

Banxico minutes – The majority contemplates gradual rate cuts beginning in 1Q24

- Banxico released the minutes of the decision held on November 9th, when they left the interest rate unchanged at 11.25% with a unanimous vote
- The document showed a less hawkish tone, similar to the statement. We highlight relevant comments in at least three fronts:
 - (1) The timing in which rate cuts could begin to materialize, with most members pointing to 1Q24;
 - (2) That once this starts, these could be gradual and not necessarily continuous; staying highly dependent to economic data and the balance of risks for prices, among other factors; and
 - (3) The recognition that the disinflationary process is very much underway, albeit with the majority still seeing risks as skewed to the upside
- We also note that Deputy Governor Irene Espinosa dissented on the statement. Specifically, she considers that the balance of risks to inflation remains to the upside and has worsened, preferring not to change the forward guidance
- Considering the recent shift in communications and our views about the economy and inflation, we now see the first 25bps rate cut in March 2024. We also change our projected path for next year slightly, albeit still anticipating the reference rate at 9.25% by the end of December

After the minutes, we modify our expected monetary policy path in 2024. In our opinion, the document reinforced the less hawkish tone perceived in the statement. Not only that, but there was relevant information about the Board's opinions. The majority of members: (1) Thought that it is highly likely that the next adjustment will be to the downside, hence reaffirming that we are currently at the terminal level of the hiking cycle; (2) opened the door for cuts as soon as in 1Q24, with additional details that shed light about the meaning of the changes made to the forward guidance; (3) on rate cuts, the statement that they could be 'gradual', 'occasional', 'not necessarily continuous' and/or a 'fine-tuning'; and (4) recognized that the disinflationary process is very much underway, albeit with the balance of risks to prices still skewed to the upside. We also note that Deputy Governor Irene Espinosa dissented on the statement. She thought that the upward bias in the risks to inflation has increased. Therefore, the central bank should remain prudent and cautious in its communications and "...avoid modifying our forward guidance in advance, given the high level of uncertainty regarding inflation's downward trajectory...". Despite of the latter, we believe that she also stated (in another section of the document) although there is the possibility of adjusting the policy stance in 1Q24, it is subject to the assumptions related to the inflationary outlook.

Based on this information, our economic and inflation outlook, we adjust our call for monetary policy. First, we reiterate that the reference rate should stay unchanged on December 14th, closing 2023 at 11.25%. Nevertheless, we now see the first cut in 2024 in March instead of May, by a magnitude of 25bps. Following this, we foresee a pause in May, consistent with the signal about 'gradual and not necessarily continuous' cuts. The declines would resume in June, with consecutive moves down going forward (see chart below). The pace would accelerate in November with two rate cuts of 50bps each. As a result, Banxico would reduce the interest rate by 200bps in 2024, ending the year at 9.25%, in line with our previous call.

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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	0pbs
December 14th	--

Source: Banxico



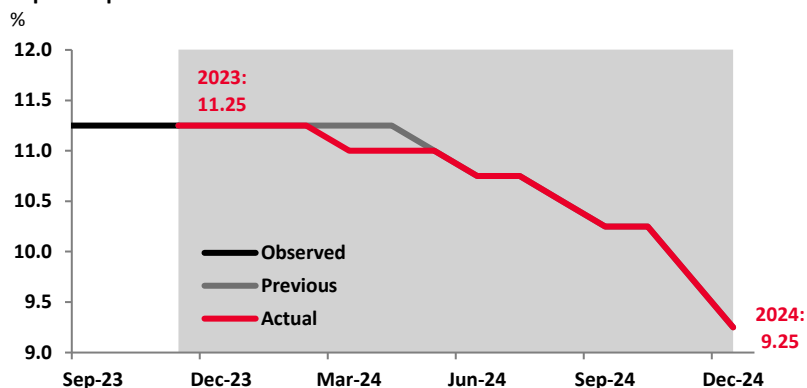
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Expected path for Banxico's reference rate



Source: Banorte

The majority leans towards a first cut in 1Q24... Given current conditions regarding the disinflationary process and inflation expectations, the forward guidance took on renewed relevance. In this context, we highlight that at least four members explicitly mentioned the possibility that rate cuts could begin in the first quarter of next year. In accordance with our assessment of individual comments (see table below), Governor Rodríguez would have indicated that in said period they could “...begin to evaluate the possibility of adjusting downwards...”. Deputy Governor Borja would have been the one who stated that “...the first reference rate cut could occur at the beginning of the first quarter of 2024”, with Deputy Governor Heath acknowledging that “...a discussion regarding the possibility of a fine-tuning of the reference rate could begin...”. At the other end of the hawk-o-meter, Deputy Governor Espinosa –who preferred to maintain prudence and caution in communications– also recognized the possibility of an adjustment in the period, although emphasizing a high level of data dependency. Lastly, arguments attributed to Deputy Governor Mejía would not have been specific about the timing at which it might be appropriate to begin rate cuts.

Banorte's assessment on Board member's comments in the November 9th minutes

Bias	Member	Order in the minutes	Relevant comments
Hawkish	Irene Espinosa	2	<p>"...we should remain prudent and cautious in our communication and avoid modifying our forward guidance..."</p> <p>"...there is the possibility of adjusting the monetary policy stance in the first quarter of next year, it is subject to assumptions related to the inflationary outlook..."</p> <p>"...looking ahead, several factors may hinder the expected path of inflation and complicate the conduction of monetary policy."</p>
	Omar Mejía	4	<p>"...it would be possible to evaluate, later on, whether the observed and anticipated disinflationary process are compatible with lower nominal interest rate levels."</p> <p>"...monetary policy's approach should remain prudent, cautious and gradual..."</p> <p>"...price dynamics have started to come close to their historical pattern a..."</p>
	Jonathan Heath	3	<p>"...in the policy decisions of the first quarter of 2024 a discussion regarding the possibility of a fine-tuning of the reference rate could begin..."</p> <p>"...although monetary policy normalization seems distant, occasional and gradual adjustments during the first quarters of next year are not ruled out."</p> <p>"...the lack of coordination between fiscal and monetary policies could delay the transmission of monetary policy and hinder its normalization..."</p>
	Victoria Rodríguez	1	<p>"...the reference rate downwards could begin to be evaluated in the policy meetings of the first quarter of 2024..."</p> <p>"...depending on the evolution of the inflationary outlook, a cycle of continuous decreases would not necessarily take place."</p> <p>"...the pressures on prices, mainly of services, and the levels of headline and core inflation that still prevail."</p>
	Galia Borja	5	<p>"...considering the expected progress on the inflationary outlook, the first reference rate cut could occur at the beginning of the first quarter of 2024..."</p> <p>"... given the prevailing environment of uncertainty, adjustments would be gradual and not necessarily continuous."</p> <p>"...its balance of risks (inflation) [...] has improved relative to March given the latest forecast revision and certain downside risks that have gained relevance..."</p>
Dovish			

Source: Banorte with information from Banxico

...but once it starts, the first changes would probably be gradual. On this, we identified very specific comments by three Board members. All of them agreed that rate moves will not be continuous. In line with previous opinions, Deputy Governor Heath talked about “fine-tuning” policy based on the real ex ante interest rate. Based on our calculations and the latest data from the central bank’s survey, its current level is around 6.9%. This is relevant as we believe that he mentioned a desirable range between 7% to 7.5% for this metric. If we add Banxico’s inflation forecasts, this interest rate could reach close to 7.9% in 1H24. Therefore, we estimate nominal cuts between 50bps to 75bps in the first half of the year for the real rate to be consistent with the abovementioned range. We are inclined towards -50bps. On the other hand, we think that Governor Rodríguez said that the easing cycle will not necessarily be continuous. Lastly, Deputy Governor Borja thinks that high uncertainty prevails, so it is also necessary to consider gradual adjustments.

The disinflation process has progressed, but upside risks remain. The Board considered that the decline in inflation has been significant, with a downward trend at the headline level. According to most members, its decline in recent months has been driven to a real extent by favorable dynamics at the core. Nevertheless, services have not yet shown an inflection point, where some costs have not been passed through completely. About the non-core, the majority considered that it remained in atypical levels by October. In addition, all members thought that: *“...the outlook continues to be challenging”* and *“...the balance of risks [...] within the forecast horizon remains biased to the upside.”*. About risks, it should be noted that: (1) Most highlighted the possibility of greater-than-expected economic resilience, with the labor market remaining tight; (2) one added that: *“...the lack of coordination between fiscal and monetary policies could delay the transmission of monetary policy and hinder its normalization”*. Finally, it was mentioned that the dilution of base effects and the anticipated rebound of non-core inflation increase the possibility that inflation persists above the variability range for longer than forecasted.

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