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Central Banks

Banxico slows the easing cycle but leaves the door open to further easing

The accompanying statement remained dovish but was more cautious

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- **We think that the easing cycle has further to run**
- **The Board remains more concerned about the economic outlook than the recent inflation rise**
- **With inflation edging lower, we expect Banxico to cut the policy rate to 3.75% by year-end and –to avoid an unwanted tightening– to 3.0% next year**

Today's dovish statement supports our view that the easing cycle has further to run

Banxico cut its policy rate by 25bp, to 4.25%, in line with our forecast, shared by most analysts: 23 of 29 analysts polled by CitiBanamex were expecting a 25bp cut, with five more anticipating no change and one forecasting a 50bp cut. The decision was unanimous. That, along with the dovish tone of the accompanying statement signals that the easing cycle has further to run, supporting our view of further easing and contrary to consensus expectations (ie, 4.25% by year-end 2020 and 2021).

As we argued (see), a slower pace of easing was likely at this point following the minutes to the last meeting that showed a split within the Board and a more cautious Banxico along with recent inflation levels that were likely to reinforce the shift towards more cautiousness. The more cautious stance is clear in the accompanying statement that added a phrase to say that the room for further easing is "narrow". The statement also signaled that future monetary policy decisions will mainly rest on the outlook for inflation and inflation expectations.

Yet, the statement remained dovish and once again –correctly in our view– brushed aside the recent inflation increase (with headline inflation now at 4.1% in the first half of September and core inflation at 4.0%), signaling that the Board remains more concerned about the economic outlook than the recent inflation increase that will most likely prove temporary. They continue to signal that inflation is not the main worry for policymakers at this moment, shrugging off the recent rise in inflation repeating that it is due to higher energy prices and a "recomposition in core inflation, decreasing that of services and accelerating that of goods". They still expect, like us, inflation to converge to 3%.

Inflation concerns are overdone: in spite of the current change in relative prices, there will not be any demand-side pressures in the coming quarters, giving Banxico further room to cut rates. In our scenario, inflation will edge down over the coming months as food and energy inflation ease and services inflation remains remarkably low. This will allow Banxico to continue easing in the last two meetings of the year (in Nov and Dec) to 3.75%, which is more than markets and analysts are currently pricing in and expecting, respectively. With inflation further edging lower next year – subject to no changes in taxes (in border VAT and/or IEPS in gasoline prices)–, Banxico will find no reasons to stop easing monetary policy. Going forward, if Banxico stops at 3.75% and inflation converges to 3.0% as they expect, the Board would unnecessarily revert some of the monetary policy easing. We continue to expect 0.0% real rate levels for the monetary policy rate (in fact, we think negative real rates are warranted). That implies two more 25bp cuts this year to 3.75% and three more in 1H21 to 3.0%.

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