

Central Banks

We think Banxico will remain on hold for the rest of the year

Stable MXN, well-behaved core inflation and well-anchored mid and long-term inflation expectations mean no more preemptive hikes

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- **A “hawkish hold” continues to be the most likely outcome in our view, as core inflation remains well behaved and the MXN has stabilized following the US-Mexico trade deal and as Canada agreed to join**
- **Recent communication signals that Banxico feels the current real policy rate level is somewhat restrictive. Looking ahead, further preemptive hikes seem now less likely. We continue to expect the next policy rate to be down, but not until 2Q or 3Q 2019**

Banxico acknowledges that inflation convergence will take longer...

In the last meeting (August 2), with headline inflation increasing and core inflation on a downwards trend, Banxico's board unanimously left the monetary policy rate unchanged at 7.75%, as we expected. The meeting minutes showed that the decision was mostly based on the view that the acceleration in headline inflation was driven by supply shocks, which should be only transitory.

More recently, in its latest Quarterly Inflation Report, Banxico acknowledged two important issues: i) inflation convergence will take longer¹; Banxico's board upwardly revised its year-end headline inflation forecast to 4.2%, and ii) the Board stated that core inflation better reflects the monetary stance, “which is why at this juncture the Board will give an especially close follow-up” to its performance. Importantly, core inflation remains stable (it will most likely remain at 3.6% in September, for the fourth month in a row) and Banxico, as we do, estimates that it will continue decreasing gradually: it now expects 3.5% by year-end.

... and finds relief on stable core inflation, FX and long-term inflation expectations

All these signs together point to a less hawkish Banxico as core inflation will continue on a gradual downward trend, the MXN has stabilized following the recent US-Mexico trade deal and will likely remain relatively strong in the near-term as Canada agreed to join this deal, and mid and long-term inflation expectations remain well-anchored.

Besides, Banxico also acknowledged the recent deceleration in economic activity in a context in which at above 4.0%, the real ex-ante monetary policy rate is now restrictive. Banxico will likely find the latest inflation data of the first fortnight of September reassuring. On the one hand, annual headline inflation did not increase further (actually edging

1: Banxico expects that “the convergence trajectory of headline inflation towards its target will be delayed, mostly due to non-core inflation behavior”.

down to 4.88% from 5.0% in the previous fortnight) as pressures on energy prices continued but perishable food price pressures eased. On the other hand, core inflation edged down 0.1pp (to 3.56% from 3.65% in the previous fortnight).

Both headline and core inflation are set to remain sticky to the downside in the near-term, but should resume their downward trend as soon as in November. Banxico already acknowledged that headline inflation will definitely converge to the 3.0% target at a slower pace than previously thought and that core inflation will only decrease slightly the rest of the year. Thus, as long as core inflation remains well behaved, as it has in the intermeeting period, and the MXN continues to stabilize (it has actually outperformed other EM currencies recently and we expect this trend to continue after Canada joined the trade deal), Banxico is likely to hold rates steady in the near-term. Looking ahead, further pre-emptive hikes are unlikely unless the inflation outlook deteriorates appreciably (not our or Banxico's base-case scenario). We think that the room for rate cuts will open between 2Q and 3Q19.

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