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GLOBAL ECONOMICS

**LATAM FLASH**

May 9, 2024

# Mexico—Banxico Holds Rate in Unanimous Decision

- **As expected, Banxico held the rate unchanged, but revised up inflation forecasts**

In line with the consensus, Banxico left the interest rate unchanged, at 11.0%, in a unanimous vote. Additionally, the Governing Board revised short-term inflation expectations upward again, while expecting it to reach the target of 3.0% in the last quarter of 2025.

After cutting the rate for the first time at the March meeting in a split vote, Banxico unanimously adopted a more restrictive stance this time by leaving the rate unchanged. During the March meeting, Deputy Governor Irene Espinosa warned about the upward risks to inflation, highlighting the increase in fiscal spending and wage pressures. Since then, private-sector analysts revised their inflation expectations upwards, the Federal Reserve adopted a more bullish tone—with the market now pricing in a single cut this year—and SHCP (Ministry of Finance) revised upwards the deficit and the debt expected for this year to a 30-year high level. All of this has led to an increase in the year-end rate expectation by analysts, now at 10.0%, implying fewer rate cuts during the remainder of the year.

April's inflation print (which came out on the same day the decision was announced) showed headline inflation edged up more than expected, from 4.42% to 4.65% y/y, while the less volatile components (core inflation) decelerated more than expected, from 4.55% to 4.37% (table 1). However, in core inflation, the services component continued to show marked stickiness, reinforcing concerns around wage cost pressures. In addition, recent climate events (droughts in most of the country), domestic security problems and international uncertainty further complicate the inflation outlook in the short term. In this sense, despite constant upward revisions, Banxico's inflation forecasts remain below private-sector expectations over most of the forecast horizon. In our opinion, the continuous revisions to Banxico's forecasts could hinder their communication efforts and complicate the process of anchoring inflation expectations, particularly in the current environment of high uncertainty about price dynamics, which would inject further uncertainty in the trajectory of monetary policy.

**Table 1: Mexico—Banxico's Headline & Core Inflation Forecasts**

| Headline Inflation | 23Q1 | 23Q2 | 23Q3 | 23Q4 | 24Q1 | 24Q2 | 24Q3 | 24Q4 | 25Q1 | 25Q2 | 25Q3 | 25Q4 | 26Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Current (May. 23) a.o.p. | 7.5% | 5.7% | 4.6% | 4.4% | 4.6% | 4.6% | 4.4% | 4.0% | 3.5% | 3.3% | 3.2% | 3.0% | 3.0% |
| Previous (March. 23) a.o.p. | 7.5% | 5.7% | 4.6% | 4.4% | 4.6% | 4.4% | 4.0% | 3.6% | 3.2% | 3.1% | 3.1% | 3.1% | 3.1% |
| Var. Current - Previous | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.2% | 0.4% | 0.4% | 0.3% | 0.2% | 0.1% | -0.1% | -0.1% |
| **Core Inflation** | **23Q1** | **23Q2** | **23Q3** | **23Q4** | **24Q1** | **24Q2** | **24Q3** | **24Q4** | **25Q1** | **25Q2** | **25Q3** | **25Q4** | **26Q4** |
| Current (May. 23) a.o.p. | 8.3% | 7.3% | 6.2% | 5.3% | 4.7% | 4.3% | 4.0% | 3.8% | 3.5% | 3.3% | 3.2% | 3.0% | 3.0% |
| Previous (March. 23) a.o.p. | 8.3% | 7.3% | 6.2% | 5.3% | 4.7% | 4.2% | 3.8% | 3.5% | 3.2% | 3.1% | 3.1% | 3.1% | 3.1% |
| Var. Current - Previous | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.1% | 0.2% | 0.3% | 0.3% | 0.2% | 0.1% | -0.1% | -0.1% |

Sources: Scotiabank Economics, Banxico.

In the latest Citibanamex Survey, analysts expected the next rate cut to happen in June. Furthermore, the median year-end rate forecast stood at 10.0% for 2024, and 7.75% for 2025. For the moment, we agree with the consensus on the next cut and the year-end rate for 2024. However, in an environment marked by both external and internal high uncertainty, we believe that hawkish scenarios are also possible, where Banxico delivers the next cut in the second half of the year and at a slower pace. In this regard, the implicit rate is 10.51%, discounting two rate cuts in the next six months; in the next two years the implicit rate stands at 8.61% discounting a total of -239bps. Upside risks to this outlook include persistently high core inflation, a more hawkish Fed, and political uncertainty in Mexico and the United States. Such episodes could lead to a more restrictive scenario with few, and slower, cuts. On the other hand, lower-than-expected economic activity and a low USDMXN represent some of the downside risks to the inflation outlook for the coming months which could lead to further cuts by Banxico.

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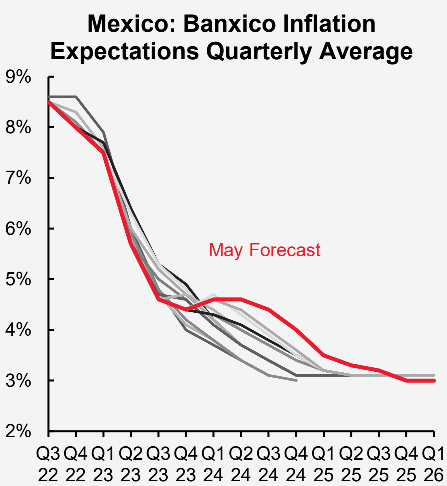
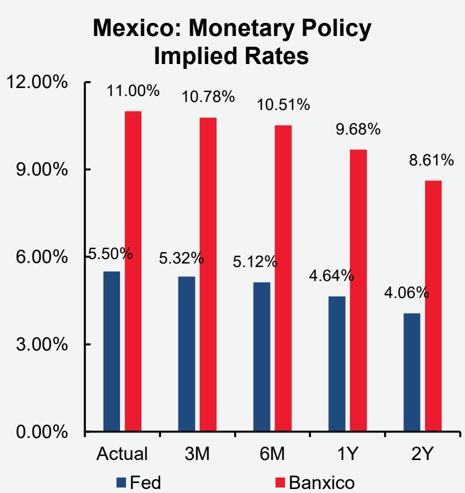
**Chart 1**




Sources: Scotiabank Economics, Banxico.

**Chart 2**




Sources: Scotiabank Economics, Bloomberg.