Banxico – The rate will likely stay unchanged for the remainder of 2023

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- **Today, Banxico's Board kept the reference rate unchanged at 11.25%, in line with our call and consensus**
- **However, and contrary to our view, the decision was unanimous**
- **We believe the tone of the statement was less hawkish, although some concerns on prices persisted. We highlight that:**
  (1) The forward guidance states that "*…it will be necessary to maintain the reference rate at its current level for an extended period...*";
  (2) The revision lower to headline inflation forecasts in 2023, with stability in core estimates; and
  (3) The comment affirming that "*…the economy has started to undergo a disinflationary process given that many pressures have eased…*". Despite the latter, they still estimate the convergence to the target in 1Q24
- **Given the tone and guidance, along previous speeches from some Board members, the recent evolution of inflation and global monetary policies, we reiterate our call of an unchanged reference rate this year at 11.25%, with cuts materializing until 1Q24**
- **The Mexican peso assimilates the end of the hiking cycle quite well**

Banxico unchanged for the first time since June 2021. As we expected, the reference rate was kept at 11.25%. It was a unanimous decision. Although we did not rule out the latter completely, it also was not our base case. We judge the tone's statement as less hawkish. Firstly, because the rate was kept unchanged for the first time in this hiking cycle (accumulating +725bps since it started in June 2021). In addition, we also noted an important change in the forward guidance, now stating that: "…*it considers that it will be necessary to maintain the reference rate at its current level for an extended period…*". Although the length of this period is still uncertain and will likely depend on how data evolves (particularly inflation), we believe it strongly signals that the interest rate has already reached its terminal level and it will be quite difficult to see additional increases –which would only mean a 'pause' in this cycle. In addition, news on inflation have been better lately. This was also reflected in the central bank's forecasts, with adjustments lower concentrated on the headline (see below). Despite of this, the balance of risks for prices remains skewed to the upside, while the convergence to the target is still estimated in 4Q24. Overall, the details of the decision were mostly in line with our expectations. In this backdrop, we reiterate our call that the reference rate will close this year at its current level of 11.25%. Meanwhile, we see cuts materializing until 1Q24, which is after market pricing, which puts it by the end of 2023 (see the section on *Fixed Income and FX strategy*). In our opinion, core inflation dynamics remain challenging. We see a decline towards 5.6% by the end of 2023 (from 7.67% in late April), which we believe will not be enough to convince most members of the Board to start easing monetary policy.

Banxico's 2023 policy decisions

Date	Decision
February 9th	+50bps
March 30th	+25bps
May 18th*	0bps
June 22nd	--
August 10th	--
September 28th	--
November 9th	--
December 14th	--

*Minutes of the decision to be released on June 1st. Source: Banxico

The inflation outlook improved further, but upside risks persist. Concerns on inflation seem to have declined again. We noted: (1) The statement that we have entered a disinflationary period as several [price] pressures have eased; (2) the acknowledgement of a relevant reduction in core inflation in the last print; and (3) the reduction in analysts' inflation expectations for 2023. The latter is consistent with the downward revision from the central bank itself in its headline inflation forecasts from 2Q23 to 4Q23 –on average by -17bps. Nevertheless, the core adjusted only for the second quarter, with the remaining periods unchanged (see table below). On the contrary, the balance of risks remained skewed to the upside despite said adjustments, with marginal changes in the main drivers. Specifically, they eliminated the comment about the effects of the geopolitical conflict in Ukraine among the downside risks. ON the other hand, they reinserted the caveat that longer-term expectations remain *at levels above the target*. We believe this suggests that concerns about the anchoring of expectations and the price-formation process still exist, this supporting the narrative that the rate will remain unchanged for an 'extended period' and our expected path for the reference rate.

CPI forecasts
% y/y, quarterly average

	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25
Headline									
Current	7.5*	6.0	5.2	4.7	4.2	3.7	3.4	3.1	3.1
Previous	7.5	6.3	5.3	4.8	4.2	3.7	3.4	3.1	3.1
Difference (bps)	--	-30	-10	-10	0	0	0	0	0
Core									
Current	8.3*	7.4	6.2	5.0	4.1	3.5	3.2	3.1	3.1
Previous	8.3	7.5	6.2	5.0	4.1	3.5	3.2	3.1	3.1
Difference (bps)	--	-10	0	0	0	0	0	0	0

Source: Banco de México. *Observed data

Other factors also support today's actions. Among them, that several central banks have ended their tightening cycles, which has implications on the relative monetary stance, adequate levels for interest rate spreads (influenced by risk, liquidity, and inflation premiums, among others) and the room to maneuver going forward. In addition, they eliminated explicit references about the Fed. Although this is not either our base case or the market's view, there is still debate on the possibility of an additional rate hike in June (Banorte: unchanged). We believe this omission reaffirms recent opinions by some members that the decisions of said central bank constitute only one factor in Banxico's reaction function. Another relevant point is that expectations of a global economic deceleration persist. Given the significant tightening that has already been achieved, its depth could be greater in case a recession materializes. On a more favorable note, they argued that financial markets have stabilized after recent banking sector turbulence. Lastly, they pointed again to the strength of the domestic labor market, which could be a tailwind for the expected pace of decline in core inflation.

From our Fixed Income and FX strategy team

The Mexican peso assimilates the end of the hiking cycle quite well. In the days leading up to the decision, the Mexican peso began to limit the strong momentum seen at the start of the week, when it reached its best intraday level since May 2016 at 17.42 per dollar. Today it returned to almost 17.80, acknowledging the end of the tightening cycle. However, some losses were offset after the announcement, stabilizing at 17.70 (-0.6%). In our view, this constitutes a clear signal that the interest rate will stay high for a prolonged period, in line with our call. Despite its recent moves, the MXN remains as the strongest currency against the USD with a year-to-date gain of 10.2%, followed by COP (+7.4%). We still think that it will maintain a defensive bias against its EM peers. In fixed income, the reaction of local rates was mild despite a trading session characterized by widespread pressures. Mbonos and TIIE-28 swaps diluted part of their losses, standing at 4bps and 6bps on average, respectively. Market bets that Banxico will cut the reference rate in the second half of the year have remained stable. The curve is pricing-in accumulated cuts of -68bps, consistent with almost three 25bps reductions in the last meetings of the year. Nevertheless, we believe today's decision strengthens our view that the interest rate will stay unchanged during the rest of this year. Hence, we expect the shortest end of the interest rate curve to see additional pressure, resulting in an even more inverted shape.

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, 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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