MNI Market Analysis

MNI Banxico Preview: May 2022

Monetary policy decision and statement release: 1900BST/1400ET - Thursday, May 12, 2022

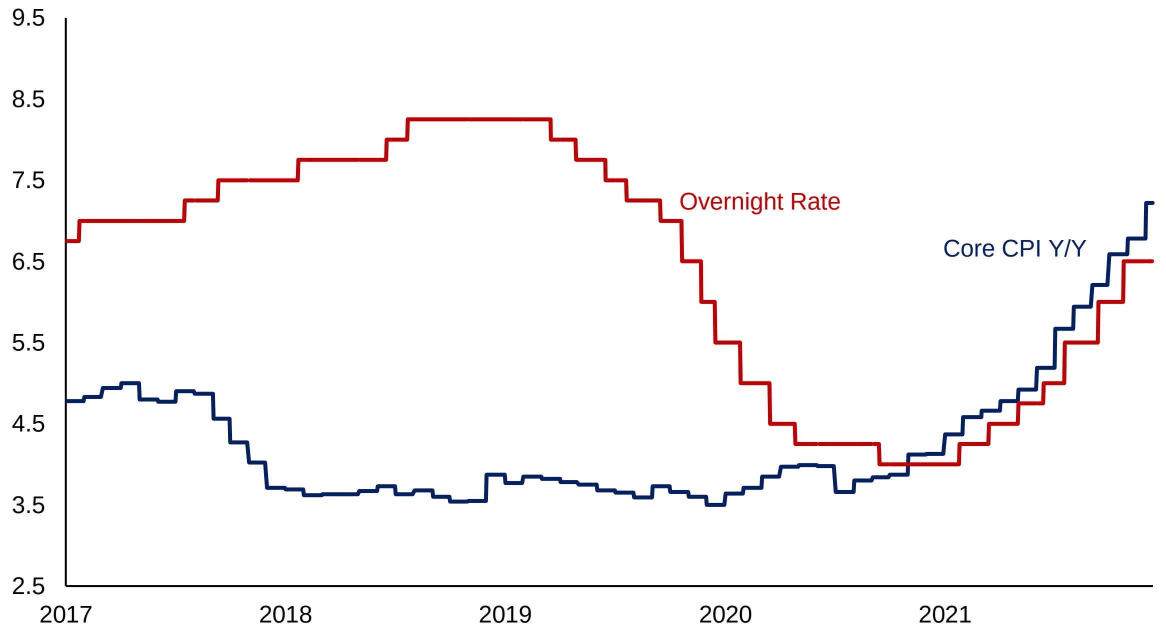
MNI Point of View

Banxico are expected to raise rates by a further 50bps to a new cycle high of 7.00% at the May meeting, retaining the pace of tightening from the previous three policy meetings. A 50bps move is consensus, despite a further deterioration in the inflation outlook, which is expected to prompt another upward revision to CPI forecasts at this meeting. A sharper than expected upward revision to forecasts could prompt a small number of policymakers to opt for a 75bps hike this month, but they're expected to be among the minority.

A 50bps rate rise at this meeting would be consistent with the rationale behind the previous three 50bps hikes in this cycle: shoring up domestic financial markets (particularly the MXN), actively heading off rising inflation expectations and keeping an eye on a tightening Federal Reserve, which has accelerated their respective pace of hikes.

At April's inflation print, there were signs that certain energy prices were moderating, however persistent increases in food prices are clearly a cause for concern at both Banxico as well as the central government. AMLO has already unveiled a scheme with major retailers to freeze the prices of certain staple goods including corn, rice and beans. Nonetheless, the effectiveness of these measures won't factor into this month's Banxico forecast, which should see both 2022 and 2023 inflation forecasts revised higher by 50-100bps apiece.

Figure 1: Core CPI is still outstripping policy rates



Source: MNI/Bloomberg

Markets will watch the vote split among the Banxico board this month for any clue on whether the tightening cycle could accelerate at coming meetings should the inflation outlook worsen further – and particularly if foreign central banks, namely the Fed, opt for more expedited tightening. The "greater inflation pressures" noted at the March rate decision have only accelerated over the subsequent six weeks, which should prompt the board to retain a hawkish stance in the accompanying statement.

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This turns focus to market expectations for Banxico's terminal rate. Sell-side analysts generally expect a further 100-150bps of tightening on top of an assumed 50bps May hike, putting the terminal rate at 8.00-8.50% at roughly the end of 2022. While a member voting for 75bps at the May meeting may be construed as near-term hawkish, it may not necessarily point toward a higher terminal rate. A number of members of the board have expressed their preference for front-loaded tightening, meaning a vote for a 75bps hike may be a preference for reaching the terminal rate faster, rather than seeing a rate north of 8.0-8.5%.

Figure 2: Banxico's March Inflation Forecasts

Forecasts for Headline and Core Inflation

Annual percentage change of quarterly average indices

	2021				2022				2023				2024
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
CPI													
Current (03/24/2022)[1/]	**4.0**	**6.0**	**5.8**	**7.0**	**7.2**	**6.9**	**6.1**	**5.5**	**4.5**	**3.4**	**3.2**	**3.2**	**3.1**
Previous (02/10/2022)[2/]	4.0	6.0	5.8	**7.0**	6.9	5.4	4.6	4.0	3.4	3.2	3.1	3.1	
Core													
Current (03/24/2022)[1/]	**3.9**	**4.4**	**4.8**	**5.6**	**6.5**	**6.7**	**5.9**	**5.2**	**4.1**	**3.4**	**3.1**	**3.1**	**3.0**
Previous (02/10/2022)[2/]	3.9	4.4	4.8	**5.6**	6.4	6.1	5.1	4.3	3.3	2.9	2.7	2.7	
Memo													
Annualized seasonally adjusted quarterly variation in percent[3/]													
Current - CPI[1/]	5.8	8.7	6.5	7.0	6.9	7.0	3.7	4.4	3.0	2.5	3.2	4.0	2.8
Current - Core[1/]	3.9	5.3	6.7	6.6	7.5	5.8	3.7	3.8	3.1	3.0	2.8	3.4	2.7

Source: Banxico

The last point of note from the May statement will be the estimate by which the bank see convergence to the 3.0% inflation target. Alongside an upgrade to CPI forecasts this month, it's possible the estimate slips a few quarters from the current view of Q1 2024.

MNI Banxico Data Watch List

Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	7.7	7.1	↑	6.2	↑					1.49
Core CPI	% y/y	7.2	6.2	↑	5.2	↑					1.46
Bi-Weekly CPI	% y/y	0.2	0.4	↓	0.4	↓					-0.82
Oil Price (WTI Active)	$	102.53	83.85	↑	75.42	↑					1.54
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
PMI Manufacturing	Index	49.3	46.1	↑	49.3	→					1.01
GDP	% y/y	1.6	19.6	↓	-8.7	↑					0.24
Industrial Man Prod	% y/y	2.5	1.7	↑	5.5	↓					-0.36
Economic Activity IGAE	% y/y	2.45	1.61	↑	4.33	↓					0.02
Monetary Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
M3 Money Supply	% y/y	8.0	10.0	↓	6.4	↑					-0.45
Non-Fin Corp Credit	% y/y	-0.9	2.8	↓	5.3	↓					-1.41
Household Credit	% y/y	16.4	17.3	↓	16.2	↑					-0.63
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% m/m	6.4	4.9	↑	5.9	↑					0.82
Consumer Confidence (Q)	Index	44.3	43.4	↑	43.6	↑					0.28
Unemployment Rate	%	3.0	3.5	↓	4.2	↓					-1.87
Nominal Wage Increase	% y/y	5.4	5.6	↓	4.2	↑					-0.22
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Bolsa Mexicana	Index	49,116	51,331	↓	51,310	↓					-0.42
Local 10-Year Yield	%	9.09	7.66	↑	7.49	↑					2.15

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

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Analyst Views (Alphabetical Order)

Banorte: To continue with 50bps hikes in May, pressured by the Fed and inflation conditions

- We forecast a 50bps hike in the reference rate to 7.00%. We believe that conditions for a tightening of this magnitude are clear, an increase of the same magnitude by the Fed last Wednesday, volatility in financial markets and persistence of inflationary pressures, especially in food items.
- As such, we expect the tone to remain hawkish, in what will likely be a unanimous decision for a second straight meeting. We consider that the relative performance of USD/MXN reaffirms the need to maintain a cautious stance, which has characterized Banxico for a while.
- On prices, annual inflation – both headline and core – kept increasing in the 1st half of April. Latest figures showed a moderation in some energy items, consistent with dynamics in international references, although with signs of a recent rebound. Nevertheless, food – both processed and fresh – maintain a concerning trend.
- The government presented a plan to combat inflation, centered in 24 basic goods. However, considering the nature of these actions and that it is still too early to measure their potential impact, the central banks will have to continue with the restriction to continue fighting this problem in coming months.
- In this context, we expect inflation forecasts from the central bank to be revised higher once again, especially for 2022. For example, Banxico's headline and core inflation estimates for 2Q22 stand at 6.9% and 6.7% y/y on average, respectively. Both are 60bps lower than our estimates of 7.5% and 7.3%, in the same order.
- Given recent dynamics and new price shocks, we find it very unlikely that these estimates are achieved. We believe forecasts for at least the next four quarters will be adjusted higher. A key issue will be if the estimated moment of convergence to target (currently in 1Q24) is delayed even further.

Barclays: Expects bank to keep pace and hike 50bps

- We expect Banxico to maintain its pace of hiking at 50bp, leaving its policy rate at 7.00%. The statement and Board's decision would be consistent with a hawkish tone, given that Banxico will likely update its inflation forecasts to the upside, amid some inflation risks materialization and slower convergence of inflation toward target under the forecast horizon, and tighter external conditions with the US Fed also hiking 50bp.
- We do not discard at least one member discussing the possibility of a 75bp hike, given this environment, but if there is another meeting at which Banxico hikes 25bp more than the FOMC, as in the previous one, it could become part of an expected reaction function, which could complicate matters if it later decides to decouple from the Fed, an idea that several board members have entertained.
- Finally, the government's recent plan to fight inflation, which focuses on a potential reduction in costs to companies and avoids direct price controls, supports our view that inflation reached its peak and that there is no need to increase pace of hiking.

Goldman Sachs: Expects the MPC to follow up with another 50bp hike

- Another 50bps rate hike is justified by the deterioration of the current and prospective inflation outlook, intense pressures on core inflation, further deterioration of inflation expectations, expected FOMC hawkish Fed Funds path, and the value in the current context for the MPC and, in particular, the new central bank governor, to establish strong inflation fighting credentials.
- We expect the forward guidance to remain data-dependent and the MPC to continue to express clear discomfort with the short-term inflation dynamics and to expect headline and core inflation to converge to the 3% target only by the end of the relevant horizon for monetary policy (1H2024).
- As well as the decision itself we will be looking for implicit and/or explicit references to the depth of the current hiking cycle, and how the FOMC signaling conditions Banxico' s short-term calibration of monetary policy.

JP Morgan: To hike 50bp; hawkish tilt likely, with at least one dissenting vote for 75bp

- Banxico's concerns are likely to focus more on the seeming deterioration in the price process ("formación de precios") amid an on-going rise in medium-term inflation expectations. Relative monetary conditions on the back of the Fed's recent and expected rate hikes should also figure prominently. On expectations, four-years-out headline inflation expectations continue to drift higher, with core inflation expectations held up at a record high.
- There seems to be an ongoing deterioration in the price process about which Banxico is likely becoming more anxious. Furthermore, regardless of the sources of upward pressure, short-term inflation dynamics continue to deteriorate, and the market is becoming increasingly skeptical about the Bank's ability to bring inflation back within the target range in coming years.
- Banxico's reaction function should remain unaffected by government measures on inflation. Additionally, Fed tightening seems to warrant at least similar rate hikes by Banxico, with risks tilted toward the CB delivering even more. In fact, we think there will likely be at least one vote out of five in favor of a 75bp hike, with all other board members supporting the 50bp hike.
- We continue to see an additional 150bp of hikes this year following next week's expected increase. Of note, Banxico's short-term inflation forecasts are again running low, in our view, and we expect an upward revision of roughly a full 1%-pt to year-end headline and core inflation estimates (5.5% and 5.2% currently, each).

Morgan Stanley: Expects Banxico to deliver a 50bp hike, in line with consensus and market pricing.

- The latest pricing for Banxico's terminal rate is hovering around 9.60% by February 2023, incorporating expectations that Banxico will continue to deliver 50bp hikes at the subsequent two meetings (June and August).
- Importantly, the curve is not pricing in any meaningful chance of an increase in the pace of hikes to 75bp in the near term, suggesting that risks are skewed towards more front-loading of pricing should the vote split change.

Scotiabank: Fed eased pressure on Banxico last week

- Markets are pricing a policy rate toward 9½% within a year from now which is above the 8¼% peak our economists expect for later this year.
- When Fed Chair Powell ruled out 75bps hikes and left estimates of the US neutral rate untouched, the effect was to somewhat ease up on pressures on Mexico's central bank. Having said that, inflation at 7½% y/y and core CPI at 6¾% y/y remain far above the 3% target.

SocGen: To continue 50bps hikes at both May and June meetings

- With inflationary pressure remaining acute, we expect Banxico to implement a 50bp rate hike in each of its next two meetings (May/June). The pace of tightening will likely be slowed in 2H22, but upside risks are significant both due to the uncertain inflation outlook, and the pace of the Fed tightening cycle.
- The Bank of Mexico tightened the policy rate by another 50bp to 6.50% in March taking total rate hikes in this tightening cycle to 250bp. The central bank had also raised its inflation forecasts in March in line with price data releases and following domestic and international developments, particularly rising commodity prices and a persistently difficult supply situation.
- Considering more recent data flow and the continued supply-side pressure on prices, we expect Banxico to again adjust its inflation forecasts upward in May.
- With inflation more than double the target, the Fed beginning the tightening cycle and real interest rates still negative, we expect the Bank of Mexico to continue to tighten at the current pace at both its meetings in 2Q22 (50bp each in May and June) followed by slower pace of tightening throughout 2H22.

TD Securities: See 50bps this month, and four further hikes until November

- The market is already pricing in some substantial increase in policy rates in 2022, suggesting that real rates will tend to rise going forward. We concur and expect another 50bps hike by Banxico this week and four further consecutive hikes until November. This will help to both counter rising inflation (and gradually take real rates into neutral or positive territory), while offsetting future Fed tightening.
- Until the end of 2022, the market is priced for approximately 270bps of additional tightening that would increase Banxico's Overnight Rate to around 9.20% (data as of 10 May). This is a modest decrease compared to a week prior, showing that the market may have already priced in a full tightening cycle. Mexico's Overnight Rate currently stands at 6.50%, below nominal inflation, which is a condition Banxico will want to normalize. This almost surely suggests another hike at the 12 May MPC meeting.
- Another factor suggesting more, but quite predictable, tightening is Banxico's historical wariness of Fed moves, especially to the upside. This means that Banxico would usually match Fed tightening on a one-for-one basis, or deliver more, in the early stages of the Fed tightening cycle, to later soften the pace. Banxico has already delivered substantial tightening since mid-2021 (+250bps to date), at an accelerating pace (+25bps in the first four meetings until December 2021, then +50bps in the successive three meetings), while the Fed also accelerated to +50bps steps but seems to have ruled out hastier 75bps moves.
- All this suggests that it seems reasonable to expect another 50bps hike by Banxico this week. Moreover, we continue to believe that the current pace will be held for at least the following four of its five meetings into year-end (Banxico's decisions are scheduled approximately every 45 days). This will help to both counter rising inflation (and gradually take real rates into neutral or positive territory), while offsetting future Fed tightening.

UBS: Sees Banxico maintaining pace of hikes at 50bps

- We expect Banxico to raise rates to 7.00% even though the Fed just accelerated its own pace of hikes and that Banxico will almost certainly adjust its inflation forecasts upwards once more at this meeting (by 100bps and 60bps on average over the next four quarters for headline and core respectively, if Banxico’s numbers are anything like our own).
- The Banxico board may consider a 75bp hike at this meeting, but we think the majority of the board will likely opt for maintaining the current pace of hikes (in fact, we expect the decision to be unanimous once more).
- The key problem we see with accelerating rate hikes is that Banxico would risk running out of runway: real rates are already on the verge of neutrality, and moving on 75bp clips would soon land Mexico in tight monetary territory. We don't see this as warranted just yet for an economy with the biggest output gap in the region, with the peso well behaved, and with close to half of inflation explained by external food price shocks.
- For now, we remain of the view that the terminal rate will be in the 8-8.5% range, barring persistent upward surprises to inflation or a meltdown in the peso.

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