Central Banks

A still cautious Banxico cuts its policy rate to 7.75%

There is still plenty of room to cut rates; we expect at least 50bp of additional easing by year-end

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- **Split vote supports our view of a reduction of the policy rate to 7.25% by year-end (vs. 7.50% expected by the consensus)**
- **A larger 50bp cut will remain on the table for November's meeting; we think that the size of the cut will ultimately depend on core inflation's performance**
- **If core inflation remains sticky to the downside, Banxico will likely lean towards a 25bp cut, but if it finally begins to slow (as we are expecting), a third member might join the two members that already see the need for a faster pace of easing**
- **Thus, we continue to expect at least 50bp worth of additional cuts (to 7.25%) by year-end and at least 100bp worth of cuts (to 6.25%) by year-end 2020**

Banxico has room to cut rates more rapidly; the decision will likely depend on the evolution of core inflation before the next meeting (Nov 14)

In a split decision, Banxico cut its policy rate by 25bp for the second consecutive meeting. This was in line with expectations (the 25bp cut was expected by 22 of 25 economists surveyed by Bloomberg, including us, we expected Banxico to keep the rate unchanged, and two forecasted anticipated a larger 50bp cut). In our note prior to today's meeting we argued that a faster easing pace was warranted but that we expected Banxico to remain cautious and lean for a 25bp cut (see). We also expected that at least one member of the Board was going to argue for the need to speed up the easing cycle. Two of the five board members voted for a half-point cut.

The tone of the statement was (surprisingly) little changed, as Banxico remains overly cautious in our view and strikes a still somewhat hawkish tone even after two members of the Board pushed for a larger cut. Banxico continues to think that the balance of risks for growth remains biased to the downside. As for inflation risks, even in light of the recent decline (headline inflation fell to its lowest level in three years in the first half of September, coming in at a better than expected 2.99%), Banxico continues only to implicitly signal that risks are balanced. Banxico repeated that "high uncertainty still persists regarding the risks that might affect inflation", and that they "will be alert to the possible materialization of inflation risks, both to the downside and to the upside".

As we expected, the rate cut has no impact on the exchange rate. This because the MXN high carry trade and the fact that the cut was expected by markets. We think that Banxico can cut an additional 200bp without having a significant impact on the exchange rate. Moreover, Banxico's Board is losing its fear to cut as they have seen that the last two cuts did not have an effect on the MXN.

There is no forward guidance again but the fact that all members voted for a rate cut and two of them pushed for a larger cut clearly signals that Banxico finally sees the need for monetary policy easing. We have been arguing throughout the year that a rate cut cycle was long overdue and the split vote signals that two members are likely to continue pushing for a faster pace of easing in coming meetings. A larger 50bp cut will remain on the table for November's meeting; we think that the size of the cut will ultimately depend on core inflation's performance. If core inflation remains sticky to the downside, Banxico will likely lean towards a 25bp cut, but if it finally begins to slow, a third member might join the two members that already see the need for a faster pace of easing. Thus, we continue to expect at least 50bp worth of additional cuts (to 7.25%) by year-end and 100bp worth of cuts (to 6.25%) by year-end 2020.

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