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Latam Daily: Banxico's Meeting Minutes and Mexican Inflation

- **Mexico: Banxico's minutes add some additional colour on Board's bias; inflation is slowing slightly, but there is no downward trend**

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MEXICO: BANXICO'S MINUTES ADD SOME ADDITIONAL COLOUR ON BOARD'S BIAS; INFLATION IS SLOWING SLIGHTLY, BUT THERE IS NO DOWNWARD TREND

Banxico's minutes add some additional colour on Board's bias

Following its surprise 50bps hike a couple of weeks ago, Banxico's Board published the **minutes** from its February 8th decision. The most relevant sentence in the minutes for monetary policy watchers was likely that "*The Board considers that given the monetary policy stance already reached, and the recent evolution of data, the adjustment in the monetary policy rate in the coming meeting will likely be of a smaller magnitude*". A slowdown in the magnitude of hikes was already anticipated by markets, who look for a moderation in the pace of tightening, with the TIIE curve currently pricing in a terminal rate of 11.70% (essentially pricing in 3X 25bps hikes in the coming meetings). This is at the top of the range of the expectations provided by Deputy Governor Heath in his comments on February 16th, where he said he anticipates a terminal rate in the range of 11.25%– 11.75%.

The latest economist consensus survey by Banamex (February 21) shows that economists see CPI inflation ending the year at 5.2%, and that it will remain at 4.0% by the end of 2024. This essentially shows that expectations remain above target for the duration of the monetary policy horizon (two years), which supports the view of further tightening ahead. In somewhat of a dissenting voice, Deputy Governor Espinosa said that "*it's dangerous to provide guidance of a smaller hike in March*" stating her view that she believes it's better to be cautions with regards to forward guidance. This statement reminds us of comments former Governor Carstens made at the IMF meetings in Peru, where he stated that for price taking central banks (i.e., not the Fed), it was arguably better to provide conditional guidance rather than forward guidance—as forward guidance as a price taker can risk credibility loss. We tend to agree with both of their assessments.

In terms of the decision to hike 50bps in the previous meeting, some key elements from the minutes include:

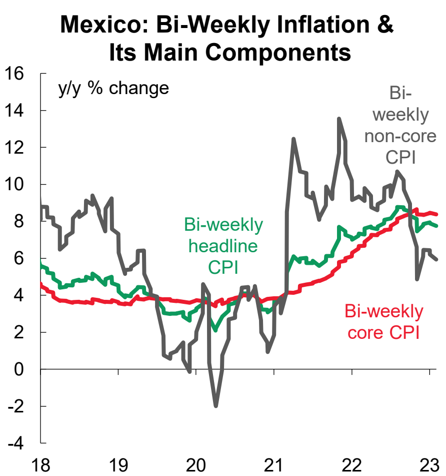
- The key driver for the 50bps hike surprise was that the Board remains concerned over the persistence in high core inflation.
- In addition, although Banxico sees 2-way risks to inflation, the balance of risks remains tilted to the upside.
- It is worth noting that the minutes show that the guidance on the next move likely being of a smaller magnitude is shared by a majority, not all the Board. We know that at least Deputy Governor Espinosa seems to believe this guidance is risky.
- Besides Espinosa, the other more hawkish member of the Board (Heath) in his comments on his expectations on the terminal rate being in the 11.25%–11.75% range seems to be open to moving 25bps in the next move.
- It's also worth noting that some members of the Board suggested that MXN's strength could be driven by high rates, which we wrote about last week. However, Banxico (and the FinMin, who jointly run the FX Commission) has so far refrained from making changes to its FX policy. Our view is that if Banxico were to start accumulating FX reserves, it could stop rolling its maturing FX swaps first. This could be combined or followed by the implementation of reserve accumulation through the **options mechanism**.

—Eduardo Suárez

Inflation is slowing slightly, but there is no downward trend

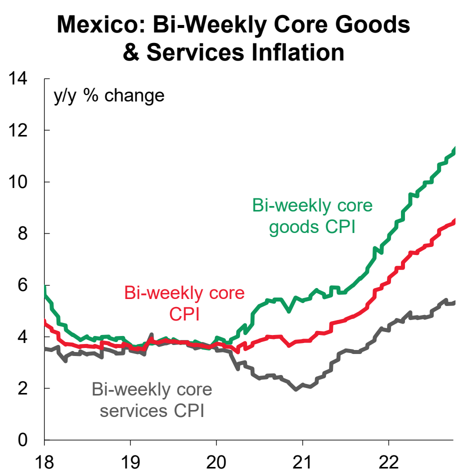
In the first fortnight of February, headline annual inflation was lower than expected, going from 7.88% to 7.76% y/y (vs 7.81% consensus) (chart1), as core inflation decelerated less than expected, from 8.46% to 8.38% y/y (vs 8.42% consensus), owing to an increase in services by 5.58% (5.54% previously), while merchandise decelerated to 10.79% (10.97% previously) (chart 2). On the other hand, non-core inflation moderated from 6.20% to 5.93%, with agriculture slightly slowing to 9.71% (9.87% previous), energy and government fees at 1.81% (2.26% previously) (chart 3). In its sequential biweekly comparison, headline inflation moderated from 0.35% to 0.30% 2w/2w (vs 0.35% consensus), and the core component marginally moderated from 0.36% to 0.35% 2w/2w (vs 0.39% consensus). In particular, merchandise accelerated to 0.40% 2w/2w (vs 0.34% previously), but services moderated their pace to 0.30% (0.37% previously). The non-core component slowed to 0.15% from 0.31%, derived from a drop in agriculture at -0.24% (0.06% previously), while energy and government fees remained at 0.52% as previously. Consumption has remained strong since last year, even with the rate hikes, therefore we maintain our stance that inflation will remain high during the first half of 2023, with pressures in merchandise and services, having already touched its peak in September 2022 (8.70% y/y), as well as their impact on households. For now, it seems that inflation will remain high without a clear downward trend, therefore analysts increased their forecast in Citibanamex Survey for the end of 2023 (5.2%) and 2024 (4.0%), also the terminal rate was revised in a range of 9.25%–12.0%, without a clear consensus.

Chart 1



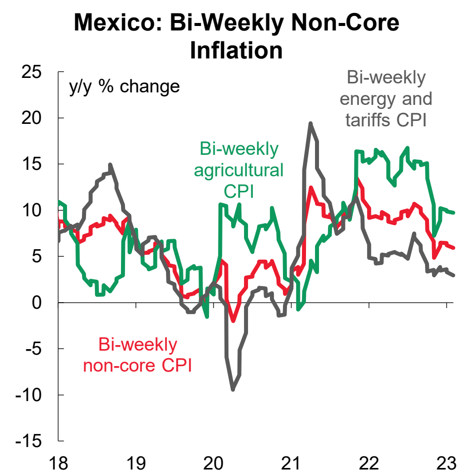
Sources: Scotiabank Economics, INEGI.

Chart 2



Sources: Scotiabank Economics, INEGI.

Chart 3



Sources: Scotiabank Economics, INEGI.

—Miguel Saldaña & Brian Pérez