LATIN AMERICA ECONOMICS UPDATE

Banxico & BanRep close to but not at the end of their cycles

- **Central banks in Mexico and Colombia both delivered 25bp hikes yesterday, and hinted that these could be the end of their cycles. But, on balance, we think that the strength of inflation will prompt policymakers in both countries to deliver a final 25bp move at their next meetings. And, once tightening cycles have drawn to a close, monetary policy will be kept tighter for longer than most are anticipating.**
- The decision by Mexico's central bank to hike its policy rate by 25bp, to 11.25%, at yesterday's meeting was never in doubt. After all, policymakers had made very clear at their last meeting (at which they raised interest rates by 50bp), that another hike (albeit of a potentially smaller magnitude) at the March meeting was on the cards.
- **Attention was always going to focus on the accompanying statement.** There were three key takeaways. First, it revealed that policymakers are not too concerned about spill-overs from the global banking turmoil. The communications stated that, apart from the volatility in the peso, there had been "limited impact" on Mexico's financial system.
- Second, the labour market was referenced for the first time, with the statement mentioning that the "labor market remains strong". Indeed, the unemployment rate has dropped to 2.9%, its lowest level since 2005, which is exerting upward pressure on wages – wage growth is running at its fastest pace since the early 2000s. And while labour market conditions should loosen as the economy slows, we expect wage growth to stay strong. **This is the key reasons why we don't expect inflation to return to Banxico's 2-4% target range until late-2024** (which is a bit later than the central bank's own projections). (See Chart 1.)
- And finally, while the statement accompanying the February meeting made clear that another hike was nailed on, that part was dropped in yesterday's communications, **suggesting that a final hike at the upcoming meeting in May in will be touch and go**.
- Meanwhile, Colombia's central bank unanimously decided to slow the pace of tightening to a 25bp hike, to 13.00%, at its meeting (compared with the 75bp hike delivered in January). The decision was based on policymakers' expectations that inflation is close to a peak as well as the fall in inflation expectations. **For our part, we think that inflation will tick up to 13.4% y/y in March, from 13.3% y/y in February, and remain at that level until mid-Q2 before starting to fall back more quickly.** (See Chart 2.)
- The central bank also revised up its GDP growth forecast for this year to 0.8% (which is in line with our forecast), from 0.2% previously. And, similar to Banxico, the statement did not give any forward guidance, although comments from Governor Leonardo Villar and Finance Minister Ocampo at the press conference suggest that a slowdown in inflation in March could prompt the central bank to end its tightening cycle.
- Markets appear to have interpreted both interest rate decision as dovish hikes, with government bond yields dropping back quite substantially in both countries. But while the next meetings will be close calls, **the strength of (core) inflation will prompt policymakers in both countries to deliver final 25bp hikes**. And, in both countries, we think that monetary policy will be kept tighter for longer than most expect.

Chart 1: Mexico Consumer Prices & Policy Rate

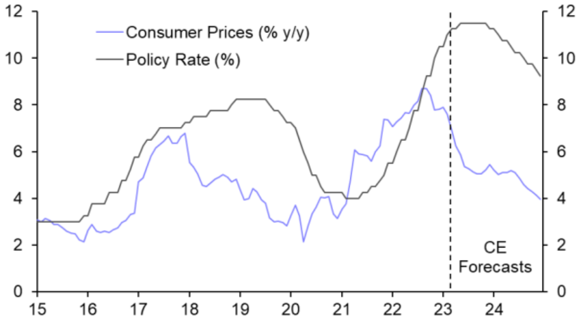
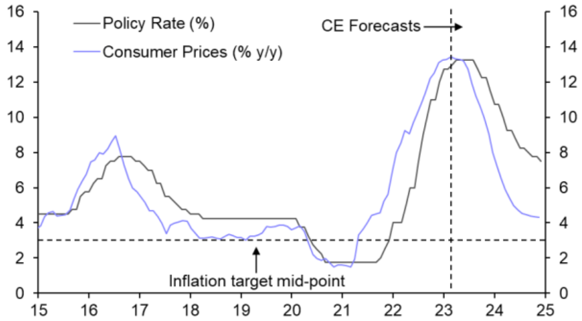


Chart 2: Colombia Consumer Prices & Policy Rate



Sources: Refinitiv, Capital Economics

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