

August 2, 2018

## Press Release

**Monetary Policy Statement**

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**Banco de México's Governing Board decided to maintain the target for the overnight interbank interest rate unchanged at 7.75%.**

Available data up to the second quarter of 2018 suggests that the world economy continued to grow at a relatively fast pace. However, there is an increasing divergence in the main advanced economies' performance. In particular, in contrast with the Eurozone, Japan and the U.K., which have grown below expectations, economic activity in the U.S. grew at a faster rate, partly in response to the fiscal stimulus implemented. Under conditions of reduced slack in the economy, this situation could exert greater pressures on inflation. As expected, in August the Federal Reserve kept the target range for the federal funds rate unchanged and reiterated its forecast of increasing it gradually. The world economy is subject to uncertainty in the short term and, to a larger extent, in the medium term. This is due to the risks associated with the intensification of trade-related disputes, to a possible tightening of financial conditions, and to geopolitical factors.

International financial markets have undergone episodes of volatility in recent weeks. In particular, asset prices of emerging economies declined, particularly those of Asian countries. In contrast, since the last monetary policy decision, the Mexican peso appreciated and exhibited lower levels of volatility. This behavior reflected, in part, lesser uncertainty after the country's elections and an improvement in the outlook for the NAFTA renegotiation. Interest rates in Mexico decreased moderately for both short and long tenors.

The latest information suggests that during the second quarter of 2018, economic activity in Mexico contracted with respect to the previous quarter. This result is partly the reflection of both the reversion in the dynamism that investment in construction had presented and the weakening of exports, although private consumption is expected to have exhibited positive results. As a result, slack conditions are estimated to have loosened, while in 2018 GDP growth is anticipated to fall to the lower half of the estimated range (2 to 3%) and, therefore, that slack conditions will continue to loosen. Given the uncertainty generated by the complex environment faced by the Mexican economy, Banco de México's Governing Board considers that the balance of risks for growth maintains a bias to the downside.

The Mexican economy is now in a better position to cope with adverse scenarios due to the central bank's monetary policy stance adopted to keep medium- and long-term inflation expectations anchored, the fiscal commitments, and the financial system's resilience. Nevertheless, the economy is expected to continue facing a complex environment, both in the external and domestic fronts. For this reason, it is particularly relevant that, in addition to following a prudent and robust monetary policy, measures to foster greater productivity are adopted and public finances are consolidated sustainably.

During the first months of 2018, annual headline inflation decreased, in line with the trajectory forecasted by Banco de México in its latest Quarterly Report. Nevertheless, since June, some of the risks to the upside that had been previously referred to materialized, due to higher-than-expected rises in the prices

of energy-related products, mainly those of gasoline and L.P. gas, which led to significant increases in non-core inflation. The referred change in relative prices affects the expected trajectory for headline inflation for the next twelve months, although its effects are estimated to be transitory. Core inflation, on the other hand, continues to follow a downward trend and is foreseen to continue to decrease within the time frame in which monetary policy operates. Under this context, expectations for headline inflation for the end of 2018 were adjusted from 4.00% in June to 4.25% in July, whereas those for the end of 2019 remained around 3.60%, and those for the medium and long terms around 3.50%.

The above scenario continues to be subject to risks and to a high degree of uncertainty. Among the upside risks to inflation are pressures on the peso exchange rate due to an environment of higher external interest rates and U.S. dollar strength, and to persisting uncertainty in both the external and domestic fronts, among which the NAFTA renegotiation stands out. In the event of a scenario in which the real exchange rate would need to adjust, Banco de México will make sure it takes place in an orderly manner, and with no second-round effects on the economy's price formation process. On the other hand, the risk of additional upward pressures on some energy prices or of increases in agricultural prices persists. There is also the risk that the trade policy measures adopted by the U.S. give rise to an escalation of protectionist and countervailing actions that could adversely affect the behavior of inflation. As for downside risks, the peso could appreciate if NAFTA negotiations turn out to be favorable. Summing up, since the last monetary policy decision, the balance of risks to the forecasted trajectory of inflation remains biased upwards, in an environment of high uncertainty.

To guide its monetary policy actions, Banco de México's Governing Board follows closely the development of inflation vis-à-vis its anticipated trajectory, taking into account the monetary policy stance adopted and the time frame in which monetary policy operates, as well as available information on all inflation determinants and on medium- and long-term inflation expectations, including the balance of risks for such factors. Given the Mexican economy's recent developments and, in particular, that the shocks that have affected inflation recently are of a transitory nature, and considering that core inflation is expected to continue on a downward trend, Banco de México's Governing Board has voted unanimously to maintain the target for the overnight interbank interest rate unchanged at 7.75%.

Looking ahead, the Governing Board will maintain a prudent monetary policy stance and will continue to follow closely the potential pass-through of exchange rate fluctuations to prices, the monetary policy stance relative to that of the U.S., and the conditions of slack in the Mexican economy. In the presence and possible persistence of factors that, by their nature, involve risks to both inflation and inflation expectations, monetary policy will be adjusted in a timely and robust manner to achieve the convergence of inflation to its 3% target and to firmly anchor medium- and long-term inflation expectations so that they attain such target.