Central Banks

Banxico cuts its policy rate for the 5th meeting in a row

The monetary policy rate has plenty of room to decline without affecting inflation or the MXN

Javier Amador / Carlos Serrano

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- **In an unanimous vote Banxico lowered the rate to 7.00%**
- **The wording of the statement remains cautious and somewhat hawkish**
- **In our view, at least a neutral stance (nominal rates of 6.0% or lower) is warranted but Banxico's hawkishness tilts the risks to less cuts not more**

Banxico remains overly cautious; the wording signals that future movements will be data dependent even if the monetary policy stance remains overly restrictive

In a widely expected and unanimous decision, Banxico lowered its policy rate by 25bp to 7.0%. The wording of the statement remained cautious as it continued to signal that the Board remains concerned about "core inflation´s resistance to decline". In fact, when citing the upside risks for the trajectory of inflation that was the first one. As risks prevailing to the upside they also cited: i) wage increases, ii) a possible exchange rate adjustment to the upside, iii) greater-than-expected increases in fresh food prices, and iv) a deterioration in public finances. As for downside risks: i) a further appreciation of the peso, ii) lower international prices of energy goods, and a greater economic slack. As for the balance of risks, they seem to continue to believe that risks are broadly balanced: "uncertainty still persists regarding the balance of risks". It is true, uncertainty is always there but if we think about the probability of the upside and downside risks to inflation, those on the downside seem more probable. There will be greater economic slack throughout 2020 as the economy will most likely grow below potential. The peso is likely to continue to outperform. If fact in a risk-off context it has recently appreciated. Thus, a possible mild depreciation should not cause pass-through for two reasons mainly: i) the recent appreciation has not translated into lower prices (ie, margins are increasing), and ii) in a context of a widening output gap along with the recent increase in margins, there would be room for firms to absorb a possible increase in the exchange rate.

In our view, risks to inflation are tilted to the downside but Banxico's characterization of them signals that the rate cut cycle will continue but will likely be more data dependent even if the monetary policy stance remains restrictive. We think that the temporary and expected rebound in inflation in 1Q20 should not be used as an excuse to pause the easing cycle at least until the monetary policy stance is neutral since inflation expectations remain well-anchored at the lowest levels in years. We continue to expect the policy rate to reach 6.0% by August 2020. In our view; a looser monetary policy stance is warranted but we expect Banxico to remain cautious as they assess a higher risk premium. Yet, Banxico's hawkishness tilts the risks to less rate cuts not more.

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