Banxico Flash

Rate cut decision made by simple majority

- Banxico's minute for the June meeting shows that two of the five board members voted for maintaining the monetary pause. The debate focused on the possible adverse effects of a negative real rate, the underestimation of inflation risks, the lag and the magnitude of the effects of the rate cut on economic activity, and the possible credibility costs arising from the decision (see chart below).
- Most members pointed out that there were three unexpected figures related to economic activity (released after the quarterly inflation report) that led them to cut this year's growth forecasts: 1) lower than expected first quarter GDP growth; 2) a negative growth rate of IGAE in march; and 3) the downward revision to the US GDP growth in the first quarter. It is important to notice that the slump of the services sector in March came as a surprise for the majority of the board, and that this was considered as the main reason behind the negative IGAE growth rate in March.
- The better FED communication was regarded, by the majority of board members, as the main cause of the lower levels of volatility in the financial markets. The latter raised concerns of an excessive risk taking behavior that could lead to another risk aversion episode.
- The board members that supported the rate cut made clear that there will be no additional cuts as the economy is expected to recover and as the monetary policy stance in Mexico and the US is now comparable.

- Bottom line: The divided decision shows that the majority of board members followed the efficient convergence criteria (inflation convergence at the lower costs to economic activity). The other two members gave more weight to the uncertainty regarding the effects of negative real interest rates and the lag associated to monetary policy actions; and the costs that the rate cut decision could have on central bank credibility.

Chart 1
Main arguments of voting members

Rate cut supporters (3 members)	Monetary pause supporters (2 members)
• **Weaker than expected economic activity** ; • **Better than expected inflation performance and anchored expectations;** • Sound management of public finance leads to a more flexible monetary policy • The beginning of FED's tightening cycle has been delayed	• **Concerns about the effects of a negative real rate** ; • **Uncertainty about the lag of monetary policy actions;** • The **costs in terms of credibility** given that the communication in October did not recommend another rate cut. • Uncertainty about the effects of new risk aversion episodes.

Source: BBVA Research and Banxico

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