Latam Daily: Mexico Central Bank Meeting Minutes and New Inflation Forecast

- **Mexico: Banxico meeting minutes; Review of our inflation forecast**

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MEXICO: BANXICO MEETING MINUTES; REVIEW OF OUR INFLATION FORECAST

I. Banxico Meeting Minutes from September 30 Meeting

Mexico's Central Bank, Banxico, released its minutes from the September 30th monetary policy meeting, giving us additional insights into the thought process of the bank's board members. At the meeting, the board voted for a 25 bps hike (bringing the new rate to 4.75%) in a more hawkish vote (3–2 split) than in the previous meeting.

Highlights from Banxico's meeting minutes:

- **On the imported inflation front, most board members still see external price shocks as driven primarily by commodity price shocks, as well as supply chain disruptions.** Two members of the board also see aggressive fiscal stimulus to consumers, and a decomposition of demand away from services towards goods as part of the story. Overall, this is fairly neutral. The demand side shocks seen by the board are still only acknowledged by a minority.

- **Most board members acknowledged that, although monetary stimulus globally should remain for some time, the FOMC is contemplating the start of its tapering.** Again, this is neutral as only one member of the board spoke about the risk of a taper tantrum, and only one spoke about a rising probability of a 2022 lift off in US policy rates. Banxico often refers to relative monetary conditions as one of the drivers of domestic policy but given that Mexico is front running the Fed, a start of the US hiking cycle likely loses relevance, unless we have disorderly market behavior.

- **On the domestic side, most of the board acknowledged that the recovery process continues, but spare capacity remains, and the recovery pace slowed in recent data prints.** Most of the board remains concerned over the weakness in investment. Overall, we think this part of the discussion is not as relevant for monetary policy. Banxico estimates that the output gap should be virtually shut by the end of 2022 (which most of the board spoke about in the minutes, and the bank's technical staff wrote in the Quarterly Inflation Report), and its estimates of "neutral rates" put it close to 6.0%. Accordingly, our view of policy settings being at neutral by the end of next year seem consistent. However, it's also worth bearing in mind that the TIIE curve now discounts a terminal rate at 7.5%, which would be on the tight side.

- **On the inflation front, it seems like the acceleration we saw in September caught most of the board off guard, which could have contributed to the shift of deputy governor Galia Borja to the pro-tightening camp.** Most of the board also seems concerned both by the continued upward trend in core inflation, and its prolonged period above 4% (the upper boundary of the target range). It's worth noting that although a large share of core inflation pressures has come from merchandise, two members of the board noted the upward swing in services inflation over recent prints. We think this will accelerate into year end, both as a result of base effects, but also the continued reopening of the economy. It's also worth noting that the majority of the board highlighted the continued rise in inflation expectations.

- **The majority of the board also saw most of the current inflationary pressures as being transitory in nature, but they also highlighted the risks that inflation inertia could settle in due to contamination in the price formation process.** As we noted following the release of Banxico's report on regional economies, 55% of manufacturing and 60% of services company executives said they planned to increase their prices at a similar or faster pace over the coming 12 months. This risk seems to be a major factor driving the inflationary spike—and concerns at the board over it.

- **In terms of risks to inflation, the majority also considers that over the policy horizon, the balance of risks remains tilted to the upside.** Esquivel is currently the sole member of the board opposing hikes, and his comment this week seems to shut the door on any near-term shift in camp, given he said in the minutes that "interest rate hikes are ineffective and inefficient".

Table 1
Mexico: Inflation

	2021				2022				2023			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Revised	4.7	5.9	6.0	6.3	5.4	3.7	3.5	3.6	3.4	3.3	3.7	3.5
Previous	4.7	5.9	6.0	6.0	5.5	3.8	3.3	3.5	3.4	3.2	3.6	3.5

Sources: Scotiabank Economics.

II. Revised Inflation Forecast

Regarding our own inflation forecasts, we mostly made upwards revisions to our expected profile for the coming year and a half (table 1), with the bulk of the shocks coming from core inflation. Towards the end of 2021 we expect the contribution in services inflation to rise, but we anticipate that overall core inflation will remain a problem. We are not yet making changes to our expected monetary policy path, but see risks clearly tilted towards a terminal rate on the "tight" side of the range as rising due to both expected price increases from producers, but also because with the length and severity of the inflation shock, the risks of contamination are rising.

—Eduardo Suárez