

Contributors

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Mexico—Banxico Plays High for Long Card

As expected, and consistent with the *semi-forward-guidance* we received from the board last month, [Banxico left its policy rate on hold in its June 22nd meeting](#). The decision, as expected, was unanimous. The tone of the release was neutral-hawkish, with some marginal revisions to inflation forecasts, but these came mostly from non-core (in the core inflation revisions we only saw one marginal downward revision to the 2023 Q2 forecast, which was lowered from 7.4% y/y to 7.3% y/y). Most importantly, the board said risks to growth were evenly balanced, while inflation risks for the policy horizon remains biased to the upside—which we agree with. We believe the board sees its current policy settings to be tight enough to drive an inflation decline process, but the work will take time. We believe that the board's view of inflation risks remaining biased to the upside is correct, based on the following factors:

- As our colleague Derek Holt wrote [here](#), there once again appears to be upside risks from global supply chains, which are seeing aggravating supply issues in tools, vehicle inventories, and now also semiconductors.
- In addition, the heavy heatwave / drought in much of North America, including Mexico presents some risks to food prices—and it's worth highlighting that one of the elements that has dramatically helped Mexican headline inflation is non-core food inflation, which is currently at unusually low levels.
- In addition, Mexican labour markets are currently very tight, with unemployment near an all-time low (the last unemployment print of 2.82% remains near the all-time low of 2.39%), and real wage levels continuing to accelerate (real wage growth stands around +3%)—which in turn suggests core services inflation may be stubborn to the downside.
- Even though 'relative monetary conditions' have lost relevance in recent Banxico statements, we think they remain (as they should) relevant for Banxico, as the Fed remains the core for setting the global price of money (particularly for EMs), and recent decisions and communication from core-CBs has remained hawkish and cautious. Banxico started its tightening cycle early and gave itself room to manoeuvre, while the very strong MXN has also given it some room. However, we think Banxico is wise to keep an eye on core central bank policy biases and settings.

The Mexican TIE curve is currently pricing in about 200bps of cuts over the next 12 months, which to us are somewhere in between realistic and aggressive. For that many rate cuts to materialize, in what has remained a resilient growth story, with very tight labour markets, MXN needs to remain a market darling. In [Mexican aggregate financial conditions](#), the exchange rate remains a relevant factor. Risks to bear in mind on this front include:

- 2024 is a presidential election year in both Mexico and the US, which adds risks of FX volatility.
- We have pending decisions on power sector arbitration starts under the USMCA framework, which if kicked-off, could put pressure on MXN.
- The [potential credit crunch](#) in the US to regional banks and SMEs could put a dent on remittance and tourism flows into Mexico.

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