

Sovereign Macro- Banxico minutes, will they do 50?

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Bottom line: although the vote was 4-1 in favor of a 25 bp hike, there were two members who preferred, or could have been persuaded, to do 50. So, in my view, the vote was not 4-1, but 2-2-1, meaning that 2 members “voted” for 50, 2 for 25 and 1 for no change. In such a scenario, either the governor was the deciding vote -he clearly argued for 25- or the consensus was to do 25 and avoid a confusing 2-2-1 vote. Generally, the board was concerned about the high and persistent level of inflation and the risk of expectations becoming unanchored. The argument for gradualism championed by the governor prevailed, but one of the dissenting camps noted that the board needed to reconsider whether the pace was appropriate perhaps fearing that they were falling behind the curve adding that it may be necessary to move beyond a neutral stance into restrictive territory. The other dissenting camp (Esquivel) said that increasing rates was ineffective and inefficient and it had failed to contain the deterioration of expectations, consuming important policy space needed when the FED decided to start to normalize rates. The hurdle to do 50 is pretty high, but not impossible, in my view. Either the governor or deputy governor Borja would have to vote for 50. I don't personally see the governor voting for 50 in his last meeting and betray his conviction for gradualism, which in his view, has helped an orderly adjustment of financial markets. Borja is a bit of an unknown but her arguments in the minutes show a cautious attitude. The minutes clarified somewhat the new sentence included in the communique that said that in future decisions “the board will monitor closely the behavior of inflationary pressures as well as that of all the factors that have an effect on the expected trajectory of inflation and its expectations”. (The underlined part was added in the last statement). This addition revealed certain concern about inflation and perhaps a greater willingness to consider the acceleration of the pace. Yesterday's inflation, showing still nasty dynamics -with super core breaking the upper end of the inflation tolerance band- may convince Borja that it is time to act and bring the 50bp decision over the top.

Beyond the December decision, recent developments regarding the appointment of the new governor will make the January decision most interesting. I hope that Banxico finally scores a victory against inflation in 2022.

See individual attributions below, which are purely speculative.

Summary views of board members

Esquivel: Hiking rates will not stop changes in consumption patterns and supply side restrictions, and it hasn't stopped the deterioration of expectations. He argued that the origin of inflation was the same as in other countries, but Mexico could afford to be patient and adopt a less stringent policy since public finances were on better footing. Hiking ahead of the FED would reduce Banxico's policy space when the former decided to start to normalize its interest rates

Borja: it is necessary to act decidedly and with responsibility; policy decisions have to be gradual in size and in time. The estimated range for the neutral range may have declined

(arguing that today's policy may already be closer to neutral). She emphasized that, in this decision, she considered necessary to continue with the monetary reinforcement.

Espinosa: the board must analyze whether the gradual adjustment approach is appropriate considering the lags and its effect on expectations. She thought that if they don't act when there is a significant increase in inflation, it risks de-anchoring of expectations and Banxico's credibility. Increments in inflation should be met with proportional adjustments in the monetary stance. She argued that they should consider the available policy margins to go beyond neutrality and they should calibrate the frontier between the neutral and restrictive postures. Moreover, the relative monetary position will become more important since net foreign financing has turned negative. In her view, an eventual acceleration of the pace should be for a predetermined duration to rule out an unbounded and prolonged cycle that could turn out to be too restrictive. She argued that since monetary tightening will continue, it would be desirable to provide a more explicit guidance of future policy adjustments. Moreover, she argued in favor of providing an actual policy path in their projections much like other central banks do.

Heath: given the evolution of inflation and its expectations and the growing risk of persistence, Banxico should act in a clear and overwhelming way to avoid contamination of the process of price formation that could de-anchor expectations. He argued that avoiding the deterioration of expectations was a clear part of the mandate of many central banks. He argued that based on the available information and the expected trajectory of inflation, Banxico should reduce its monetary stimulus by 50bp. He recognized that while the policy implemented so far is gradual, it also increased the risk of a discrete adjustment in future decisions. The current monetary posture is still accommodative and provides room to make the necessary and sufficient adjustments. He argued that the communique should include the concept that the decision was motivated by their desire to stop the strengthening of second round effects.

Diaz de Leon: he said that considering the magnitude and simultaneity of the inflationary shocks it was necessary to reinforce the policy posture so that the policy rate is consistent, at all times, with a declining path of inflation toward the target. For him, monetary policy must contribute to keeping inflation around its target, providing an orderly adjustment of the economy, the currency market and the yield curve, while avoiding capital outflows. In his view the reinforcement of policy is necessary because otherwise price formation would be adversely affected with significant deterioration in financial markets.

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