Banxico adds 25 bps to monetary accommodation and leaves the window for further rate adjustments opened

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- As widely expected, Banco de México reduced the reference rate from 4.50% to 4.25%, in yesterday's monetary policy decision. With this adjustment, it further reduced the ex-ante short term real interest rate from 0.9% to 0.7%.
- Against our expectation of a tight majority decision, it was unanimous, showing that Board members decided to favor the "common ground" found in their willingness to reduce the pace of monetary policy accommodation.
- A more concise accompanying communiqué focused attention on the outlook for inflation as sort of a "sufficient statistic" towards the attainment of Banxico's ultimate goal.
- On this front, the Bank continues believing that current inflation levels do not affect its prospects for headline and core inflations converging to the 3% target within its 12-to-24-month forecast horizon, although it did put special emphasis to the fact that they are subject to considerable short- and medium-term risks.
- All in all, we believe this was a neutral statement, one that did not put an effort to signal that the window for further rate adjustments was closed. Accordingly, we continue expecting an additional and final 25 bps rate cut in November's decision.
- Admittedly, at this point in time, this baseline scenario is almost as likely as one in which the reference rate remains unchanged. Nevertheless, with currently available information, we do believe that there is room for an extra reduction of the ex-ante real rate. More so, if we consider that after grinding the reference rate to a halt, Banxico will maintain that terminal level unchanged for quite some time.

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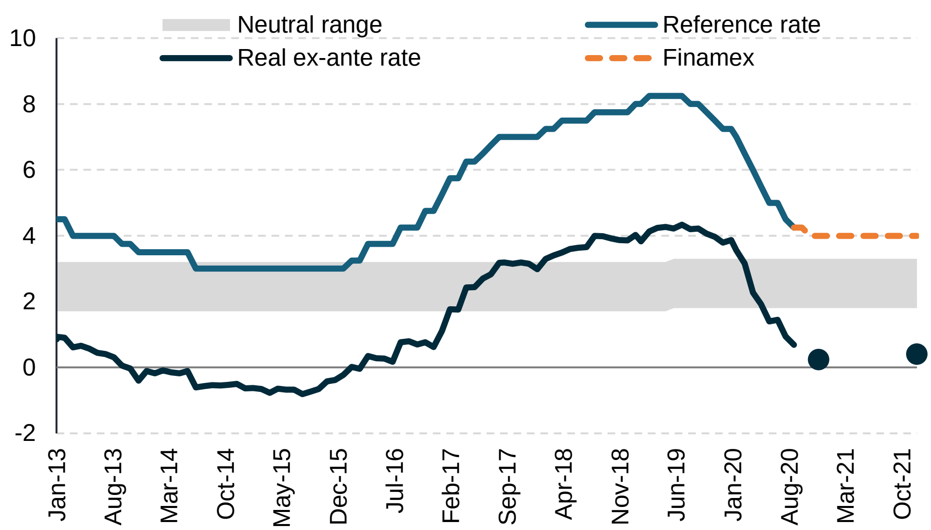
Banco de México reduced the reference rate by 25 bps, from 4.50% to 4.25%, in yesterday's monetary policy decision. With this adjustment, the Central Bank further reduced the ex-ante short term real interest rate –the only one relevant to assess the monetary policy stance, by the way– from 0.9% to 0.7% (see Figure 1). Although the size of the adjustment was widely expected (17 out of 23 economists surveyed by Bloomberg, including us, anticipated the decision), there was more discrepancy about the configuration of votes that would lead to it. Against our expectation of a tight majority decision, it was unanimous (see Table 1).

Figure 1. Reference and real ex-ante rates (%)



Source: Finamex Economic Research with data from Banco de México and Bloomberg.
Note: The shadowed area corresponds to Banco de México's estimated ranges for r* in the long-term.

The overall information provided by the accompanying communiqué leads us to see this outcome as nothing more but the fact that Board members decided to favor the "common ground" found in their willingness to reduce the pace of monetary policy accommodation, and believe it does not say much about each member's preferences regarding the terminal reference rate. We look forward to the corresponding Minutes to learn if the former agreement was also reflected in more unified views about the outlook for inflation, event to which we assign a low probability.

Table 1. Banco de México's Board Members Decisions and Dissents

Decision's date	Previous reference rate	Current reference rate	Movement in the reference rate	Quorum	Unanimous decision?	No. of dissenting votes on: Decision	No. of dissenting votes on: Comuniqué's tone
Sep 26, 2019	8.00%	7.75%	-25		No	2 (-50 bp)	-
Nov14, 2019	7.75%	7.50%	-25		No	2 (-50 bp)	-
Dec 19, 2019	7.50%	7.25%	-25		No	1 (-50 bp)	-
Feb 13, 2020	7.25%	7.00%	-25	5	Yes	-	-
Mar 20, 2020 *	7.00%	6.50%	-50	5	No	1 (-25 bp)	-
Apr 21, 2020 *	6.50%	6.00%	-50	5	Yes	-	-
May 14, 2020	6.00%	5.50%	-50	5	Yes	-	-
Jun 25, 2020	5.50%	5.00%	-50	5	Yes	-	-
Aug 13, 2020	5.00%	4.50%	-50	5	No	1 (-25 bp)	-
Sep 24, 2020	**4.50%**	**4.25%**	**-25**	**5**	**Yes**	**-**	**-**

Source: Finamex Economic Research with data from Banco de México.
*Advanced and out of calendar sessions.

With respect to the accompanying communiqué, it was more concise than in previous decisions. We attributed the former to Banxico's efforts to revamp its communication strategy (announced at the beginning of the year) and, more importantly, to its desire to send the message that the outlook for inflation is the focus of attention –loosely speaking, kind of a sufficient statistic– towards the attainment of its ultimate goal, i.e. inflation convergence to the 3% target.

Accordingly, the policy statement limited to make a factual description of domestic financial markets, economic activity and recent inflation and inflation expectations dynamics. In this regard, two things are noteworthy. First, that by specifying that the environment for economic activity remained uncertain, its balanced of risk tilted to the downside, and that wide slack conditions are expected throughout the control lag of monetary policy, the Central Bank signaled that there was no additional adjustment in its outlook for economic activity since its previous decision. Second, that the Bank continued emphasizing the recomposition –or change in relative prices– within core inflation, "with services inflation remaining low and merchandise inflation increasing."

Now, what about inflation projections? Not much new, which under the current high inflation environment, is a good thing:

i. The Bank continues believing that current inflation levels do not affect its prospects for headline and core inflations converging to the 3% target within its 12-to-24-month forecast horizon, although it did put special emphasis to the fact that they are subject to considerable short- and medium-term risks.

ii. No significant changes to the “balanced” risks to the upside and downside of inflation projections and to the uncertainty surrounding them.

iii. A little –yet important– detail on this front: the clarification that the scenarios that the Governing Board considers to assess their policy action refer to those for inflation.

All in all, we believe this was a neutral statement, one that did not put an effort to signal that the window for further rate adjustments was closed. Indeed, Banco de México acknowledged that its room for maneuver is limited. However, rather than thinking of this as a hawk statement, we interpret it as a natural continuation of its rhetoric towards putting an end to the easing cycle.

Accordingly, we continue expecting an additional and final 25 bps rate cut in November’s decision. Admittedly, at this point in time, with a risk-off episode going on, uncertainty coming from the unfolding of the U.S. presidential elections and the risk of a surge in COVID-19 contagions during fall, on the global front, and with inflation still not registering a clear inflexion point, on the local front, this baseline scenario is almost as likely as one in which the reference rate remains unchanged. Nevertheless, with currently available information, we do believe that there is room for an extra reduction of the ex-ante real rate. More so, if we consider that after grinding the reference rate to a halt, Banxico will maintain that terminal level unchanged for quite some time.

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