

Banxico Watch

Banxico shifts to a steeper tightening pace

Javier Amador / Carlos Serrano
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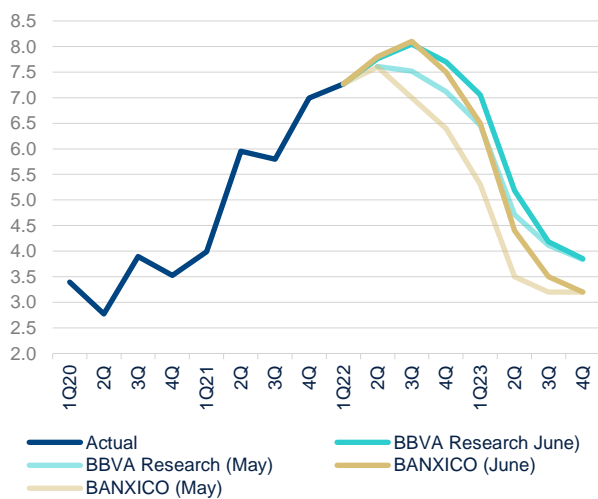
We expect the policy rate to peak at 9.50% in this cycle

- **Banxico raised the policy rate by 75bp to 7.75% and signaled that another hike of this size was possible at its next meeting, but also that a larger hike was unlikely:** “[...], the Board intends to continue increasing the reference rate and will consider acting with the same forcefulness in case it is required”. The (unanimous) decision was widely expected ([see](#)). The decision came a few hours after inflation in the first half of June surprised (sharply) to the upside. Thus, in our view, the forward guidance given by the Board does not intend to further step up the tightening pace is a strong hint that, in line with our view ([see](#)), the most likely scenario is that Banxico will match Fed’s expected hikes through December, taking the policy rate to 9.50% by year-end.
- **Banxico revised sharply to the upside the expected path for both headline and core inflation, as we anticipated.** It now expects headline and core inflations to average 7.5% and 6.8% in 4Q22, up from 6.4% and 5.9%, respectively. To account for today’s big inflation surprise (+0.2% FoF for both headline and core inflation prints) we also adjusted to the upside our expected headline and core inflation trajectories. We now expect inflation to peak in 3Q (as opposed to 2Q previously) and we continue to expect that inflation will start to ease in 4Q, but at a somewhat slower pace compared to Banxico’s expected paths (see Figures 1 and 2). We (now) anticipate headline inflation to average 7.7% in 4Q (0.2pp above Banxico’s new forecast) with core averaging 7.1% in the same quarter (+0.3pp compared to Banxico’s 6.8% forecast). An additional upward revision to its inflation forecasts might be in the cards at the next scheduled meeting (Aug) if today’s big inflation surprise was not fully accounted for.
- **With high odds that the Fed will repeat the 75bp hike in July, we continue to expect Banxico to repeat today’s (75bp) move at its next meeting in August.** Besides, we think that the Fed will shift to a smaller 50bp hike in September, and will follow with two 25bp in November and December. After today’s decision, the strong negative inflation surprise, and the Board’s hint that it does not plan to further up the tightening pace, we continue to think that Banxico will match the 175bp worth of additional hikes that the Fed will likely deliver by year-end. We thus continue to expect Banxico to take the policy rate to 9.50% by December. **We think that the policy rate will peak at 9.50% in this cycle**, given that our expectation is that inflation will start to ease in 4Q22 and the economy will continue to show plenty of slack. We thus think that Banxico will stop following the Fed in early 2023 if it keeps up increasing the fed funds rate by then.
- **In our view, for coming meetings it would be useful for markets and analysts to get a better understanding of Banxico’s goals with its policy tightening. Forward guidance as to what specifically it is aiming for with the current tightening pace and what signals is looking for before it shifts to smaller hikes and/or before the cycle comes to an end would be very useful.** The Fed has acknowledged that a lot is beyond the influence of its tools but also signaled that it is trying to slow demand (demand is much stronger in the US and its demand could have an influence on global imbalances) and avoid a de-anchoring of long-run inflation expectations. There is no pressing need for Banxico to slow domestic demand, which is weak and likely to weaken further with increasing headwinds. Are hikes only objective is to anchor expectations? Is

avoiding the Mexican peso from depreciating another goal? What signal will mark a shift? What have the 375bp worth of hikes during this cycle have attained so far?

Both headline and core inflations are now expected to peak in 3Q22

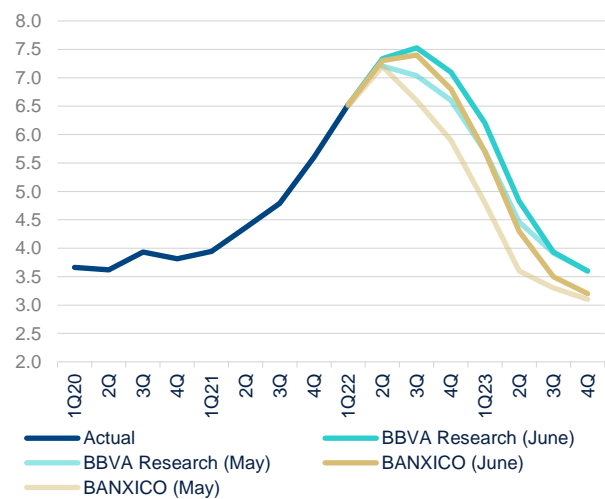
Figure 3. **HEADLINE INFLATION OUTLOOK**
(YoY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research based on data by INEGI and BANXICO.

An additional upward revision to its inflation forecasts might be in the cards at the next scheduled meeting (Aug)

Figure 4. **CORE INFLATION OUTLOOK**
(YoY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research based on data by INEGI and BANXICO.

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