Central Banks

Banxico cuts rates but the (cautious) tone of the statement is largely unchanged

In spite of relatively hawkish wording, more rate cuts are on the way

Javier Amador / Carlos Serrano

August 15, 2019

- **The majority of the Board finally comes round to the view of the need for monetary policy easing with a real ex-ante rate above 4.0% in a context of a weakening economy and falling inflation**
- **Surprisingly, the tone of the statement was broadly unchanged and it remains on the relatively hawkish side**
- **In spite of this, and the absence of any (and thus poor and misguiding) forward guidance, this cut should mark the start of an easing cycle**
- **We continue to expect an additional 25bp rate cut (to 7.75%) before year-end and 100bp worth of cuts (to 6.75%) by year-end 2020**

Poor forward guidance in a still hawkish statement but more rate cuts are on the way

In a divided decision, four of five members voted to cut the policy rate by 25bp to 8.00%. As we forecasted since December 2018 an easing cycle would begin this year, and as we anticipated since late February it would start in 3Q19. It did today. The vote was not as close as we would have thought. It was not only that Esquivel –who was right all along, disagreeing first two meetings ago with the overly hawkish tone, as it did not resemble reality and then voting for a rate cut in June– had to convince two members of the Board to win a close vote. The majority was on board with the decision, reflecting that Banxico finally sees the need for monetary policy easing.

The rate cut was warranted. We have been arguing that Banxico has been overly cautious and its tone more hawkish than needed. This was the second meeting in which we argued why we would have voted for a rate cut and we have been expecting the start of the easing cycle in the summer as soon as inflation stood below 4.0%. The main reason for our hold call in this meeting was that the tone in the accompanying statement of the previous monetary policy decision in June was still quite hawkish, and did not signal that the Board was in the onset of discussing a rate cut. In addition, communication-wise it made more sense for Banxico to first strike a conclusive dovish tone and to cut in September in order to maintain credibility in its communication as well as to be able to use forward guidance as another monetary policy tool. We continue to think that and what we find surprising is not the decision but the tone of the statement, which remained largely unchanged, cautious and (relatively) hawkish. The Board said that the balance of risks for growth remains "biased to the downside". As for inflation risks, in light of the recent decline, Banxico continues only to implicitly signal that risks are balanced and that "there is still marked uncertainty in the risks that could influence inflation". We, on the contrary, believe that inflation risks are tilted to the downside.

There is no forward guidance in the statement whatsoever. Of course, no central bank should pre-commit to future movements of interest rates, but communication is another tool and forward guidance is important. They only said that the Board would take “required action based on incoming information”. That and saying nothing is the same thing. It is understandable that they might not want to signal an easing cycle so they can test the waters with this first cut, but a hawkish cut with no forward guidance serves no purpose for Banxico’s communication. One would have expected more dovish tweaks and/or some hints to future actions that of course will depend on incoming information.

As we have mentioned before, the cut had no significant effect on the MXN, as rate cuts were priced-in and as the risk-adjusted carry trade remains among the highest in the emerging market world. In this aspect, there is still plenty of room to cut.

In spite of this, we continue to expect an additional 25bp rate cut (to 7.75%) before year-end and 100bp worth of cuts (to 6.75%) by year-end 2020 as they seem to finally come to the view that easing is needed and with inflation falling they now seem to believe more in their own expected inflation path. Albeit their communication is poor, with inflation set to fall further, the Board now seems to be open to change its (still) restrictive stance. That requires several rate cuts. We continue to think that more are on the way and that today’s cut marks the start of a long overdue and needed easing cycle.