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Banxico Watch

75bp hike a done deal; all eyes on hints of a near end of the tightening cycle

Javier Amador / Carlos Serrano

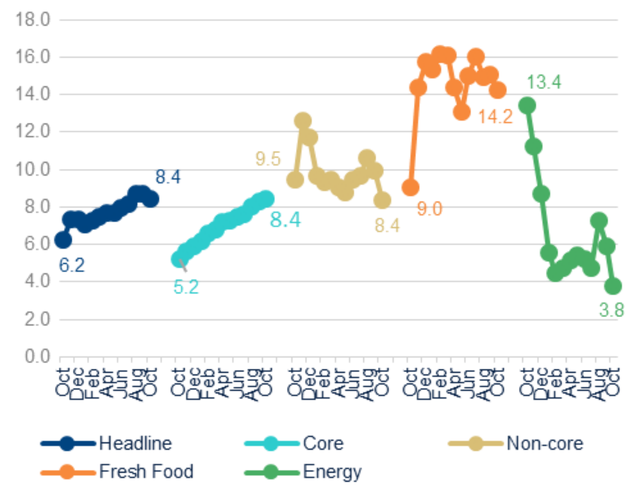
November 9, 2022

Will Banxico hint at a possible decouple from the Fed in the near term? Core inflation data will hold the key

- **Banxico will continue following in the footsteps of the Federal Reserve (Fed) and will lift the policy rate by 75bp, to 10.00%.** Last week, the Fed delivered the fourth consecutive 75bp hike, taking rates to 3.75-4.00%, as widely expected, but surprised markets with a much more hawkish tone. Speed is now less important for the Fed, but the ultimate rate level will be higher than previously projected by the FOMC, expected by most analysts and priced in by financial markets. Powell's remarks signaled that a majority of FOMC members are now projecting a (higher) peak target range of 4.75-5.00%, in line with our recently revised baseline scenario which anticipates a 5.00% peak fed funds rate that will be reached in 1Q23 (for more see). That is, likely there is still 100bp worth of additional hikes for the fed funds rate. **The main question going forward is whether Banxico will stick to its strategy of matching every additional Fed hike or will start to discuss a decouple from the Fed as soon as in December?**
- October's inflation data confirm that **headline inflation is likely now past its peak, but core inflation has not yet started to soften and edged up in October** (Figures 1 and 2). Yet, most core inflation components are showing signs of peaking (Figure 2). The one that is still driving core inflation up is core food goods which should, as in other countries, not be classified within core prices. Banxico should take comfort that all the other core inflation components have stabilized. Moreover, a discussion about recent inflation trends in spite of all the tightening over 2022 should bring about a discussion within the Board about the little impact that a much tighter stance has had on inflation considering that the main drivers have been global and have mostly come from external supply factors, something that is reflected in the low pace of recovery of the Mexican economy. In fact, Banxico started the hiking cycle before other central banks and core inflation has yet to soften. Besides, **with tomorrow's 75bp hike, the real ex-ante policy rate will be 4.50%. With inflation set to soften ahead (Figures 3 and 4), the monetary policy stance will become much more restrictive fast**. In our view, Banxico should start decoupling from upcoming fed funds rate hikes (likely worth an additional 100bp). **If Banxico matches future expected fed funds rate hikes, the real ex-ante would soar to 7.00%, an excessively tight stance in a context of waning demand and easing inflationary pressures.**
- **Will Banxico hint that the tightening cycle will soon come to a close? We think it should but we do not expect clear signals in the statement.** Yet, with the strong 3Q GDP print showing that the economy expanded above trend (1.0% QoQ) and with core inflation still edging higher, we think that Banxico will not yet signal that it will consider decoupling from the Fed as soon as in December. Given that Banxico has yet to show that it is willing to let the interest rate spread narrow somewhat in the short term, we think that the end of the tightening cycle is getting closer but that there is still additional tightening in the pipeline. In December we still expect them to match the Fed with a 50bp or 75bp hike. **Signs of a policy shift to a slower pace of hikes are possible but probably still unlikely, thus, all eyes will be on hints of what Banxico will be looking for in the data to slow the tightening pace and then end the cycle.**

The job creation pace is slowing down and job openings are falling quickly, but labor demand…

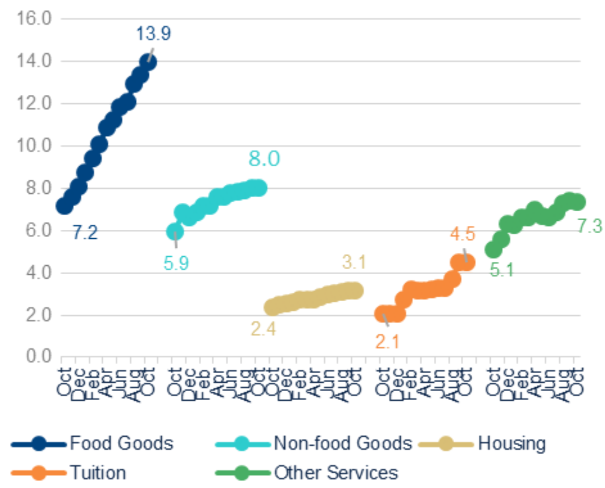
Figure 1. **HEADLINE INFLATION BREAKDOWN (YOY % CHANGE)**



Source: BBVA Research based on data by INEGI.

… needs to fall further for the labor market to rebalance and for core services inflation to peak

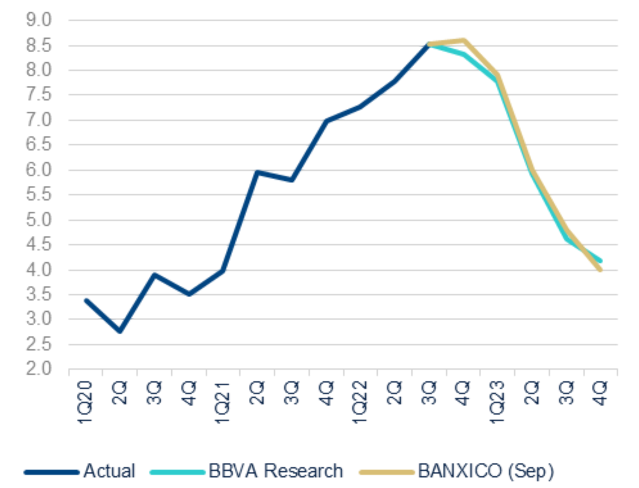
Figure 2. **CORE INFLATION BREAKDOWN (YOY % CHANGE)**



Source: BBVA Research based on data by INEGI..

Core goods inflation rapid easing will not be enough to bring core inflation down to 2.0%

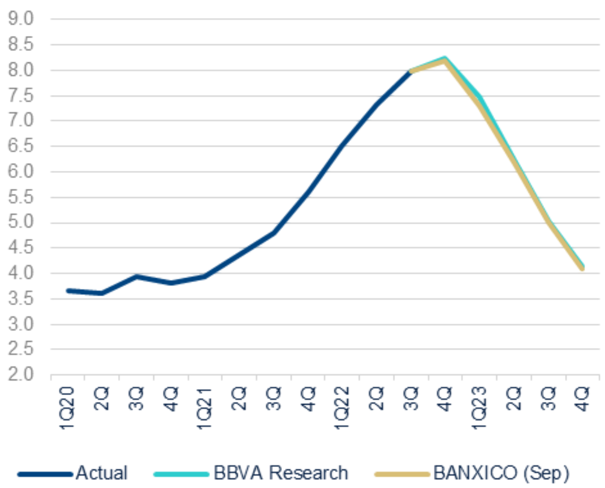
Figure 3. **HEADLINE INFLATION OUTLOOK (YOY % CHANGE)**



Source: BBVA Research based on data by INEGI.

The Fed will leave the door wide open for either a fifth 75bp hike or a smaller 50bp hike

Figure 4. **CORE INFLATION OUTLOOK (YOY % CHANGE)**



Source: BBVA Research based on data by INEGI.

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