

## Banxico minutes –Premature to talk about cuts

- Banxico published the minutes of the decision held on June 22<sup>nd</sup>, in which they left the interest rate unchanged at 11.25% with a unanimous vote
- The document showed a more hawkish tone relative to the statement, which we believe was reflected in:
  - (1) The need to maintain an extended pause, even with some members stressing that it must be ‘long enough’, signaling more time;
  - (2) The broad opinion that talking about cuts to the reference rate is premature; and
  - (3) The need to let the tightening already achieved to work through the different transmission channels
- Considering the opinions throughout the document and our more hawkish Fed view, we believe the possibility of a cut in November has declined drastically, albeit with the door still open for December. All in all, we maintain our view that the easing cycle will begin until February 2024
- The market reduced further its bet about rate cuts this year

**Banxico’s minutes showed a more hawkish tone, suggesting that cuts will take time to materialize.** After a statement with few changes, the minutes had a more restrictive tone. In our view, they provided more clarity on some of the conditions that should materialize during the current monetary ‘pause’ for cuts to begin. In this sense, members agreed that the period in which the rate must remain high will be prolonged and/or extended, albeit with some even more hawkish as they talked about an even longer period. Regarding the start of the easing cycle, four of five members affirmed that it is ‘premature’ or ‘too early’ to discuss it, while the remaining participant even elaborated on the possibility of additional hikes. In this context, sentiment prevails about the need to let different policy transmission channels to achieve the bank’s goal. Considering this and our call of tighter US monetary policy –with 50bps of accumulated hikes in the next two meetings–, we think the possibility of a cut as soon as November has declined sharply. We believe the door is still open for a reduction in December, especially contingent on price dynamics and if the Board eventually sees risks for inflation as more balanced. Nevertheless, our base case is still that Banxico will be cautious in a challenging inflation backdrop –particularly for the core. Therefore, we reiterate our view that the easing cycle will begin in February 2024.

**A ‘long enough’ or ‘sufficiently long’ pause.** Our attention centered on greater details about the time span in which the current level of the rate is expected to be. All members elaborated on this. First, they agreed that it is necessary to maintain policy in restrictive territory due to inflationary pressures and the global backdrop. Second, on the ‘extended period’ –used once again in the statement– a couple of participants added the adjective “enough” or “sufficiently” to said pause (see table in the following page). In our opinion, this (1) Constitutes a signal supporting that the next move will not happen in the short-term; and (2) a series of conditions need to be fulfilled before cuts materialize.

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### Banxico's 2023 policy decisions

Date	Decision
<a href="#">February 9<sup>th</sup></a>	+50bps
<a href="#">March 30<sup>th</sup></a>	+25bps
<a href="#">May 18<sup>th</sup></a>	0bps
<a href="#">June 22<sup>nd</sup></a>	0bps
August 10 <sup>th</sup>	--
September 28 <sup>th</sup>	--
November 9 <sup>th</sup>	--
December 14 <sup>th</sup>	--

Source: Banxico


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In this sense, we believe that Galia Borja was, once again, very explicit when arguing about three conditions: (1) The consolidation of headline and core inflation to the downside; (2) a neutral balance of risks for inflation; and (3) a reduction in expectations towards historical averages. Similarly, Governor Rodríguez remarked that “...*the reference rate should be maintained at its current level for a period that is long enough to ensure that inflation declines in a sustained manner and that the upward bias of the balance of risks for inflation moderates...*”.

**Banorte's assessment on Board member's comments in the June 22<sup>nd</sup> minutes**

Bias	Member	Order in the minutes	Relevant comments
 Hawkish	Irene Espinosa	2	<i>“...it cannot be ruled out that the level of monetary restriction attained should be maintained for longer than anticipated or that a greater or lesser tightening may be required...”</i> <i>“...it is essential to preserve the level of monetary restriction attained...”</i> <i>“...statement should highlight that the favorable evolution of inflation has mainly responded to external factors...”</i>
	Galia Borja	4	<i>“...the reference rate foreseen by fixed-income markets for the end of 2023 and 2024 is below the level required to guarantee the convergence of inflation to its target over the forecast horizon...”</i> <i>“...anticipating changes in the monetary cycle would be premature...”</i> <i>“...monetary restriction will require a prolonged period to be properly transmitted, since the lags with which different channels operate are ample and differ from each other...”</i>
	Omar Mejía	5	<i>“...it is still prudent to communicate that the pause will continue for a sufficiently long period...”</i> <i>“...t currently it is not appropriate to discuss the possibility of interest rate cuts...”</i> <i>“...considered it prudent to refrain from taking actions that could diminish the effectiveness of the accumulated adjustment [...] that would relax the monetary stance prematurely...”</i>
	Victoria Rodríguez	1	<i>“...the reference rate should be maintained at its current level for a period that is long enough to ensure that inflation declines in a sustained manner and that the upward bias of the balance of risks for inflation moderates...”</i> <i>“...it is still too early to consider the possibility of interest rate cuts...”</i> <i>“...monetary policy has contributed to the resilient behavior of the Mexican peso...”</i>
	Jonathan Heath	3	<i>“...the monetary stance must be prevented from becoming too restrictive given the expected decline in inflation expectations...”</i> <i>“...it is too early to believe that the interest rate cuts which are anticipated by market indicators for the end of 2023 will materialize...”</i> <i>“...the term “extended period” should remain undefined until there is greater certainty about an improvement in the inflationary outlook...”</i>
			Dovish

Source: Banorte with information from Banxico

**Premature to talk about cuts.** As can be seen in the table, four of five members emphasized that it is too early to start discussing lowering the reference rate. The fifth member, who we believe is Irene Espinosa, still alludes to the possibility of additional hikes, so she likely shares that view as well. Nevertheless, some moderated their comments. We highlight a mention –that we think was from Jonathan Heath– that “...*the monetary stance must be prevented from becoming too restrictive given the expected decline in inflation expectations...*”. This is relevant as it contrasts with the lack of comments of a possible ‘excessive tightening’ from other members, alluding to a less *hawkish* tone. Considering this, our view that cuts will take longer to start –until early 2024– seems to have gathered strength at the margin.

**Monetary policy transmission channels must be allowed to operate.** Most members (Jonathan Heath, Galia Borja, and Omar Mejía) addressed the need to allow transmission channels to operate in a timely manner. We think Mejía indicated that their effect will be more noticeable in coming months. At the same time, Heath probably highlighted that the expectations channel will be fundamental, although not leaving out others and the materialization of larger effects on monetary aggregates.

Lastly, Borja expressed that these “...are operating in the required direction, particularly with regards to the exchange rate channel.” In our view, these comments are closely linked to the need of maintaining the reference rate at the current level.

*From our Fixed income and FX strategy team*

**The market reduced further its bet about rate cuts this year.** In a session with hefty losses in US Treasuries of up to 15bps triggered by data that supports a higher reference rate in the US, Mbonos and TIEE-IRS swaps adjusted up to +20bps in the long-end. After the release, these securities extended their losses at the margin. In turn, it also induced more modest market bets about rate cuts in 2023. Swaps are pricing-in by year-end only -38bps from -57bps last week, and -81bps at the time of Banxico’s last meeting. Considering our monetary policies views relative to the market, we see higher rates at the very front end. Hence, we see as relatively attractive to pay 3-, 6-, and 9-month TIEE-IRS swaps, albeit only tactically as gains could be limited by downward surprises in short-term inflation prints.

The Mexican peso sold off, triggered mainly by strong ADP employment report in the US. With this, it was the weakest EM currency today, followed by COP (-2.0%). The USD/MXN went from 17.03 to 17.37, representing a 2.1% depreciation. Moreover, one-month implied volatility in ATM options rose to 9.79% from 8.89% yesterday. In our view, today’s pressures are mostly due to profit taking on carry trades. Considering the tone of the minutes, we expect MXN strength to remain supported by an attractive carry, solid macroeconomic fundamentals, and increasing inflows from exports, remittances, tourism, and nearshoring-related investments. We see a tactical short-term opportunity to sell USD if it reaches 17.47 per dollar, where the 50-day MA would act as support.

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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 Thalia 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, Juan Carlos Mercado Garduño, Daniel Sebastián Sosa Aguilar, Jazmin Daniela Cuautencos Mora 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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