers it will still be necessary to raise the reference rate in its next monetary policy meeting…*". Although less hawkish in terms of the likely pace, we believe this at least implies one more rate hike, with Banxico leaving the door open for even further adjustments if necessary. Considering the *hawkish* surprise, unanimous vote, and forward guidance, we believe the central bank clearly signaled that the hiking cycle is not over yet. As such, we modify our call, now seeing two more 25bps increases each, in March and May (previously: only +25bps in March), with the terminal rate reaching 11.50% (previous: 11.00%). Furthermore, we think risks are tilted towards even more hikes if inflation keeps surprising to the upside. Some concerns remain in this front, especially for the core, as reflected in another meaningful upward revision to their forecasts (see below). Among them, we note high turn-of-the-year price adjustments –along with further planned increases in electricity tariffs, which could pass through to services–, and other cost pressures stemming from the minimum wage hike and reforms to the Federal Labor Law, to name some.

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Banxico's 2023 policy decisions

Date	Decision
February 9th*	+50bps
March 30th	--
May 18th	--
June 22nd	--
August 10th	--
September 28th	--
November 9th	--
December 14th	--

*Minutes of the decision to be released on February 23rd. Source: Banxico

Other potential drivers include the Fed's hawkish bias –warning about the possibility of a higher-than-expected terminal rate, currently priced-in at 5.00% to 5.25%– and the potential effect from China's reopening on commodity prices (despite being muted so far). On the contrary, positive news include lower natural gas and gasoline prices in the US, MXN resilience, and supply chain improvements. Given this plethora of drivers, we will closely analyze the minutes of this meeting, which will be released on February 23rd. Our focus will be on assessing the balance of risks to inflation among Board members. This could become key in case of an eventual split vote about whether to extend the hiking cycle or to pause, particularly given that: (1) Considerable uncertainty remains about the adequate level of the terminal rate and inflation dynamics; and (2) the monetary stance, which is already significantly restrictive.

Concerns remain centered on core inflation. Although attention was already focused on the core component, we believe this was reinforced as they factored-in recent dynamics –with pressures remaining in processed foods, along with some negative signals in services. In this context, they expect a slower disinflationary process, with upward revisions to both the headline and core components. In the former, the average for 2023 was pushed up by +48bps; for the latter, it was of +60bps. For 2024, changes were more modest and equal to +28bps and +25bps, in the same order, as seen in the following table. With this, the convergence to the target was delayed one quarter, expected by 4Q24. Also relevant, they highlight a new increase in analysts' inflation expectations for 2023 and 2024. Despite these adjustments, the balance of risks remains skewed to the upside, albeit with some changes to the drivers that could have a stronger incidence higher. Specifically, they removed references about possible shocks related to the pandemic –likely because of the normalization of supply chain disruptions that has already been achieved– and to the war in Ukraine. Nevertheless, this was substituted by the upside effect that China's reopening could have on commodity prices.

CPI forecasts
% y/y, quarterly average

	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24
CPI									
Current	8.0*	7.7	6.4	5.3	4.9	4.2	3.7	3.4	3.1
Previous	8.1	7.5	5.9	4.8	4.2	3.8	3.4	3.1	3.0
Difference (bps)	--	20	50	50	70	40	30	30	10
Core									
Current	8.4*	8.2	7.3	6.2	5.0	4.1	3.5	3.2	3.1
Previous	8.5	7.8	6.7	5.5	4.3	3.7	3.2	3.0	3.0
Difference (bps)	--	40	60	70	70	40	30	20	10

Source: Banco de México. *Observed data

From our Fixed Income and FX strategy team

The market increased its view of the terminal rate, now close to 11.50%. Banxico's surprise triggered strong losses in local fixed-income, especially at the short-end. The Mbonos' curve flattened on losses of 21bps at that section. The 2/10 spread exacerbated its inversion as it went from -139bps yesterday to -149bps, not seen since 2014. Also, short-end TIIE-IRS swaps sold off 30bps, with the 2-year maturity (26x1) adjusting as much as +50bps, and the long-end losing 15bps.

Hence, the market recalibrated its view, betting on a higher terminal rate. The curve is now pricing-in two consecutive hikes of 25bps, in March and May, reaching 11.50% vs the 11.00% expected at the end of 1Q23, before this decision. Although we see absolute yield levels as very attractive in short-term Mbonos –mainly the Dec'23 maturity, which is trading at multi-year highs– and in long/receiver positions in short-end TIIE swaps, we remain cautious and without directional positions due to high volatility and uncertainty about the level of the terminal rate.

In FX, the Mexican peso diluted completely the day's losses prior to the decision, going from 18.95 to 18.73 per dollar. The currency stabilized around 18.77, equivalent to a 0.9% gain. We believe MXN will stay resilient in coming months and probably test another break lower of the 18.50 psychological level, helped by an even wider spread vs the Fed, now at 625bps from 600bps previously. Thus, the currency has increased its carry attractiveness relative to other EM peers that have slowed or paused (*e.g.* Brazil). Lastly, we believe nearshoring will play a positive and additional role in supporting the currency.

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, Daniel Sebastián Sosa Aguilar and Andrea Muñoz Sánchez, 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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