October 12, 2023

Banxico minutes – The Board seems more cautious about an eventual start of rate cuts

- **Banxico released the minutes of the decision held on September 28th, in which they left the interest rate unchanged at 11.25% with a unanimous vote**
- **The document showed a quite hawkish tone, even more so than in the statement. In our view, this was reflected in:**
  - **(1) The reaffirmation of an 'extended period' with the rate at its current level, with a cautious tone about the moment when interest rate cuts could begin;**
  - **(2) Concerns about the inflation path, emphasizing the persistence of high prices in services; and**
  - **(3) The delay in the estimate of inflation's convergence to the target**
- **Considering these points, we reiterate our expectation that the first cut will materialize in May 2024. Additionally, we reaffirm our forecast that the rate will end at 9.25% at the end of next year**

Banxico showed a more hawkish tone due to the persistence of high inflation, greater dynamism of domestic activity, global uncertainty, and the fiscal stance. In our opinion, the minutes reflected a more hawkish tone, even to what we had already assessed in the statement. As in recent minutes, the discussion focused on the definition and implications of the 'extended period' that the central bank believes it will be necessary to maintain the interest rate at its current level. On this occasion, we believe that members were more forceful about it. All of them recognized that the inflationary outlook remains complex despite the current disinflationary process. In this regard, we highlight three factors addressed by the Board: (1) Persistence of the core component, particularly in services; (2) a balance of risks for inflation that remains skewed to the upside; and (3) the need to delay the estimate of the convergence of inflation to the target to 2Q25. Even more relevant, we consider that members were more cautious due to other factors, such as: (1) Stronger-than-expected economic activity –with signs that GDP kept expanding in 3Q23; (2) uncertainty about the dynamism of advanced economies, as the US remains resilient, but China and the Eurozone are weaker; (3) the high likelihood that the fiscal stance will be expansionary in 2024, something that they had not anticipated. In this context, we reaffirm our call that the reference rate will remain at 11.25% towards the end of 2023. In addition, cuts would begin until May 2024, with the reference rate ending said year at 9.25%.

The current pause will continue for an 'extended period'. Based on what was expressed by all members, we believe it is very feasible that the sentence about the need to maintain the rate at its current level for an 'extended period' will be repeated at least in the next two decisions left this year. In this sense, everyone reiterated the need to state clearly that the current restrictive stance should stay for a longer period to guarantee the convergence of inflation to its target. In this regard, and on the more hawkish side, we highlight the comments that we believe were made by Deputy Governor Irene Espinosa, saying that: "*… in view of the more complex outlook, forward guidance should highlight that a restrictive stance will be maintained for a more extended period than previously foreseen…*". In the same sense, we believe that Deputy Governor Jonathan Heath "*…indicated that the period in which the nominal interest rate remains fixed should last at least for the rest of the year, with the possibility of extending beyond the first quarter of 2024…*".


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Banxico's decisions in 2023

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

Source: Banxico

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Broadly speaking, and as shown in the table below, it is our take that members' opinions suggest greater caution, signaling a more restrictive tone.

Banorte's assessment on Board member's comments in the September 28th minutes

Bias	Member	Order in the minutes	Relevant comments
Hawkish	Irene Espinosa	2	*"...the fiscal package could generate pressures on aggregate demand. [...] the consequences for inflationary dynamics could be even greater for that year."* *"...reiterated that it is convenient to maintain the monetary stance in restrictive territory during the entire forecast horizon."* *"... it will be necessary to maintain the level of monetary restriction for an even longer period than that foreseen in the previous meeting and, going forward, expanding this policy stance could be required, either actively or passively."*
	Jonathan Heath	3	*"...the disinflationary process faces domestic pressures from a tightening labor market and the dynamism of aggregate demand, in addition to the still uncertain effects of fiscal expansion..."* *"... the period in which the nominal interest rate remains fixed should last at least for the rest of the year, with the possibility of extending beyond the first quarter of 2024..."* *"...the monetary policy statement should maintain the categorization of such period as "extended" and even "not yet defined"."*
	Omar Mejía	4	*"...current uncertainty is more associated with the speed at which inflation will converge to its target..."* *"... inflation's behavior over the forecast horizon still faces significant challenges..."* *"...pointed out that services prices are showing a larger pass-through of accumulated cost-related shocks, due to the greater demand they face..."*
	Galia Borja	5	*"...the main challenge continues to be the persistence of core inflation, especially that of services."* *"...the relevance of having communicated a prolonged pause and of continuing to be cautious with the stance that has been achieved, given the prevalence of the challenges in the inflationary front."* *"... that communication has contributed to avoid a premature easing of monetary conditions."*
Dovish	Victoria Rodríguez	1	*"...is required to avoid reference rate cuts that are premature or implemented faster than necessary and, consequently, that could jeopardize the downward trajectory of inflation."* *"... the more gradual decline in inflation* [...] *could imply that, looking ahead, the reference rate may need to be lowered more gradually, once the disinflationary process allows for such decreases."* *"...the reference rate should remain at its current level for an extended period."*

Source: Banorte with information from Banxico

Attention to the balance of risks for inflation. The Board indicated that the disinflation process continued, with the non-core component as the main driver. Meanwhile, the core has been gaining ground in recent months. However, the latter has been affected by domestic pressures, such as the strength of economic activity and the labor market. This has been reflected more clearly in services. In this sense, most members considered that services' strength could induce a higher passthrough effect of accumulated costs. It should be noted that: (1) All members considered that the outlook remains complex, with the balance of risks skewed to the upside, and with some stating that it has deteriorated since the last decision; (2) some "…*stated that the expansion of the fiscal deficit for 2024 could represent additional inflationary pressures…*"; and (3) some members did not rule out "…*the possibility of greater cost-related pressures.*". Furthermore, one member asserted that "...*there is the risk of inflation stagnating above the variability range in 2024, given increasing domestic pressures...*". In this context, the Board considered it appropriate to delay convergence for two more quarters, from 4Q24 to 2Q25.

Next year's fiscal stance is a driver considered by the Board. Fiscal policy in 2024 and its possible effects were discussed, both on the path of inflation and the potential monetary policy reaction. Thus, some members thought that "…*the expansion of the fiscal deficit for 2024 could represent additional inflationary pressures*...". In this sense, we believe Deputy Governor Heath emphasized that "… *the lack of synchronization [between both policies] implies it is necessary to pay attention to: i) the possibility of offsetting the likely effects of this stimulus on aggregate demand; and ii) the possibility that the fiscal stance lasts longer than anticipated, if the fiscal balance reduction projected for 2025 is not of the expected magnitude*.".

We think Deputy Governor Espinosa said that: "*…if the fiscal consolidation process contemplated for 2025 is not achieved, given the challenges that this implies, the consequences for inflationary dynamics could be even greater for that year.*" In this sense, we will be very attentive to members' public comments about this new factor.

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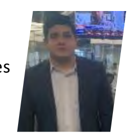

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