Central Banks

The easing cycle is over

Banxico's Board kept its policy rate unchanged at 4.0%; the wording signals a shift from a dovish to a cautious tone

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- **Wording changes clearly reflect that the shift from dovish to cautious was driven by the strong inflation print, core in particular, in the data released yesterday, as we anticipated in the note following the unexpected jump in inflation (see)**
- **All five Board members voted to keep the policy rate on hold**
- **The easing cycle is done; the next movement will likely be a hike, but will not take place anytime soon and will be driven by the Fed**
- **Banxico's Board explicitly acknowledged that base effects will further push up inflation, but that the rise will prove temporary and inflation will fall back to below-4.0% levels**
- **The aim is to signal that this rise will not come as a surprise and in a context of weak demand, that the Board will not react to this**
- **Banxico's Board will not be in a rush to start a hiking cycle**
- **We expect Banxico to leave the policy rate unchanged the rest of the year and throughout 2022**

A unanimous shift from dovish to cautious within the Board is evident; the easing cycle is done, but Banxico will not start to remove its accommodative stance anytime soon

Banxico's Board unanimously decided to keep the monetary policy rate on hold at 4.0%. Wording changes signaling a significant and unanimous change of sentiment within the Board clearly signal that the Board has moved from a dovish bias to a cautious approach.

As we expected, the Statement reflects that the main driver of this change of sentiment was the strong inflation print in the data released just yesterday. As we explained, the latest inflation data was likely going to mark the end of the easing cycle (for more see). The statement confirms this expectation, and in our view, clearly signals the end of the easing cycle. Banxico's Board signaled that it intends to remain vigilant on inflation and its drivers, but at the same time, indicated that it will not react to the already anticipated temporary rise that will push up inflation above 5.0% in April (we expect headline inflation to peak at 5.4% in April, driven by base effects). Inflation will fall back to below-4.0% levels during the summer and third quarter, before increasing again to slightly above-4.0% levels by year-end. The strong base effects associated with last year's volatility will drive this volatility in the remainder of 2021. Banxico signal that this is expected and will not react to it –naturally, so long as mid-term inflation expectations are not affected. In other words, the aim of explicitly acknowledging that base effects will further push up inflation is to signal that this rise will not come as a surprise and in a context of weak demand, that the Board will not react to this. The challenge, in our view, is to convey this message in order to keep expectations well anchored while this temporary increase in inflation develops.

Therefore, Banxico's Board will not be in a rush to start a hiking cycle. We expect Banxico to leave the policy rate unchanged the rest of the year and throughout 2022, this contingent on the Fed also staying in pause until 2023.