

Central Banks

# We expect another 25bp hike to 5.0% and think that the chance of a larger hike is low

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## In our view, it would be important for the Board not to signal the possibility of a faster pace of tightening

- **A strong core inflation print and a further rise in 12-months ahead core inflation expectations will keep Banxico in a tightening mode.** Inflation was broadly in line with our above-consensus forecasts in October with the headline rate rising 0.84% MoM and core inflation increasing 0.49% MoM. The annual rates keep trending upwards: headline inflation was 6.24% YoY, up from 6.0% in September, while core inflation was 5.19%, up from 4.92% in September. Inflation is set to increase further in November with unfavorable base effects. We expect headline and core inflations to reach 6.9% YoY and 5.4% YoY, respectively. Furthermore, 12-month ahead inflation expectations continue to climb, with the both the headline and core 12-month expected inflation rates rising to 3.8% in Banxico's October Survey, up 0.1pp. Although short-term inflation pressures remain linked to transitory factors, namely the effects on goods prices of global supply disruptions and the effects on services prices of the continued reopening of the economy, Banxico has signaled that they will continue to pre-emptively hike the policy rate to avoid a possible increase in mid-term inflation expectations. This in a context in which price pressures have been driven by changes in relative prices,
- **We expect Banxico to revise upwards its headline inflation forecasts for 4Q21 and 1Q22 and we would not be surprised if one of the hawk members of the Board votes for a larger 50bp hike.** With headline inflation set to increase sharply in November, Banxico's current 6.2% YoY average expected inflation in 4Q21 is unlikely and thus, an upward revision to a level close to our 6.7% YoY forecast is likely. Higher inflation at the end of the year implies higher year-on-year inflation at the start of 2022. Thus, Banxico will likely also revise up the 5.6% average expected inflation in 1Q22. We do not anticipate a notable revision for the following quarters and thus we anticipate that Banxico will stick to its story, consistent with ours, of inflation starting to ease in 2Q and easing sharply in 2H22. We do not anticipate major changes to core inflation forecasts. It is possible that one member will vote for a larger 50bp hike.
- **Yet, we think that the majority of the Board will not vote for a larger hike.** We think that a faster pace of tightening is not warranted and would risk and unwanted excessive policy tightening in 2022. With medium-term inflation expectations well anchored, Banxico should signal that the current gradual pace of rate increases is adequate as it continues to give time to assess how price pressures and expectations evolve. Moreover, GDP slightly contracted in Q3 and there are no signs of demand-side pressures that would prove sticky. Both the economy and the labor market still have plenty of slack, and the Mexican recovery is slower than in other Latin-American economies. Lastly, if Banxico hikes the policy rate by 25bp two more times by year end, it will take the rate close to the neutral estimated level with the Federal Reserve about to start the liftoff in late 2022. We think that it is a better strategy to avoid increasing rates faster.

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