

Banxico Watch

Banxico holds rates steady...

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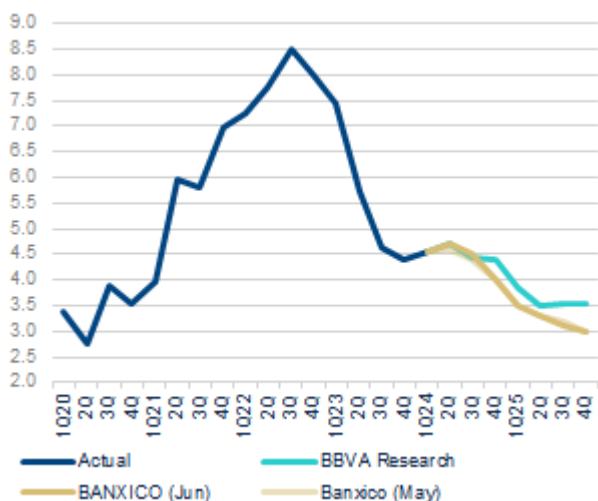
... but paves the way for a rate cut soon (in the next meeting?) with many dovish tweaks in the wording of the statement

- **Banxico's five-member board voted 4-1 to hold rates steady at 11.00%.** While the decision to leave rates unchanged was widely expected and anticipated by an ample majority of analysts, the fact that the decision wasn't unanimous came as a bit of surprise considering the recent peso weakening and that Banxico was set to revise up its short-term headline inflation forecasts. More so given that Omar Mejía, who voted for a 25bp rate cut at this meeting had voted for a pause in May after hinting that he was leaning for a rate cut. We fully agree with Omar Mejía's vote as we have been arguing that the current stance is overly restrictive ([see](#)) and unwarranted considering the inflation dynamics and expectations. This vote further highlights differing points of view within the Board in a context in which core inflation is set to decelerate for the 17th month in a row in June, expectations are well-anchored, activity has continued to come in weaker than expected and the real ex-ante rate stands at 7.2% i.e., the policy stance is overly tight.
- **Banxico continues to signal it will proceed with caution, but a less hawkish wording opens the door for a rate cut as soon as in the next meeting (in early August).** Admittedly, the statement acknowledged that the peso had weakened "noticeably" owing to "idiosyncratic factors", but it was downplayed after noting that "more recently, domestic financial markets have displayed a better behavior" and while Banxico revised up its near-term headline inflation forecasts as we expected, it mostly left its core inflation forecasts unchanged as we also anticipated. On economic activity, the wording dropped the reference to a strong labor market from the last statement, said that economic activity weakness continued at the start of the second quarter, and noteworthy added that "the balance of risks to growth of economic activity is biased to the downside". Moreover, in the policy paragraph Banxico said that going forward it will take into account the "effects of a weaker-than-anticipated economic activity [on inflation]" when assessing the possibility of cutting rates. On inflation, Banxico continues to expect the disinflationary process to continue while it acknowledges that the impact of a weaker peso is "partly offset" by the effects of "the greater weakness" of economic activity. We can think it can more than offset it, considering the low levels of exchange rate pass-through observed in recent years. Although in Banxico's view the balance of risks to inflation remains biased to the upside, **the Board now "foresees that the inflationary environment may allow for discussing reference rate adjustments."** Taking together all these dovish tweaks, our perception is that Banxico will likely discuss a rate cut as soon as in the next meeting in early August and is hinting that if financial risks do not surge, it will most likely cut rates in either August or September.
- **Overall, Banxico seems to have opened the door to a 25bp cut at the August meeting.** Banxico clearly dialed down its recent hawkishness in spite of peso's weakening and short-term risks, and while it continues to strike a cautious tone, it is increasingly acknowledging the weaker economic activity in a context in which the policy stance is set to remain overly restrictive throughout 2H24-2025 (i.e., for a longer period than warranted in our view) with core inflation softening further. **We expect that Banxico will cut the policy rate only twice this year by 25 bps each (in August or September and November or December) followed by cuts at**

each of next year's eight policy meetings (200bp worth of cuts). This means that in the absence of an acceleration in the expected rate cut cycle, the policy stance will remain very restrictive during 2024-25, with an ex-ante real rate well above 3.4%, the upper limit of the estimated range for the neutral rate in the long term.

Banxico brought even closer its headline inflation expected path to ours for this and next quarters...

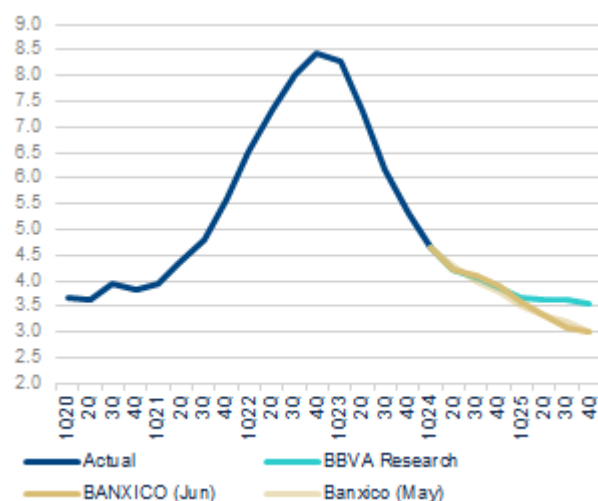
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

... and left mostly unchanged its core inflation forecasts, which remain close to ours for 2Q-1Q25

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



Source: BBVA Research / Banxico / INEGI

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