Central Banks

Banxico remains cautious but eases tone

Less hawkish wording suggest rate cuts later this year are likely

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- **One member of the Board (likely Esquivel) voted for a rate cut**
- **The statement was less hawkish signaling that Banxico took a small step towards easing**
- **We continue to expect 50bp of rate cuts (to 7.75% by year-end), beginning in September**

Dovish tweaks to the wording and dissenting vote signal a small step towards easing later this year subject to incoming inflation data

In a divided decision with one dissenting vote (likely Esquivel's), and as forecasted by all 23 analysts surveyed by Bloomberg, Banxico kept its monetary policy rate unchanged at 8.25% despite slowing inflation, weakening growth and easing risks. The 8.25% interest rate level during 1H19 was last seen in 4Q08, when headline and core inflation averaged 6.2% and 5.3%, respectively, compared with 4.0% and 3.9% now and when the global credit contraction caused by the financial crisis meant that a capital outflow scenario was possible. We argued that Banxico should start cutting rates at this meeting but that it would not happen. It did not. Yet, one member voted for a cut and the tone was less hawkish. Both point to a small step towards easing later this year.

The tone of the statement remains hawkish but there were tweaks in both the discussion on growth and inflation. The Board repeated that "The balance of risks for growth has become more uncertain" but acknowledged that "its downside bias has increased". As for inflation risks, in light of the recent decline, Banxico implicitly signaled that risks are more balanced by acknowledging that "some have diminished and others have gained relevance" and by eliminating from the reference repeated in previous statements that "relative to its forecasted trajectory" risks remained tilted to the upside. In our view, it would have been better to explicitly state that the risks are more balanced or tilted to the downside, but nonetheless, the changes show more flexibility and a better characterization of the recent inflation performance and its most likely dynamics going forward. In our note two days ago (see), we argued that Banxico risked making a sharp U turn in its communication in the next few months unless they started to acknowledge the improved backdrop for inflation and started to ease the tone and show more flexibility. They did just that.

Although it is important that one member voted for a rate cut as easing will be in discussion in coming meetings, we view as more significant the less hawkish tone of the statement. This considering that the dissenting vote likely came from Gerardo Esquivel, who disagreed with the hawkish tone of the previous statement and likely remains alone within the Board (for now) in his view on inflation risks. The fact that the wording was less hawkish might be more significant as the tone inched closer to resembling weak growth, slowing inflation and easing inflation risks. Going forward we should now focus on likely small incremental steps towards a more dovish tone, paving the way for rate cuts later this year. We now expect more decisive changes to the tone of the statement in the next meeting (Aug 15) and a rate cut in the following meeting (Sep 26). We continue to expect the start of the easing cycle in 3Q19, as reality catches with Banxico.

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