Banxico Watch

Banxico hints it will likely cut rates in March…

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… but signals cautiousness once it begins a rate-cut cycle

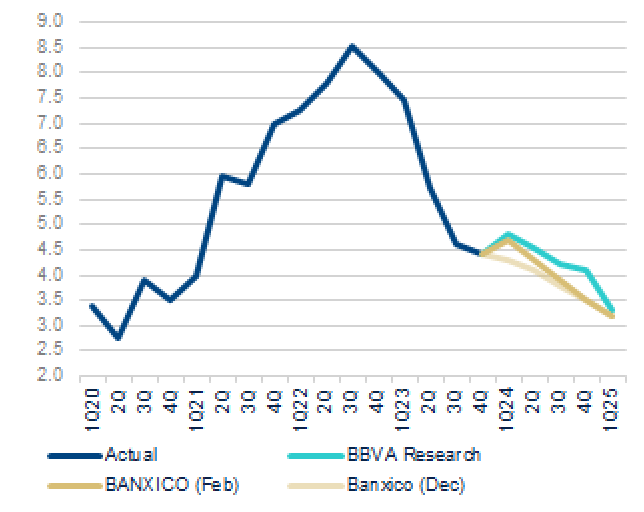
- **Banxico kept the policy rate unchanged at 11.25% for the seventh consecutive meeting but continued to pave the way to likely start an easing cycle in the next meeting (March), as we anticipated and in line with our baseline scenario** (see). The decision to stay on the sidelines one more meeting was expected by most analysts (27 out of 30 in the latest Banamex Survey), and it was again unanimous. Following last week's 4Q23 GDP release, Banxico downgraded its assessment for economic activity, which "slowed down more than anticipated," but concerns seem to persist among Board members regarding continued risks stemming from a "labor market [that] remained strong."

- **A key change in the wording of the statement hints that Banxico will likely start to cut rates in March.** As we anticipated, Banxico revised upwards its short-term headline inflation expected path on "supply shocks on some specific items of the non-core component," but also noted that "headline inflation is still foreseen to converge to the target in 2Q25." At the same time, Banxico fine-tuned its 1Q24 core inflation forecasts to the downside. With these adjustments, Banxico brought both paths closer to ours (Figures 1 and 2). As we also expected, the Board continued to describe (for the last meeting?) inflation risks as biased to the upside but also acknowledged that "core inflation, which better reflects the trend in inflation, continued decreasing," and repeated that it expects the disinflation process to continue. Under this backdrop, the statement included a key change in the forward guidance signals that Banxico is getting ready to start a rate cut cycle, further opening the door for it to begin as soon as at its next meeting in March: instead of repeating that the policy rate was likely to be kept unchanged "at its current level for some time," it now states that "in the next monetary policy meetings, [the Board] will assess, depending on available information, the possibility of adjusting the reference rate."

- **We think that Banxico will cut the policy rate by 25 bps to 11.0% in the next meeting in March to avoid an unwarranted increase in the already overly restrictive real ex-ante policy rate.** We also continue to think that, considering the restrictive monetary policy stance, the core inflation trend, and the exchange rate levels, Banxico should not skip rate cuts at any meetings, but its cautiousness, hawkishness, and recent Board members' hints suggest that consecutive rate cuts are still unlikely at the start of the gradual easing cycle. Banxico is also likely to stay cautious in the next few quarters and may not want to cut by larger 50 bps moves at any meeting this year, even if that implies keeping the stance excessively restrictive. They will also be conservative at the beginning of the easing cycle until they get more clarity as to how the Fed will conduct its own cycle. Today's statement reflected some of this caution by stating that "the [inflation] outlook is still challenging." Thus, we continue to expect Banxico to bring down the policy rate to 9.0% by year-end 2024, but risks are tilted to a somewhat higher rate.

Banxico revised upwards its short term headline inflation expected path as we expected…

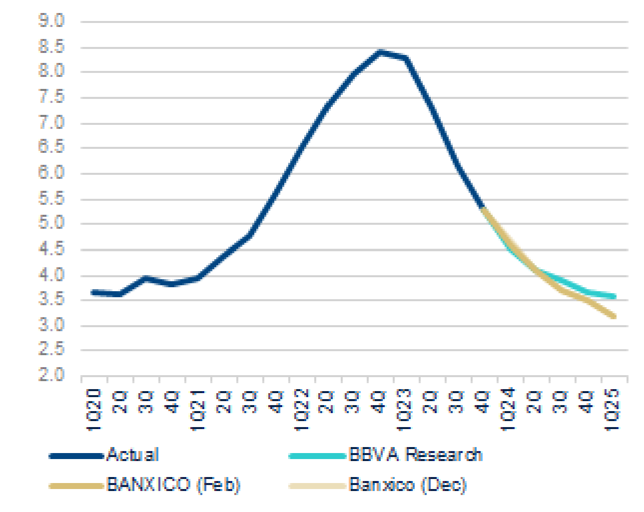
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



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

… but revised somewhat down its 1Q24 core inflation forecasts, bringing both closer to ours

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



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

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