

June 27, 2019

## Press Release

**Monetary Policy Statement**

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**Banco de México's Governing Board has decided to maintain the target for the overnight interbank interest rate at 8.25%.**

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Available information suggests that the world economy decelerated during the second quarter of the year. This situation was due to moderation of growth in some of the main advanced and emerging economies. Although job creation has slightly decreased, unemployment rates in the main advanced economies remain at low levels and wages continue recovering gradually. In turn, headline and core inflation in these economies have remained at low levels and their expectations have decreased. The aforementioned environment has increased the possibility that central banks of the major economies will adopt more accommodative monetary policy stances. In its June meeting, the US Federal Reserve left unchanged the target range for the federal funds rate. In its policy statement, it mentioned that the uncertainty faced by the US economy has increased, under conditions where there is absence of inflationary pressures and that, hence, it will follow closely the economic developments. It added that it would take the appropriate measures in order to sustain the economic expansion with a strong labor market and inflation at levels close to its symmetric 2% objective. This led to a decline in interest rates throughout the entire yield curve and to an increase in risk appetite levels in international financial markets. Nevertheless, risks to the global economy persist: a further escalation of trade tensions between the United States and its main trade partners; the weakness of some of the major economies extending longer than foreseen; new episodes of volatility arising in international financial markets; and, the intensification of certain political and geopolitical risks. For this reason, the balance of risks for the global economy remains biased to the downside.

Since the last monetary policy decision, domestic financial markets underwent episodes of volatility due to the threat of tariffs on Mexican imports by the U.S. and to the revisions to the outlook or the credit rating of sovereign debt and of Pemex's debt by some rating agencies. Nevertheless, more recently, given the agreement reached between the governments of Mexico and the United States, and the greater risk appetite among investors in view of the outlook for more accommodative monetary policies, the peso exchange rate reverted its previously observed depreciation and government securities' long- and medium-term nominal and real interest rates decreased significantly. Nonetheless, risks that may deteriorate the performance of financial assets in Mexico are still present. In particular, although domestic financial markets have been adjusting to this environment, uncertainty regarding the bilateral relationship between Mexico and the United States and the credit outlook both for Pemex's debt and for Mexico's sovereign debt persists.

The current environment continues to pose significant medium- and long-term risks that could affect the country's macroeconomic conditions, its potential growth, and the economy's price formation process. In this regard, it is particularly important that, in addition to a prudent and firm monetary policy, measures

to foster an environment of confidence and certainty for investment and higher productivity are adopted, and public finances are consolidated in a sustainable way. In this context, addressing the deterioration of both the sovereign's and Pemex's credit ratings and achieving the fiscal targets set in the Economic Package for 2019 are necessary. Strengthening the rule of law, tackling corruption, and fighting insecurity are equally imperative.

Available information suggests that in April economic activity increased marginally on a month-to-month basis, below market expectations, standing out a slowdown of the services sectors, after the contraction exhibited in the previous quarter, and that most components of aggregate demand, especially those related to domestic demand, remain weak. Thus, slack conditions in the economy have loosened even further than expected. The balance of risks for growth has become more uncertain and its downside bias has increased.

Between April and the first fortnight of June, headline inflation fell from 4.41% to 4.00%, due to the significant decline of the non-core component, which went from 6.08% to 4.34%, reflecting the lower increases observed in the prices of fruits and vegetables as well as in energy products, the latter partly due to the fall in their international references. The lower increases of both of these components more than offset the increases registered in livestock product prices. As for core inflation, it was 3.87% both in April and in the first fortnight of June. Such result is due to the fact that although the rate of change of food merchandise prices continued to increase, that of services decreased during the period. Between May and mid-June, short-, medium- and long-term headline and core inflation expectations did not register significant adjustments, albeit in all cases they remained above the 3% target. Regarding information drawn from market instruments, medium- and long-term breakeven inflation expectations remain at high levels.

As for inflation risks, some have diminished and others have gained relevance. To the upside, the possibility that the peso exchange rate comes under pressure stemming from external or domestic factors stands out. Should the economy require adjustments either to the real exchange rate or to medium- and long-term interest rates, Banco de México will contribute to orderly adjustments, in an effort to prevent second-round effects on the economy's price formation process. The threat by the United States to impose tariffs on Mexican imports and the adoption of compensatory measures also deserves mention, although this risk has decreased as a result of the recent agreement. Other risks are that energy prices revert their downward trend or that agricultural and livestock product prices exhibit increases; that public finances deteriorate; that core inflation's persistence influences medium- and long-term inflation expectations by making them show a greater resistance to decline; and, that global protectionist measures escalate. In addition, given the magnitude of several wage revisions, that cost-related pressures arise, insofar as such revisions exceed productivity gains. To the downside, that the peso exchange rate appreciates, possibly associated with a context of more accommodative monetary policy stances and lower interest rates worldwide, or in case greater certainty regarding the trade relation with the United States is achieved. Another downside risk is that the prices of certain goods included in the non-core subindex register lower rates of change, as observed in the case of energy goods, due to the greater weakness exhibited by the world economy. In addition, that slack conditions widen more than anticipated, as suggested by the latest information on economic activity, which might influence the behavior of core inflation. Given the aforementioned, high uncertainty persists regarding the risks that might affect inflation.

To guide its monetary policy actions, Banco de México's Governing Board follows closely the development of inflation vis-à-vis its forecasted trajectory, taking into account the monetary policy stance and the time frame in which monetary policy operates. In this process, it uses available information on all inflation determinants as well as on medium- and long-term inflation expectations, including the balance of risks for such factors. Monetary policy must also respond prudently if for any reason the

uncertainty faced by the economy increases considerably. In this context, considering that the current monetary policy is consistent with the convergence of inflation to its target within the time frame in which monetary policy operates, Banco de México's Governing Board has decided by majority to maintain the target for the overnight interbank interest rate at 8.25%. One member voted to reduce the target by 25 basis points. Considering the challenges to consolidate a low and stable inflation as well as those the economy's price formation is subject to and the amount of slack in the economy, the Governing Board will continue to follow closely all factors and elements of uncertainty that have an impact on inflation and its outlook and will take the required actions based on incoming information so that the policy rate is consistent with the orderly convergence of headline inflation to Banco de México's target within the time frame in which monetary policy operates.

Banco de México's Governing Board will maintain a prudent monetary policy stance and, under the current environment of uncertainty, will follow closely the potential pass-through of exchange rate fluctuations to prices, Mexico's monetary policy stance relative to that of the U.S.-in an external environment that it is still subject to risks- and the behavior of slack conditions and cost-related pressures in the economy. In the presence and possible persistence of factors that, by their nature, involve risks to both inflation and its expectations, monetary policy will be adjusted in a timely and firm manner to achieve the convergence of inflation to its 3% target and to strengthen the anchoring of medium- and long-term inflation expectations so that they attain such target.