

**Central Banks**

## Banxico points to keeping rates steady

### Unsurprisingly, Banxico acknowledged high inflation and rising risks

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- The wording of the statement had some (hawkish) tweaks but points to a long pause in spite of acknowledging upside inflation risks
- Clearly, Banxico has become more worried with inflation, but does not seem to be overly concerned
- In our view, the statement balanced well inflation concerns with the expectation of inflation pressures winding down in coming months
- We continue to expect Banxico to keep rates steady throughout 2021-22 as opposed to the more hawkish view priced in by financial markets

### Banxico balanced well inflation concerns with the expectation of easing inflation pressures

Banxico's Board unanimously decided to keep the monetary policy rate on hold at 4.0%, as expected by all analysts. In our view, the wording changes point to a long pause even on the back of increasing inflation risks. Unsurprisingly, Banxico acknowledged both higher inflation and increasing risks on the back of higher-than-expected inflation in April along with mounting inflation risks arising from the further increase in energy prices, rising costs and initial signs of higher services prices led by a change in relative demand as the economy gradually normalizes.

After ending the rate cut cycle in the previous meeting<sup>1</sup>, today's decision was expected by all analysts and all eyes were going to be on the wording and what tone would Banxico's Board strike to balance high inflation and mounting risks with the expectation of inflation easing going forward. Clearly, Banxico has become more concerned with inflation, but does not seem to be overly concerned. This should not come as a surprise since headline inflation is well above the target range and core inflation is slightly above 4.0%.

In our view, the statement balanced well inflation concerns with the expectation of inflation pressures winding down in coming months. On the one hand, the statement acknowledge the persistence of core inflation at high levels as well as upside risks arising from external [energy and commodity] prices, which imply rising costs, but on the other, it also noted that Banxico is still expecting inflation to converge to 3.0%, now in 2Q22. These concerns and inflation scenario are broadly in line with our take on inflation. In our view, headline inflation has now peaked and is set to drop sharply in Q2, but we now expect it to drop back to below 4.0%-levels until March 2022. We are expecting core inflation to gradually ease in coming months, reaching 3.5% by year-end but this scenario relies on no additional spike in energy

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1: A few analysts still think that the door for additional cuts might still open in 2021

prices or other cost increases that allows core goods inflation to ease as well as an expectation of only a mild increase in services prices.

Overall, in our view Banxico's Board will not be in a rush to start a hiking cycle and is not overly concerned about inflation. We continue to expect Banxico to keep rates steady throughout 2021-22 as opposed to the more hawkish view priced in by financial markets, which are now anticipating a 25bp rate hike in the next nine months while odds of this hike taking place in six months are now close to 50%.

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