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Banxico Watch

Banxico cuts rates again; signals more easing ahead

Javier Amador / Iván Fernández / Carlos Serrano

September 26, 2024

Forward guidance suggests a streak of consecutive rate cuts ahead is likely

- **Banxico lowered its policy rate by 25 bps for the second consecutive meeting, to 10.50%.** Following the 3-2 divided vote of the last meeting, a fourth member of the Board joined the three less hawkish members in voting for a rate cut. Yet, unexpectedly, it was Deputy Governor Irene Espinosa, perceived by most (until now?) as the most hawkish member. Deputy Governor Jonathan Heath voted to hold the rate steady at 10.75%. His views have become harder to pinpoint. Although he expressed concerns about the possible effect of last month's rate cut on Banxico's credibility[1], he seemed open to vote for rate cuts as soon as in today's meeting just five days after that[2]. With headline inflation cooling substantially from its recent peak over the last four fortnights (coming down from 5.6% YoY to 4.7%), core inflation easing further (it is now set to cool down for the 20th month in a row in September), and in a backdrop of worsening growth prospects, we thought he could joined in voting for a rate cut at today's meeting. We will know more about the reasons behind his dissenting vote when the minutes are released.
- **Although we think that a 50bp cut would have been welcomed given that before today's rate cut the real ex-ante rate had not yet started to decline, we believed a smaller 25bp move was more likely.** As we argued in our note before the meeting, the favorable inflation trend in the intermeeting period strongly supported the view that the 3-2 vote in favor of a 25bp rate cut in August was the right one, since July's surge of non-core inflation proved to be driven by a short-lived change in relative prices, against which a monetary policy response is useless in a backdrop of well-anchored inflation expectations (for more see). Today's decision was expected by most analysts (30 out of 36 in the latest Banamex Survey), but some (6) were anticipating a bigger 50bp rate cut.
- **The wording of the statement turned more dovish, but remained cautious. The forward guidance signaled more confidence about the rate cut cycle going forward.** Although Banxico reiterated that the balance of risks to inflation remains biased to the upside, it also stated that the "inflation outlook has been improving." Furthermore, albeit Banxico said that the improving inflation outlook "still calls for a restrictive monetary policy stance," it also underscored that it expects core inflation to keep decreasing. We think that both the solid macro fundamentals and the weak exchange-rate pass-through, particularly in a context of weakening demand, have prevented Board members from showing significant signs of concern about the exchange rate depreciation since the outcome of June's elections. Although it is well known that core services inflation is the main reason behind Banxico's cautiousness, the wording of the statement did not acknowledge

[1] "Headline inflation cannot be rising and we are lowering rates, it is contradictory, it goes against expectations."
[2] I think the moment "when we can systematically lower rates is around the corner."

its continued stickiness. In our view, core services inflation is set to break its stickiness in coming months in a context of weakening economic activity and slower job creation. The increased confidence of a majority of Board members on the inflation outlook seems also to be anchored on the expectation of “a partial reversal in the supply shocks,” which implies that a further cooling of non-core inflation is in the pipeline. Worsening growth prospects were another element supporting today’s decision, as worries around economic activity have continued to build up: “economic activity is undergoing a period of weakness, [...] employment has slowed down [and] the balance of risks to growth remains biased to the downside.” We share these concerns, but at the same time think that Banxico still fails to acknowledge that part of such weakness can be attributable to an excessively tight monetary policy stance that has been held for longer than warranted. In fact, in view of the lags of monetary policy, we think that Banxico is already late in adjusting the excessively high real ex-ante rate, and thus, the monetary policy stance is set to continue to weigh on the economy in the coming quarters.

- **Banxico left its inflation forecasts mostly unchanged: it revised down slightly (by 0.1 pp) its 4Q24 headline estimate and its 4Q24 and 1Q25 core inflation forecasts.** After these changes, Banxico’s core inflation projections for the next two quarters now match ours (see Figure 2), but it remains more optimistic about the scope for headline inflation easing by the end of the year. This optimism probably reflects the recent changes Inegi made to the inflation components’ weights. Electricity prices, which are seasonally set to increase sharply over the next two months, now weigh less, and thus, monthly inflation in October and November will likely be lower than in previous years.

- **The forward guidance now strongly suggests that Banxico is set to embark in a streak of consecutive rate cuts ahead.** It seems that in a backdrop of an “improving” inflation outlook and worsening growth prospects, a majority of members do not share Deputy Governor Jonathan Heath’s view that only a fine-tuning of the current monetary policy restriction is possible as long as long-term inflation expectations remain above the 3.0% target. Instead, they probably think the central bank has ample wiggle room to cut rates. Board members now expect that the inflationary environment “will allow further reference rate adjustments.” Banxico was not as confident in August when it anticipated that lower inflation pressures “may allow” further rate cuts going forward. We do not only think that Banxico should keep cutting rates without any pause in the future but also consider that at some point in 2025 it should consider a faster rate-cut pace given that, even if as we expect the central bank is not likely to take a breather in any meeting in the foreseeable future, monetary policy will remain restrictive throughout this and next year with inflation well below 4.0% during 2025. We expect two more 25bp rate cuts in November and December, to 10.00%, while our 2025 year-end forecast of 7.50% is below consensus expectations.

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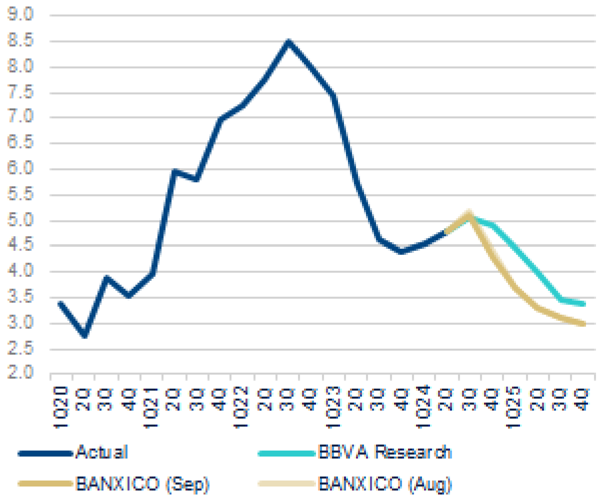
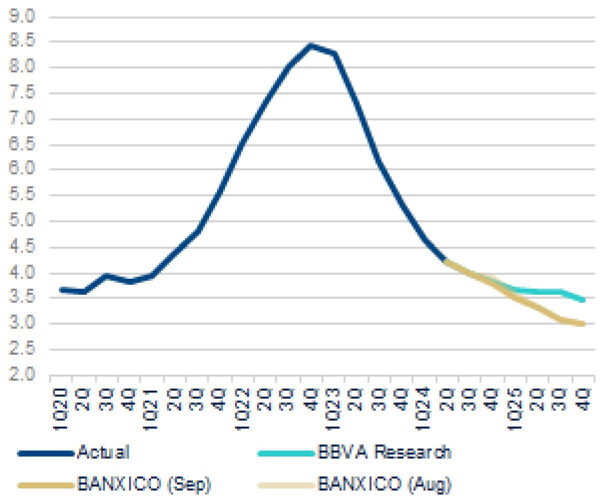
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

… its 4Q24 headline inflation estimate and its 4Q24 and 1Q25 core inflation forecasts

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



Source: BBVA Research / Banxico / INEGI

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ENQUIRIES TO:
BBVA Research: Paseo de la Reforma 510, Colonia Juárez, C.P. 06600 Mexico City, Mexico.
Tel.: +52 55 5621 3434
www.bbvaresearch.com