LATIN AMERICA ECONOMICS UPDATE

Banxico to keep rates high for longer than most expect

- **Mexico's central bank held its policy rate at 11.25% at today's Board meeting, bringing the tightening cycle to an end. But with inflation unlikely to return to target until late-2024, policy will probably stay tighter than most expect over the next couple of years.**
- Today's decision looked set to be a close call after Banxico dropped its explicit guidance on further rate increases at its last meeting in March. The uncertainty was reflected in the split in the Bloomberg consensus poll – 19 of the 24 analysts correctly anticipated that rates would be kept on hold, whereas we were among five that had anticipated another 25bp hike. In the event, the decision to hold rates was unanimous.
- The case for rates to be left on hold had strengthened in the run-up to the meeting. While provisional GDP figures showed robust growth of 1.1% q/q in Q1, the industrial production figures for March suggested that **the economy was losing momentum at the end of the quarter**. (See Chart 1.)
- **Meanwhile, inflation dropped sharply to 6.3% y/y in April, amid a broad-based easing of price pressures**. Services inflation, which had been a key focus for Banxico amid concerns about the persistence of price pressures, fell from a 20-year high. (See Chart 2.) **The peso has also continued to rally** and is now up by 10% against the dollar year-to-date, which will help to further dampen price pressures.
- **We had thought that tight labour market conditions – which Banxico had flagged at its last meeting and again today – would keep policymakers in tightening mode**. The unemployment rate remains low at just 2.8%. And wage growth is strong at close to 11% y/y. (See Chart 3.)
- Today's decision means that the tightening cycle is now over. But with inflation unlikely to return to Banxico's 2-4% target range until late-2024 (see Chart 4), the shift to rate cuts and subsequent policy loosening is likely to be gradual. For its part, Banxico stated that it will keep the policy rate "at its current level for an extended period". **While rate cuts are still likely late this year, policy will probably stay tighter than the consensus and markets anticipate**. We have tweaked our forecast and now expect the policy rate to end this year at 11.00% (previously 11.25%) and next year at 9.00% (previously 9.25%).

Chart 1: Industrial Production (SA, % m/m)

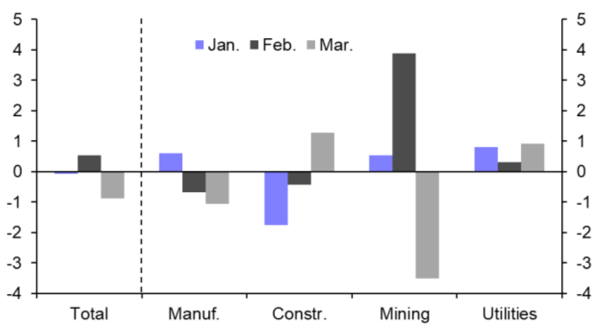


Chart 2: Consumer Prices (% y/y)

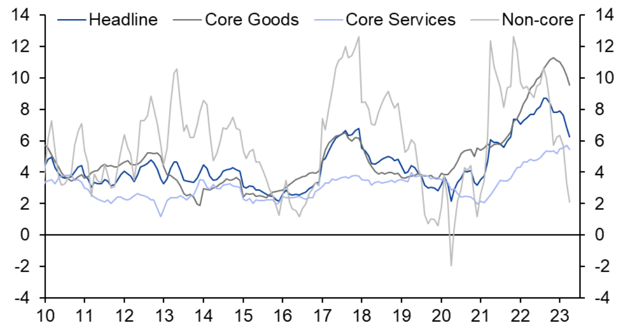


Chart 3: Wages (% y/y)

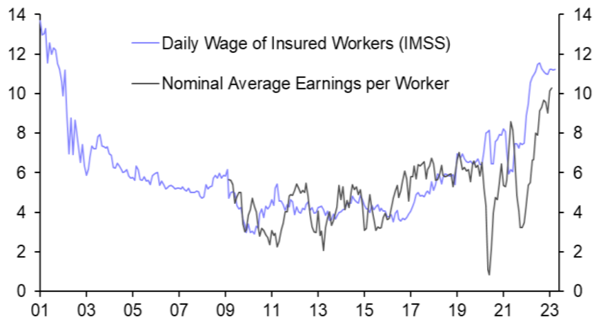
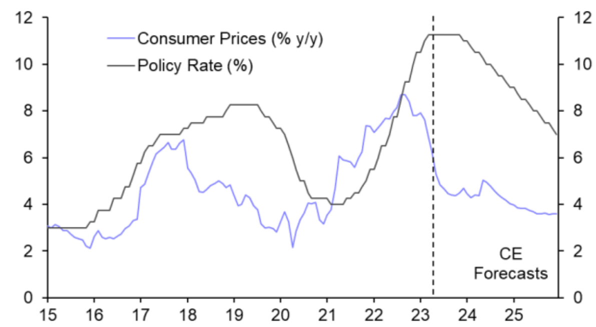


Chart 4: Consumer Prices & Policy Rate



Sources: Refinitv, CEIC, FocusEconomics, Capital Economics

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