

**Central Banks**

# Sizable upward revision to core inflation forecasts points to more tightening

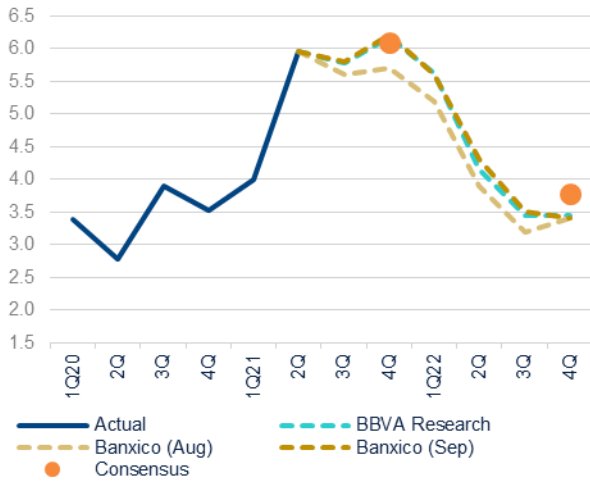
Javier Amador / Carlos Serrano  
September 30, 2021

## The tightening cycle will likely continue, but we stick with our more dovish view than priced in by markets for 2022

- **Banxico hiked the policy rate by 25bp to 4.75%; the wording of the Statement was broadly unchanged.** The central bank still thinks that current inflation pressures will prove temporary, acknowledges that long-term inflation expectations have remained stable, and continues to project that inflation will ease sharply in 2H22. Yet, the majority of the Board also continues to believe that additional pre-emptive tightening is warranted: “Although the shocks that have affected inflation are expected to be transitory, due to the diversity, magnitude and the extended horizon in which they have affected it, may imply risks for the formation prices and inflation expectations”.
- **However, two major changes point to more tightening.** The first major hawkish signal is that Galia Borja, who had joined Gerardo Esquivel in voting for a pause in the previous two meetings, voted in favor of a 25bp rate hike this meeting. The second is that Banxico revised up its core inflation forecasts, which were already higher than consensus expectations (see figure 2). We were expecting the updated headline projected inflation path to come close to our expected path as it did (see figure 1), but we were not anticipating a further upward revision of core inflation forecasts. This revision was significant and implies that Banxico is now expecting core inflation to reach levels of c. 5.5% by year end, significantly above consensus and BBVA Research’s forecasts (see figure 2). This change likely led Galia Borja to vote for a rate hike.
- **Considering that Banxico expects core inflation pressures to intensify in coming months, we stick with our base scenario of one more 25bp rate hike in November but our bias now shifts to an additional one to 5.25% in December.** Yet, as inflation is expected to decline sharply next year and taking into account the implied tightening with an increasing ex-ante real policy rate, a wide negative output gap, and with a new governor, likely more dovish, we stick with our view that the tightening cycle will not reach the c. 6.0%-6.25% levels currently priced in by markets.

**Banxico's updated headline inflation path now mimics ours...**

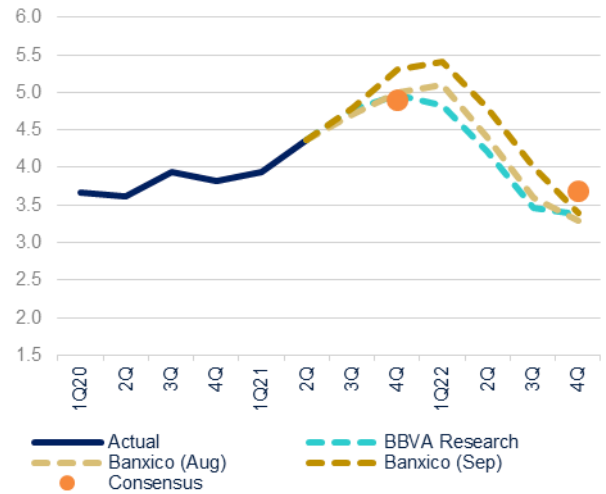
Figure 1. **HEADLINE INFLATION OUTLOOK (YoY % CHANGE)**



Source: BBVA Research / Banxico / Bloomberg / Banamex Surveys

**... but its core inflation forecasts are much more negative than consensus and ours**

Figure 2. **CORE INFLATION OUTLOOK (YoY % CHANGE)**



Source: BBVA Research / Banxico / Bloomberg / Banamex Surveys

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### ENQUIRIES TO:

BBVA Research – BBVA: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.

Tel.: +52 55 5621 3434

[bbvaresearch@bbva.com](mailto:bbvaresearch@bbva.com) [www.bbvaresearch.com](http://www.bbvaresearch.com)

