BBVA Research

Banxico Watch

One more rate hike to come and done? We expect one last 25bp hike at February's meeting

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December 15, 2022

Banxico signals that the tightening cycle is about to end

- **Banxico continued following in the footsteps of the Fed and lifted the policy rate by 50bp, to 10.50%, as widely expected. All members voted for the 50bp hike except for Gerardo Esquivel that voted for a smaller 25bp hike.** Similar to the Fed's slowdown in the pace of hikes yesterday (see). Banxico also shifted to a 50bp rate hike today, following four consecutive 75bp interest rate hikes. **Yet, while the Fed signaled multiple hikes in 2023 and suggested that the policy rate might peak above 5%, Banxico strongly hinted that the end of the tightening cycle is in sight.** This is in line with our base scenario which anticipates that the Fed will decouple from the Fed in March (in that month we expect the Fed to lift the fed funds rate 25bp and we anticipate that Banxico will start a relatively short-lived pause and move to the sidelines with the rate at 10.75%).

- **The Board added a line in the policy paragraph that points to only one more hike at the first meeting of next year**: "The board considers it will still be necessary to raise the reference rate in its next monetary policy meeting". Banxico left the door open for a smaller last hike saying that “it will assess [...] the pace of adjustments based on the prevailing conditions”. We stick to our call that Banxico will match the Fed one last time andhike the policy rate by 25bp to end the cycle at the February meeting when signs that the inflation rate will be declining and economic activity decelerating there will become more evident.

- **Banxico fine-tuned its projected paths for headline and core inflation. It now expects a 8.1% YoY for headline inflation in 4Q22 (down from 8.3%).** It adjusted its expectation for core inflation for this quarter to 8.5% YoY(up from 8.3%), slightly above our 8.4% YoY forecast. For 4Q23 Banxico now expects headline and core inflation to average 4.2% and 4.3%, respectively (up from 4.1% and 4.1%), broadly in line with our 4.1% and 4.2%. The big picture is that Banxico continues to anticipate a marked inflation easing next year, as we do, contrast to analysts’ conesus that anticipates a 5.1% inflation rate at the end of the year. Our view that both headline and core inflation will ease markedly (to 4.0% by Dec-23) is much more positive than the one held by the consensus (5.1%).

- **Today’s decision and strong hint strongly supports our view that Banxico will decouple from the Fed as early as in March**. We continue to expect that with excessively high real rates in a context of a worsening economic outlook and improving inflation outlook, Banxico will start to cut rates before the Fed, in 3Q23. By August next year, with inflation likely around 4.3%, the real expost rate will soar to c. 6.5%, while the real ex ante rate will be even higher, probably c. 7.0%, significantly higher than the US. These levels together with weaker growth, much lower inflation and milder inflation risks will likely draw Banxico to start a gradual rate cut cycle. Looking ahead, inflation will be driven more by services than goods and Banxico will need to take into account that monetary policy is less effective against inflation in services. We continue to expect the monetary policy rate to end next year at 9.75% and 2024 at 7.75%. We expect a faster pace of easing compared to the consensus which is anticipating a 10.25% level by the end of next year. In particular, we think that in the coming months Banxico will need to start pondering the risks of thigherning too much. We think that the economic scenario in a few quarters will bias the outlook to even somewhat lower rates ahead. In the short term, the most likely scenario is one more smaller 25bp hike in February to close the tightening cycle.

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