

## Banxico Watch

# Banxico will hold the policy rate steady at 11.25%

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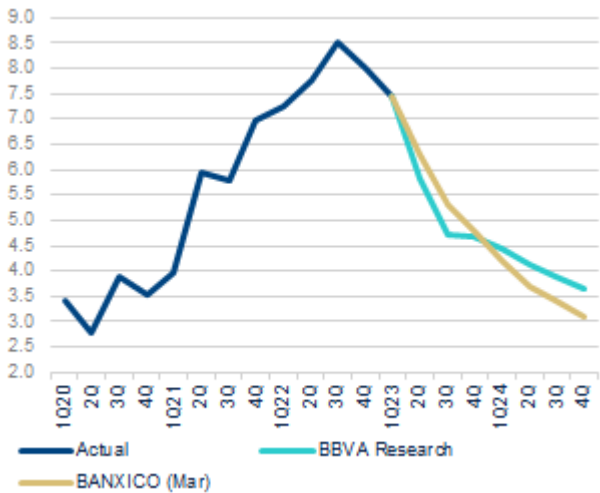
May 17, 2023

## The next move is not around the corner but will be a cut

- Two weeks ago, the Fed** hiked the fed funds rate 25 bp to 5.00-5.25% but **strongly hinted that it's done hiking rates**. In the Q&A, Chair Powell put a dovish spin to the still hawkish statement and signaled that the Fed will likely be patient on inflation since bringing it down to 2.0% "[is] going to take some time, and it's not going to be a smooth process." Although, as we expected, hopes of rate cuts any time soon were dashed, we expect Fed's next move to be a rate cut (for more [see](#)). After the Fed's move, the spread between the policy rate in Mexico and the fed funds rate fell back to 600 bp (from 625 bp following Banxico's surprising 50 bp hike in Feb), a much higher level than the c. 450 bp average observed in the last 15 years. **The Mexican peso has strengthened further over the past two weeks even as expectations of a pause built up (i.e., despite projections of some narrowing in the interest rate spread)** following better-than-expected inflation data, the discussion within last meeting's Minutes in which at least two members felt that peak rates had already been reached, and comments from two members of the Board, the Governor being one of them, strongly signaling that they were ready to vote for a pause at this upcoming meeting. **A more dovish Fed, strongly signaling that it will now move to the sidelines and a stronger peso give Banxico room to start a pause at this meeting.**
- Over the intermeeting period, headline inflation eased more rapidly than projected by Banxico, while core inflation came down somewhat more than Banxico's expected path.** Since the previous meeting, headline inflation has eased (-)0.9 pp to 6.3% YoY and core inflation has come down (-)0.5 pp, to 7.7% YoY. We project that headline inflation is set to moderate in 2Q 0.5 pp more than what Banxico was expecting in March to a 5.8% average and core inflation will likely ease in this quarter 0.2 pp more than projected by Banxico in the last meeting. Thus, we think that **Banxico will revise down its 2023 headline inflation path to bring it closer to our forecasts** (see figure 1) and also believe that it might fine-tune its short-term core inflation forecasts (see figure 2). Moreover, within core inflation, core goods inflation has continued to ease, while core services inflation stopped increasing in April and finally started to show initial signs that it might be starting to slow down. Fundamental core, which had been increasing for almost two years, is now declining. **A sharper drop in both headline and core inflation is in store, as suggested by trend measures** (see figures 3 and 4) based on seasonally-adjusted monthly prints. Thus, Banxico might feel some comfort knowing that the core inflation seasonally-adjusted trend points to a downward pathway in the coming months that will finally break the stickiness shown over 4Q22 and 1Q23. By the end of this year, we anticipate levels of 4.6% YoY and 4.8% YoY, respectively for headline and core inflation.
- In a backdrop of a less hawkish Fed, easing inflation, a strong peso, and market and consensus expectations of a pause, **we expect Banxico to hold the policy rate steady at 11.25% and signal that it will most likely move to the sidelines** to assess how the elevated real ex-ante rate (set to breach 7.0% next month as expectations fall with current inflation and stay above that level over coming months) feeds in the economy weakening demand -in a context of decelerating US economy- to bring about softer inflation. Banxico's next move is not around the corner but will most likely be a cut. **With inflation easing towards 4.5% by year end, we now have a strong bias that Banxico might start to cut rates in 4Q and considering the overly tight monetary stance, we think it should.**

**Headline inflation has eased more rapidly than projected by Banxico...**

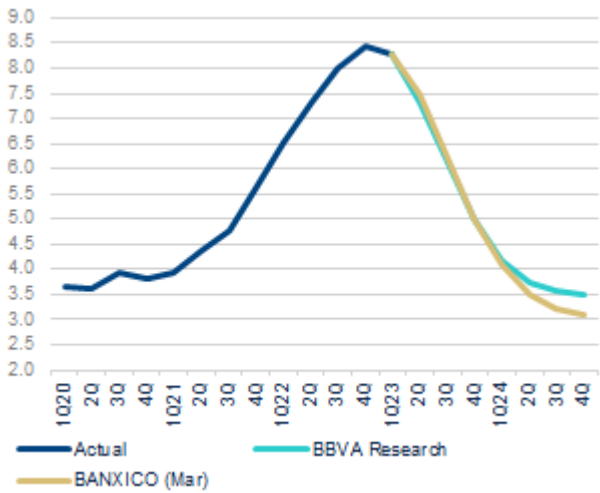
Figure 1. **HEADLINE INFLATION OUTLOOK**  
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research based on data byBANXICO & INEGI.

**... and core inflation has come down somewhat more compared to Banxico's expected path**

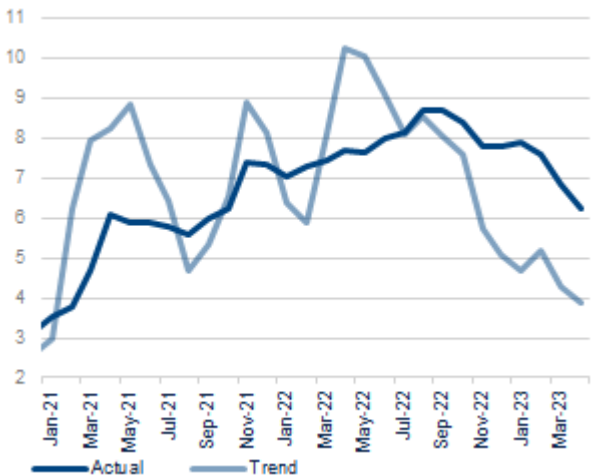
Figure 2. **CORE INFLATION OUTLOOK**  
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research based on data byBANXICO & INEGI.

**A sharper drop in both headline and core inflation is in store...**

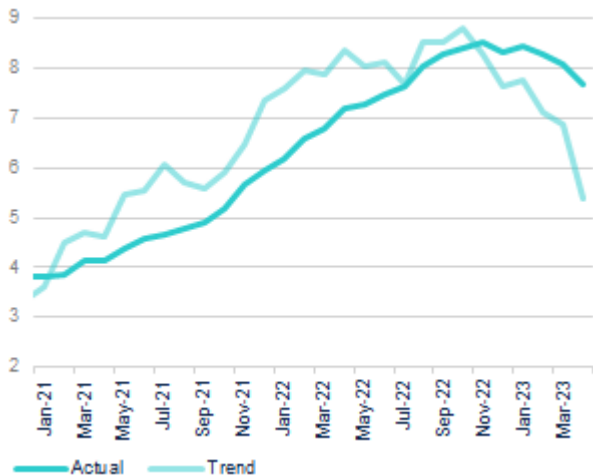
Figure 1. **HEADLINE INFLATION: ACTUAL & SA TREND\***  
(YOY % CHANGE & 3MMA MOM ANNUALIZED % CHANGE OF SA INDEX)



Source: BBVA Research based on data by INEGI.  
\*Own calculations.

**... as suggested by trend measures**

Figure 2. **CORE INFLATION: ACTUAL & SA TREND\***  
(YOY % CHANGE & 3MMA MOM ANNUALIZED % CHANGE OF SA INDEX)



Source: BBVA Research based on data by INEGI  
\*Own calculations.

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