

Banxico Watch

Banxico ends hiking cycle...

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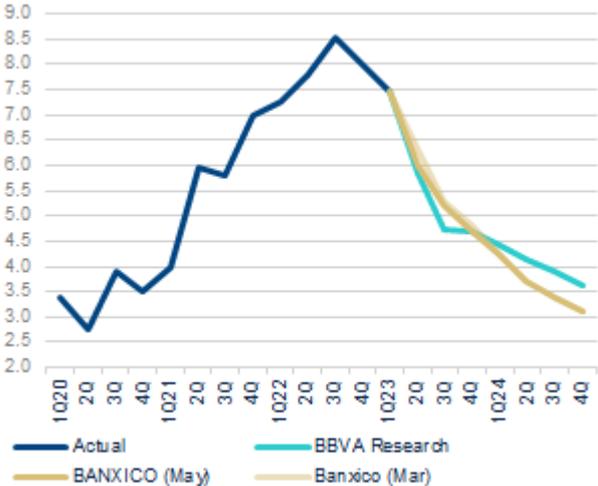
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... but will keep rates on hold for a while

- Banxico, in an unanimous decision, kept the policy rate steady at 11.25%, ending the fastest-ever rate-hiking cycle.** The decision was widely expected after Banxico dropped the explicit call for more hikes in the previous statement, the minutes struck a more dovish tone, core inflation started to ease more rapidly, the Fed signaled it was most likely done hiking rates, and the Governor said it late April that the Board would consider pausing at this meeting. **Banxico acknowledged that a “disinflationary phase” is underway, headline inflation “continued to slow” and the latest core inflation reading “[...] showed a more marked reduction”.**
- As we anticipated (see), Banxico revised down its 2023 headline inflation path to bring it closer to our forecasts** (see figure 1) and fine-tuned its short-term core inflation forecasts, adjusting to the downside this quarter’s forecast. We think that headline inflation is going to ease somewhat more rapidly than what Banxico expects this quarter and next (see figure 1) but its average 4Q forecast (4.7%) is now in line with ours. Banxico’s 2023 core inflation expected path remains broadly in line with ours (see figure 2). Yet, the central bank continued to characterize the balance of risks to inflation as biased to the upside. **Since the economy “has started to undergo a disinflationary process” we can be confident that following today’s decision the hiking cycle is now over.**
- Looking ahead, as we expected, Banxico signaled that it will keep the policy rate unchanged for a while.** As we argued yesterday (see), Banxico stated that it will keep the policy rate “at its current level for an extended period”, moving to the sidelines in the coming meetings. The next move is not around the corner but after a long pause Banxico will shift to rate cuts. The main question going forward is whether Banxico will keep rates steady throughout the remainder of 2023 allowing the real ex-ante rate to increase further (beyond 7.0-7.5%) given that inflation will not yet fall back to the target range, or will be forward-looking and start to cut the nominal policy rate in 4Q. With either option, **monetary policy will remain very tight in the foreseeable future. We think Banxico should not tighten the stance further in 2023. Thus, with inflation easing towards 4.5% by year end, we think Banxico should start to cut rates in 4Q.** The exchange rate reaction to the pause was muted. We expect that a strong peso will allow Banxico to start a rate cut cycle before the Fed.

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

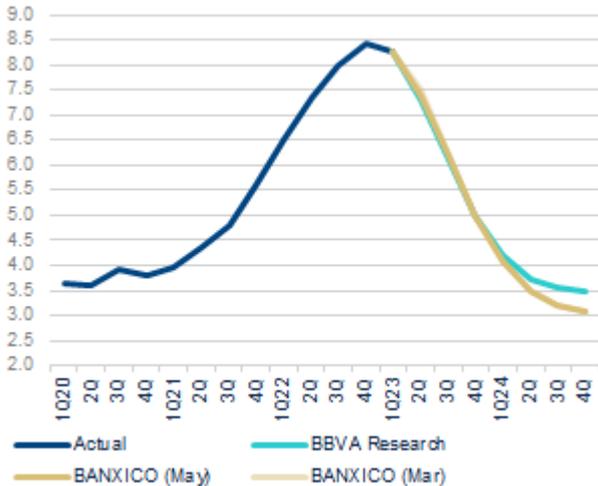
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



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

... and fine-tuned this quarter's core inflation forecast to the downside

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



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

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