Banxico QR – Less inflation concerns despite an upward revision in GDP

- **Banxico published today its 1Q23 *Quarterly Report* (QR). In our opinion, the document reaffirms the less hawkish tone from the latest releases, supporting the view that the tightening cycle is over**
- **GDP for this year was revised to 2.3% from 1.6% (Banorte: 2.0%). For 2024, it stands at 1.6% from 1.8%. Inflation forecasts and their balance of risks were unchanged relative to the previous statement**
- **During the Q&A session, attention centered on actions ahead, particularly on the possible start of an easing cycle**
- **We reiterate our forecast that the reference rate will remain unchanged for the remainder of the year, ending at 11.25%. After this, we expect cuts to materialize in 1Q24**
- **The market still sees lower rates starting in September**

More optimism on the economy and lower inflation concerns in the *Quarterly Report*. The 1Q23 *Quarterly Report* (QR) was presented today in a press conference led by Governor Victoria Rodríguez. We highlight adjustments in various estimates, particularly for economic activity. The GDP projection for 2023 was higher, at 2.3% from 1.6%, with next year's falling to 1.6% (previous: 1.8%). As usual, the inflation path and its balance of risks were unchanged from the previous statement. In addition, we highlight questions on actions ahead during the Q&A. These included potential responses to Fed moves, the definition of the 'extended period', and the timing of when cuts might begin. The prevailing response was to be cautious as they need to remain data dependent. Although clear signals were limited, we think the document endorses the less hawkish tone of the last decision, awaiting additional information on each member's particular bias in tomorrow's minutes. Considering this, we reiterate our call that the rate will remain unchanged for the remainder of the year, closing at 11.25%. After this, we expect cuts to materialize in 1Q24.

Questions from the press focused on actions ahead. Questions covered a wide variety of topics. However, we highlight those on upcoming policy actions and the conditions necessary for additional hikes or the eventual start of the cuts. In broad terms, Governor Rodríguez said that the monetary stance that has already been achieved should be allowed to operate. On potential hikes linked to additional Fed actions, she reiterated that this is only one factor in their reaction function. This has gained relevance again as expectations of additional tightening in the US (in June or July) have increased. On the other hand, we had more information on eventual cuts. The Governor emphasized that it is not possible to talk about a specific period as to what they mean by 'an extended period', but that it has to be long enough for inflation to diminish. She also added that it is premature to think about cuts. To a more explicit question about market expectations, Deputy Governor Espinosa commented that, while it is possible that cuts could materialize by September, she believes it is unlikely considering current forecasts.

May 31, 2023

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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	--

Source: Banxico

Deputy Governor Borja stated that they would need to see a more neutral balance of risks and expectations returning to their historical averages to begin the accommodative cycle. On another relevant front, Deputy Governors Heath and Mejía responded on the desirable level of the ex-ante real rate. The former estimated that 6% to 7% would be appropriate in this 'phase' of the cycle. Initially, the rate would be adjusted through inflation expectations (with no change in the nominal rate); subsequently, it could be with changes in the reference rate. In particular, he also said that if the ex-ante real rate rises too much (for example, above 7.5%), some adjustments could be made. The second member favors a more detailed follow-up on the level of the nominal rate, but without giving more details on specific levels that could be appropriate.

No changes in the inflation outlook relative to the previous statement. The inflation trajectory was the same as the one in the last decision, in tandem with the previous seven reports. The list of the main factors in the balance of risks –both to upside and downside– is practically the same, only with additional information in each one. Moreover, the balance remains tilted to the upside. At the press conference, Governor Rodríguez stated again that a disinflationary process has already started. However, we noted Deputy Governor Borja's comments that concerns about the core, particularly in services, remain elevated. Given our estimates for this component, we believe it will be drag for starting rate cuts.

CPI forecasts
% y/y, quarterly average

	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25
Headline	7.5*	6.0	5.2	4.7	4.2	3.7	3.4	3.1	3.1
Core	8.3*	7.4	6.2	5.0	4.1	3.5	3.2	3.1	3.1

Source: Banco de México. *Observed data

Higher GDP in 2023. They revised their estimate for this year upward by 90bps to 2.3%, with a range between 1.7% and 2.9%. This stands above our 2.0% and consensus (banking sector survey: 1.9%). The revision is largely due to the strong dynamism in 1Q23. However, they anticipate a deceleration starting in the second quarter due to a challenging external backdrop. For 2024, the estimate was adjusted to 1.6% from 1.8% (range: 0.6% to 2.6%), recognizing a deterioration in expectations about industrial production in the US. In the trajectory, they see a gradual improvement in activity throughout that year. When asked explicitly about a possible US recession, Governor Rodriguez limited herself to mentioning that the institution's forecasts contemplate a slowdown, without assessing its depth. With this, the slack would be less than in the last QR, although with a slight widening towards the end of 2023 which would close afterwards, in 2024.

Other estimate changes. Banxico raised estimates for job creation affiliated to IMSS this year, while moderating them for 2024, consistent with their updated economic outlook. On external accounts, wider deficits are broadly anticipated for both the trade balance and the current account. For more details, see the tables below.

Banxico's Forecasts
Current Report (1Q23)

	2023	2024
GDP (% y/y)		
Central scenario	2.3	1.6
Range	1.7 to 2.9	0.6 to 2.6
Employment (thousands)	600 to 800	530 to 730
Trade Balance (bn)	-26.9 to -20.9 (-1.6% to -1.2% of GDP)	-28.9 to -20.9 (-1.7% to -1.2% of GDP)
Current account (bn)	-22.3 to -12.3 (-1.3% to -0.7% of GDP)	-19.8 to -7.7 (-1.2% to -0.4% of GDP)

Source: Banxico

Banxico's Forecasts
Previous Report (4Q22)

	2023	2024
GDP (% y/y)		
Central scenario	1.6	1.8
Range	0.8 to 2.4	0.8 to 2.8
Employment (thousands)	420 to 620	540 to 740
Trade Balance (bn)	-24.2 to -18.2 (-1.5% to -1.1% of GDP)	-27.1 to -19.1 (-1.7% to -1.2% of GDP)
Current account (bn)	-14.1 to -4.1 (-0.9% to -0.3% of GDP)	-18.9 to -6.9 (-1.2% to -0.4% of GDP)

Source: Banxico

Banxico will keep the rate unchanged for the rest of the year, with cuts until 1Q24. We think the document supports our view that a complex inflation outlook and greater economic resilience will prevent the central bank from starting an easing cycle as early as this year. Therefore, we reiterate that the rate will remain unchanged at 11.25%. We estimate that inflationary conditions –with a downward consolidation in core inflation– and the state of the economy –with lower dynamism– will be more appropriate to initiate cuts until 1Q24.

From our Fixed Income and FX strategy team

The market still sees lower rates starting in September. The reaction of local rates to the QR was practically nil, with the trading day characterized by modest gains led by US Treasuries. Mbonos gained 2bps and TIIE-IRS flattened, with few changes in the short-end and gains of 3bps in the long-end. Despite the Board's signal that they will remain cautious, markets keep betting that Banxico could cut starting in September, with the reference rate closing this year between 10.50% and 10.75%. We rule out cuts in 2023, so short-term rates could correct higher. In addition, we reiterate our preference for nominal vs. real rates due to a further moderation in inflation ahead. In FX, the Mexican peso weakened in a session with a global USD rebound. It returned to 17.70 per dollar (-0.2%) amid losses in most DM and EM currencies. We reiterate our view that the MXN will remain supported by an attractive volatility-adjusted carry, its closeness and dependency to the US economy (which has surprised to the upside), and favorable expectations about nearshoring, among other factors.

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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, 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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