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Banxico Watch

Banxico slows the pace of hikes and hints at possible end of the hiking cycle…

Javier Amador / Carlos Serrano

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… but inflation data will tell

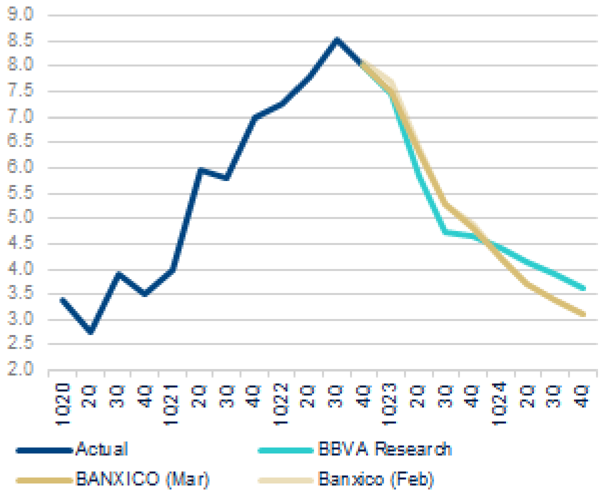
- **Banxico raised the policy rate by 25 bp to 11.25%, took a less hawkish tone and left the door wide open for a pause at the next meeting in May.** The five members of the Board voted for the smaller-sized hike. As we argued in our note two days ago, a sign pointing to the near end of the cycle was likely. Also, as we anticipated, Banxico pointed out that future moves are more uncertain (see). **Banxico acknowledged that inflation is slowing**: “[...] annual headline inflation has decreased more than expected”, while core inflation has come down “gradually”. Moreover, it pointed out that "with this action, [...] the monetary policy stance adjusts to the trajectory required for inflation to converge to its 3% target within the forecast horizon."

- **Banxico revised down its headline inflation forecasts for the next two quarters and brought them closer to our projected path** (see figure 1), but, as we anticipated, moved slightly up its short-term core inflation forecasts, also to bring them in line with ours (see figure 2). It continued to characterize the balance of risks to inflation as biased to the upside. We think that Banxico was conservative in its downward revision to its 2Q and 3Q headline inflation forecasts (see figure 1). Considering that by the time of the next meeting in May headline inflation will have gone further down by at least 1 pp while core inflation will likely fall around 1.5 pp, we think that Banxico will characterize inflation risks as balanced in May. Moreover, given that consensus will likely gradually come round to the view that inflation is easing more than most are penciling in, real ex ante rates will likely rise more than 1 pp, to a very restrictive +7.0%, by May. **If our inflation forecasts prove accurate, we think that today’s change in tone implies that the odds of a pause in May will be above 50%.** Yet, Banxico has frequently acted in a backward-looking fashion, most recently in February when it surprised everyone and raised rates by 50 bp in response to a temporary rebound in inflation in January after having signaled that a smaller hike was likely. Thus, an additional hike cannot be ruled out if inflation pressures resurface, even if considered temporary i.e., if solely driven by supply-shocks..

- **Banxico** dropped the language pointing to future hikes in its forward guidance, and instead **suggested that future moves will be inflation-data dependent, and will take into account “the monetary policy stance already attained”.** Thus, although Banxico gave no explicit guidance on its next steps, and said that future decisions will depend on the inflation path, we think that inflation will come down faster than expected by Banxico in the next two months, which will open the door for a pause in a context of higher real interest rates (i.e., a more restrictive policy stance). Moreover, Banxico stated that it is now taking into account the tightening in global financial conditions. **We now think that the odds of an 11.25% peak for the monetary policy rate increased sharply today.** Looking further ahead, we continue to think that Banxico is likely to move to the sidelines for a relatively long period of time, but will embark in a rapid rate-cutting cycle beginning in 1Q24. We anticipate that Banxico will cut the policy rate by 300 bp during 2024 to a level of 8.50% by the end of next year in order to prevent real ex ante rates from becoming excessively high, which will be unwarranted with falling inflation. In fact, we think current levels are already unwarranted considering that real rates are set to increase sharply and that the disinflationary process is already underway. . Given that even after these expected cuts the real rate would remain very high, we have a downward bias for this forecast.

Banxico adjusted down its short-term inflation outlook, bringing it closer to ours…

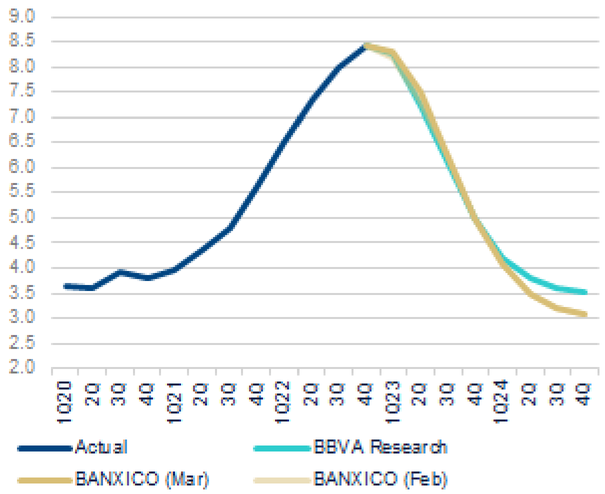
Figure 1. **HEADLINE INFLATION OUTLOOK** (YOY % CHANGE, QUARTERLY AVERAGE)



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

… but revised up its short-term core inflation forecasts, to bring them in line with our path

Figure 2. **CORE INFLATION OUTLOOK** (YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research based on data byINEGI & BANXICO.

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