Banxico QR – Stronger GDP growth and a positive output gap are consistent with modest rate cuts

- **Banxico published today its 3Q23 *Quarterly Report* (QR). In line with our view, the highlight was the upward revision to GDP forecasts for this year and in 2024**
- **Specifically, this year's GDP was revised to 3.3% from 3.0% (Banorte: 3.3%). For 2024, the central bank anticipates 3.0% from 2.1% (Banorte: 2.4%). As in recent QRs, inflation forecasts were unchanged relative to the latest policy statement**
- **Questions were centered on the likely path and strategy for monetary policy ahead. They reiterated that the first interest rate cut could be debated as soon as in 1Q24, but it would not necessarily mean the start of an easing cycle. Comments were also made about the fiscal outlook, the minimum wage increase for 2024, and capital flow dynamics, among others**
- **We reaffirm our call that the reference rate will end this year at 11.25% and that the first 25bps cut will materialize in March 2024. In our view, current economic strength and a more positive output gap imply higher inflation risks from the demand side**

GDP growth revised higher and a more positive output gap… In line with our view, and for a second time in a row, GDP growth estimates for this year and 2024 were revised to the upside. With this, they are more aligned, albeit slightly more positive, than our call. Specifically, GDP for 2023 is now expected at 3.3% y/y from 3.0% (Banorte: 3.3%), with next year also stronger, at 3.0% from 2.1% (Banorte: 2.4%). For 2025, an additional deceleration is forecasted, to 1.5%. As a result, the output gap –an estimate about the cyclical position of the economy relative to its potential– is more positive when compared to the previous QR. At the time, it was calculated at +0.7% of potential GDP in 3Q23; currently, this period was increased to 1.4% (Banorte: 0.8%). In addition, Banxico locates it in positive territory for the full forecast horizon in its base case scenario, which ends in 4Q25. Previously, it returned to negative in 3Q24 (see chart on the next page). We highlight this metric as it is important for the central bank's assessment about the risks to the convergence of inflation to the target (in 2Q25), as well as inflation forecasts. At the margin, a more positive output gap would reinforce the upside skew to the balance of risks. On the latter point, we note also the comments made by Deputy Governor Jonathan Heath in a radio interview this week. He mentioned that: *"…This is not what we were seeing a year ago […]. Instead, the economy has been stronger, so right now we see a situation in which there are inflationary pressures that can be explained by the excess of aggregate demand…"*.

…with the Q&A still focused on possible rate cuts ahead. After the shift towards a less hawkish tone in the November 9th decision, questions centered on the possible policy path and strategy ahead. Governor Victoria Rodríguez reaffirmed that the first interest rate cut is not projected for December, while they will likely open this discussion on 1Q24 (based on the latest minutes, it is our take that at least four members also share this view) and that, when this happens, it 'won't necessarily be in consecutive meetings' (with comments in this sense from three out of five Board members in the same document). On the latter, we noted that Deputy Governor Mejia said he would not rule out the possibility of rate cuts in consecutive meetings, while Deputy Governor Heath reaffirmed some of his recent public comments about 'fine tuning' policy early next year. Other considerations included: (1) If the fiscal outlook for next year was already included in their expectations; (2) how concerned or not were they about the minimum wage revision for 2024 for prices; and (3) portfolio outflows from Mexico so far this year.


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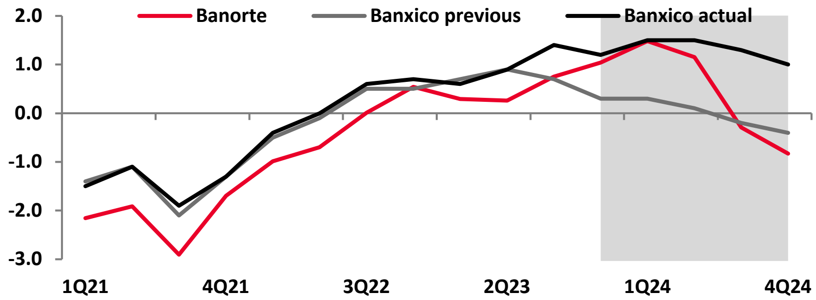
Banxico's decisions in 2023

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

Output Gap
%



Source: Banxico and Banorte

We reaffirm that the first cut will be in March 2024, along with 200bps of accumulated reductions next year. The QR's content, forecast revisions, and the comments made in the press conference, were in line with our expectations and with no important surprises. In this backdrop, we maintain our view that the first cut will be in March, followed by a pause in May. After this, reductions would resume in June, albeit in consecutive decisions going forward. Starting in November, the pace would quicken, with two 50bps cut each. As a result, there would be 200bps of accumulated cuts in FY2024, with the reference rate ending in December at 9.25%.

They reiterated that the balance of risks for inflation is titled to the upside, with forecasts and factors to the upside and to the downside unchanged. As usual, the inflation trajectory was the same as in the last decision. On the balance of risks, the driving factors were unchanged and in the same order as in the statement. Only where mentioned more details on each of them.

CPI forecasts
% y/y, quarterly average

	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25
Headline	4.6*	4.4	4.3	4.0	3.7	3.4	3.2	3.1	3.1
Core	6.2*	5.3	4.5	3.9	3.5	3.3	3.2	3.1	3.1

Source: Banco de México. *Observed data

2023 and 2024 GDP estimates revised upwards, resulting in a more positive output gap. For 2023 activity GDP growth increased +30bps, standing at 3.3% (range: 3.1% to 3.5%), in line with our forecast and slightly below consensus (banking sector survey: 3.4%). The main drivers were: (1) A more robust growth trend in 3Q23, with a positive performance in the three economic sectors; (2) a tight labor market and high wage growth; (3) the positive evolution of domestic demand, especially investment; and (4) export growth. Meanwhile, the revision for 2024 was even higher than our expectations, at +90bps to 3.0% (range: 2.3% to 3.7%). Specifically, "*…the revision for said year is explained, mainly, by the fiscal stance…*". Finally, the initial forecast for 2025 implies a significant moderation at 1.5% (range: 0.7% to 2.3%). Returning to the output gap, the highest point would be at 1.5% in 1S24. Consistent with our outlook for prices, we believe that the strength of aggregate demand implies elevated risks for inflation and its expectations.

Other estimate changes. Banxico narrowed the range of its estimate for job creation affiliated to IMSS for this year, 2024 was raised, and 2025 forecast was added. Overall, the labor market is seen as stronger. On external accounts, narrower deficits are broadly anticipated for both the trade balance and current account. For more details, see the tables below.

Banxico's Forecasts
Current Report (3Q23)

	2023	2024	2025
GDP (% y/y)			
Central scenario	3.3	3.0	1.5
Range	3.1 to 3.5	2.3 to 3.7	0.7 to 2.3
Employment (thousands)	670 to 770	610 to 810	550 to 750
Trade Balance (bn)	-16.0 to -10.0 (-0.9% to -0.6% of GDP)	-27.8 to -19.6 (-1.5% to -1.1% of GDP)	-26.8 to -17.4 (-1.5% to -1.0% of GDP)
Current account (bn)	-18.6 to -8.6 (-1.0% to -0.5% of GDP)	-24.3 to -11.6 (-1.3% to -0.6% of GDP)	-23.4 to -7.4 (-1.3% to -0.4% of GDP)

Source: Banxico

Banxico's Forecasts
Previous Report (2Q23)

	2023	2024
GDP (% y/y)		
Central scenario	3.0	2.1
Range	2.5 to 3.5	1.3 to 2.9
Employment (thousands)	670 to 830	570 to 770
Trade Balance (bn)	-30.6 to -24.1 (-1.7% to -1.3% of GDP)	-30.4 to -22.2 (-1.7% to -1.2% of GDP)
Current account (bn)	-31.6 to -21.5 (-1.8% to -1.2% of GDP)	-28.6 to -15.6 (-1.6% to -0.8% of GDP)

Source: Banxico

Analyst Certification.

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, Juan Carlos Mercado Garduño, Paula Lozoya Valadez, 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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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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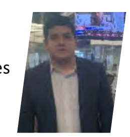

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