

Banxico Watch

Rate cut cycle gets underway

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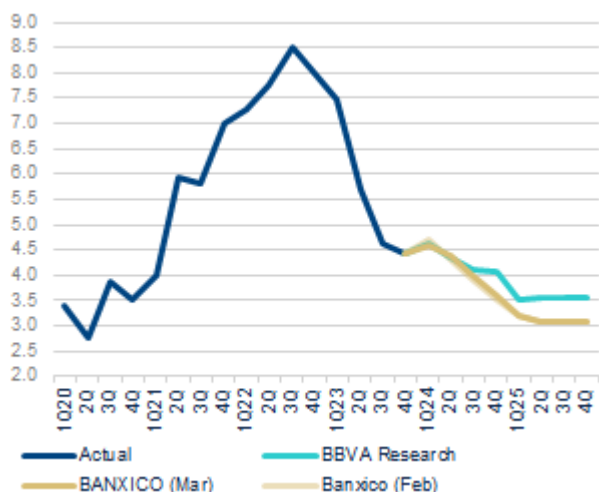
Albeit wording gives little forward guidance, it leaves the door open for consecutive rate cuts ahead

- **As widely expected, Banxico cut the policy rate by 25 bps to 11.00%, following a 4-to-1 vote, as we anticipated (see).** The decision to finally begin to prevent a further tightening of what we consider an overly restrictive policy stance comes after yesterday's Fed decision to keep the target range for the fed funds rate at 5.25-5.50% (see). Thus, the spread between both countries' target rates narrowed somewhat to 550 bps, still well above its one-decade pre-pandemic 450 bp average level, giving Banxico a wide margin to continue normalizing the policy rate going forward without risking, in our view, a sharp depreciation of the peso in the short term. The muted reaction of the exchange rate following the rate cut supports this outlook. Moreover, some orderly depreciation of the exchange rate would be a positive factor for the economy.
- **Wording signals that Banxico will remain cautious.** A majority of Board members decided to deliver a long-anticipated first rate cut even as they reiterated that the balance of risks to inflation remains biased to the upside and they expect the Mexican economy "to show greater dynamism" during 1Q24 "compared to the weakness of the previous quarter." The labor market is still considered to have remained "strong," although it is off to a weaker start in 2024 compared to the last two years, and while a somewhat higher emphasis was added to Banxico's acknowledgement of the disinflationary process, which has been "underway since the last time the reference rate was adjusted," it continued to convey a cautious tone as "challenges and risks [...] prevail, which requires monetary policy to continue being managed prudently."
- **Minor changes to inflation forecasts do not change the expectation of further inflation easing ahead.** Banxico fine-tuned its inflation forecasts but expects "the disinflation process to continue." The forecasts for headline and core inflation were fine-tuned to no more than a 0.1 pp change for any quarter. Year-end core inflation forecasts were left unchanged and "remain practically at the same levels as those of the previous meeting" for this quarter and the following two, while headline inflation is still foreseen to converge to the target in 2Q25 (Figures 1 and 2).
- **Little forward guidance, but the wording leaves the door open for consecutive rate cuts ahead.** Although Banxico didn't commit to any additional rate cuts going forward, by stating that in future meetings, "it will make decisions depending on available information," it left the door open to cut the policy rate in consecutive meetings ahead, as will likely be warranted in our view.
- **This first cut marks the start of a long and gradual easing cycle that will most likely keep the monetary policy stance restrictive throughout this year and next.** We continue to expect Banxico to cut the policy rate at each remaining meeting in 2024 (even if the vote probably becomes 3-2 at some point in the following meetings, probably as of June) to bring the policy rate down to 9.25% by year-end, thus avoiding an unwarranted further increase in the real ex-ante rate in 2Q24, and starting to gradually ease the very tight stance in 2H24 when we believe core inflation will be below its upper bound target of 4%. Even if Banxico

lowers the nominal rate to 9.25% by December and to 7.25% by the end of next year as we expect, the stance will clearly remain restrictive throughout 2024-25, and the real ex-ante policy rate will most likely remain above the upper limit of the neutral estimated range of 3.4%. That is, we think that Banxico has plenty of room to cut the policy rate without skipping any meetings in the remainder of the year and in 2025.

Banxico brought closer its headline inflation expected path to ours...

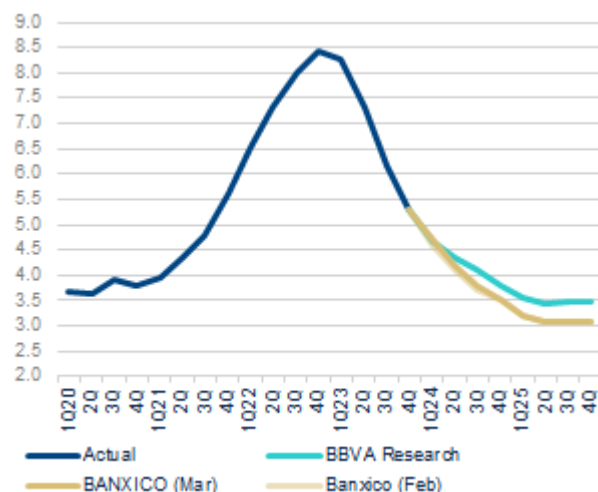
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



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

... and kept its core inflation forecasts mostly unchanged

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



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

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