

Banxico minutes –Not yet time to discuss rate cuts

- Banxico released the minutes of the decision held on August 10th, in which they left the interest rate unchanged at 11.25% with a unanimous vote
- The document maintains a hawkish tone, like in the statement, which in our view was reflected in:
 - (1) The need to remain in pause for an ‘extended period’, with some members ruling out cuts this year;
 - (2) The recognition that the disinflationary process is underway, albeit with the balance of risks still skewed to the upside;
 - (3) A better outlook for economic activity; and that
 - (4) The relative monetary policy stance –both against advanced and emerging markets– seems to have less weight in the reaction function
- Considering the above, we reiterate our call that the easing cycle will begin until February 2024
- We reiterate our preference for front-end TIE-IRS payers

Banxico's minutes maintain a hawkish tone. We think the tone was similar to that of the statement. However, the document gave more clarity on several fronts. Specifically, we note that all members reaffirmed the need to keep the rate at its current level for an ‘extended period’, with some even stressing that it will be difficult to see rate cuts this year. Moreover, the balance of risks to inflation remains skewed to the upside even if the disinflationary process is already underway, with several factors that may imply additional shocks. As seen on previous instances, we believe that the relative monetary stance has less weight in Banxico’s reaction function. Not only *vis-à-vis* the Fed, but also because of cuts in some emerging countries in the region (e.g. Brazil, Chile). In addition, they recognized a more positive outlook for activity. Considering these factors and a still challenging outlook for inflation towards the end of the year –with a relevant rebound likely at the non-core–, we reiterate our call that the easing cycle will begin until February 2024.

Broad agreement on the desirability of an ‘extended’ pause. All members seem to agree with this statement, which is key for the effects of the monetary tightening already achieved to materialize and for inflation to converge to its target. Notwithstanding, what it implies in magnitude does seem to vary among members. On the hawkish side, Deputy Governor Irene Espinosa sounds willing to more rate hikes if conditions warrant it, while Deputy Governors Galia Borja and Omar Mejía speak only of letting the transmission mechanisms operate. We remain somewhat doubtful about Deputy Governor Jonathan Heath, as he continues to talk about the possibility of a ‘fine tuning’ despite also stating that it is still premature to consider a rate cut. Broadly speaking, we identified some reluctance to talk about possible rate cuts. In our view, Mejía was the bluntest, commenting that “...it is not prudent to discuss the possibility of cuts...”. Meanwhile, Espinosa says that conditions “... urge caution against rushing with the withdrawal of monetary...”.

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Banxico's 2023 policy decisions

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

Source: Banxico


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Considering this, as well as other comments (as detailed in the following table), we believe that the probability of rate cuts this year keeps diminishing.

Banorte's assessment on Board member's comments in the August 10th minutes

Bias	Member	Order in the minutes	Relevant comments
<i>Hawkish</i>			
	Irene Espinosa	2	"...maintaining the level of monetary restriction longer than expected or even that a further tightening is required, cannot be ruled out..." "...there are two risk factors with significant implications for monetary policy conduction [...] that urge caution against rushing with the withdrawal of monetary restriction..." "...these two factors reinforce the convenience of maintaining the monetary policy stance in restrictive territory during the entire planning horizon..."
	Omar Mejía	5	"...currently it is not prudent to discuss the possibility of cuts in the reference rate and that it must stay at its current level for an extended period..." "...timely and decisive actions have allowed it to implement a more gradual tightening cycle than in other emerging economies, but in a more timely manner than in advanced economies..." "...since there is a stance consistent with inflation's convergence and monetary policy operates with lags, the effects of this monetary tightening should be allowed to continue having an incidence on the economy, which appears to be operating at its potential."
	Galia Borja	4	"...warned that expectations implicit [...] anticipate a cycle of cuts [...] for 2024 similar to that of an economic crisis scenario, which is not consistent with the expected behavior of economic activity." "...monetary restriction will still require an extended period to be adequately transmitted..." "...the greater resilience of the economy may suggest a more gradual transmission of monetary policy onto domestic demand..."
	Jonathan Heath	3	"...it is still premature to consider a possible cut, even in the case of a fine-tuning to avoid an overly restrictive stance." "...the forward guidance, the period during which the policy rate will remain in place must still be characterized as extended, as such period may cover the rest of the year." "...normalization towards a neutral stance is foreseen beyond the forecast horizon."
	Victoria Rodríguez	1	"...considered that the reference rate must still remain at its current level for an extended period." "...it is essential to continue with a very cautious approach, carefully assessing the outlook for inflation and its determinants..."
<i>Dovish</i>			

Source: Banorte with information from Banxico

Looking to the balance of risks for inflation. The Board noted that the phase of disinflation is already underway, albeit with most of the decline attributable to the more volatile component (non-core). Furthermore, the majority emphasized that core inflation remains elevated and even shows some persistence. Moreover, one member pointed out that *"...while external pressures on this component have diminished, domestic pressures have increased..."*. In this context, all agreed that the balance of risks remains skewed to the upside, pointing out to pressures on the latter. It is worth noting that: (1) Some members commented on the possibility of greater cost-push pressures –given strength in the labor market and domestic demand– as an upside risk; and (2) one warned about *"...the possibility that economic growth above 3% narrows the output gap and leads to inflationary pressures..."*. In this backdrop, the majority considered that the improvement in the inflation outlook is still delicate in the face of these risks.

Less importance of the relative monetary stance, both to the upside, and downside. We identified specific comments from three members, Governor Victoria Rodríguez, as well as Jonathan Heath and Omar Mejía. The first was quite clear in stating that, despite heterogeneity in monetary policy decisions elsewhere, local actions will depend on the inflation outlook. The second argued that cuts in EMs obey to independent circumstances to those of our country, so they should not be taken as a reference. The last one stated that the local monetary authority acted early, allowing for more gradual actions to be taken than in other countries.

We believe these comments are relevant given lingering doubts about the effect of external decisions on local assets –mainly the exchange rate, a relevant variable for the price of imported goods– and whether this would require a response from the Mexican monetary authority.

Favorable growth outlook. Overall, the Board acknowledged that activity was better than expected in 2Q23. The outlook appears to be more constructive ahead, which we believe will be reflected in an upward revision to its 2023 GDP estimate in next week's *Quarterly Report* (August 30th).

From our Fixed income and FX strategy team

We reiterate our preference for front-end TIEE-IRS payers. Local assets assimilated the hawkish tone in the minutes, with the market recalibrating its expectations towards more modest rate cuts this year (accumulating -17bps by December against -23bps before the statement). As a result, front-end TIEE-IRS payers have benefited. We reiterate our preference for these strategies as we maintain our long-held call that Banxico will keep the benchmark rate unchanged at 11.25% for the rest of 2023. Also, we think yields of high-duration Mbonos look attractive for long-term portfolios, mainly the May'33, Nov'38, and Nov'42 maturities. However, high volatility and the closeness of Powell's speech at Jackson Hole (on Friday) insert upside risks for rates, so we prefer a more cautious stance. Finally, we believe that the Mexican peso will stay defensive, supported by its attractive volatility-adjusted carry.

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