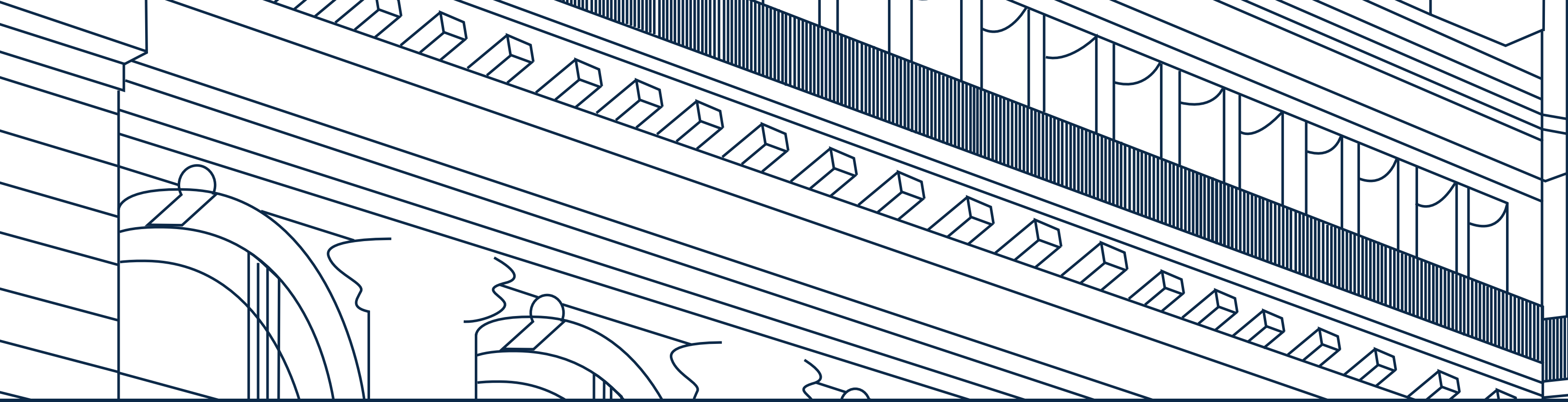

BANCO DE MÉXICO®

Minutes number 108

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on May 9, 2024

FOREWARNING
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11. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: May 8, 2024.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Gabriel Yorio, Undersecretary of Finance and Public Credit.
- María Elena Méndez, Secretary of the Governing Board.

Prior to this meeting, preliminary work by Banco de México's staff analyzing the economic and financial environment as well as the developments in inflation and the determinants and outlook for inflation, was conducted and presented to the Governing Board (see Annex).

2. ANALYSIS AND RATIONALE BEHIND THE GOVERNING BOARD'S VOTING

International environment

Most members pointed out that economic performance remains heterogeneous across countries. One member added that, overall, world economic activity remains resilient. **Some** members noted that the US economy continues showing strength. Regarding its labor market, **one** member highlighted that it remains tight. However, **another** member underlined that preliminary figures indicate that the expansion of that economy during the first quarter of 2024 was lower than anticipated and lower than observed towards the end of 2023. He/she added that although total consumption continues growing at a robust pace, driven mainly by services, consumption of goods contracted due to lower spending on durables. He/she argued that this differentiated dynamics between consumption of goods and that of services is observed in an environment of a more limited access to credit due to high interest rates, lower excess savings, and greater caution by consumers given the recent evolution of the labor market. He/she noted that the unemployment gap has continued closing, which has been accompanied by some moderation in the pace of growth of nominal wages. He/she stated that signs of a cooling in labor demand have become stronger. He/she pointed out that vacancies continue trending downwards and that the non-farm payroll has observed growth rates at levels close to its historical average. Regarding other countries, he/she noted that the euro area registered a greater dynamism compared to the previous two quarters, when it had registered slightly negative rates. He/she pointed out that economic activity in the United Kingdom has been driven mainly by the services sector and industrial production, after having been in technical recession in the second half of 2023. He/she mentioned that emerging economies have shown greater dynamism compared to the end of 2023. He/she expressed that China's growth has been driven mainly by consumption.

Some members highlighted that, in several advanced economies, economic activity is expected to moderate in 2024. **One** member underlined that growth in the euro area and the United Kingdom is expected to be relatively low. However, **some** members highlighted that the expected growth rate for the United States have been revised upwards. **One** member stated that a greater dynamism is foreseen for emerging economies. He/she underlined that the outlook for global economic activity is subject to high uncertainty. He/she warned that among global risks the following stand out: the intensification of geopolitical turmoil; a further deceleration of the Chinese economy; a greater impact of the value chain reconfiguration process; and the risks of high fiscal deficits, especially in emerging economies, in an environment of tight financial conditions.

Most members pointed out that headline inflation has been decreasing in most economies. However, they expressed that it remains above their respective central banks' targets. One member also indicated that the rate of reduction has been decreasing at a more moderate pace than that observed in 2023. **Another** member noted that in some cases in its latest readings headline inflation even increased. **The majority agreed that the behavior of headline inflation is partly due to increased pressures on energy prices. One** member highlighted that core inflation continued decreasing, although **some** members indicated that it has done so at a more moderate pace. **One** member pointed out that recent US inflation figures have turned out to be higher than anticipated. He/she added that in most emerging economies the latest readings reflect persistence of inflation at high levels. **Another** member considered that, although the disinflation has advanced worldwide, this process has not concluded and there are still challenges ahead.

Most members mentioned services inflation resistance to decline. One member underlined that inflation persistence in this component is a global phenomenon and that, in most cases, it does not correspond to the phase of the economic cycle countries and regions are currently in. **Most members emphasized this persistence in the case of the United States. One** member noted that, in the first quarter of 2024, monthly changes in service prices have been, on average, higher than those observed in the second half of 2023. **Some** members commented that within services, the housing component has exhibited more persistence than others. **One** member added that said persistence is observed in housing rents, where market prices tend to adjust more gradually, and he/she also pointed out the financial services component, where the auto insurance item stands out.

Some members highlighted that inflation is expected to continue declining worldwide. However, **some** members indicated that projections for inflation in some economies were revised upwards. **One** member pointed out that most central banks maintain their expectation that inflation will return to its target towards the end of 2025 and, in some cases, such as the Federal Reserve, towards the beginning of 2026. **Another** member stated that in most emerging economies prospects of convergence towards the end of this year and the beginning of 2025 are maintained.

The majority mentioned that most central banks in advanced economies left their reference rates unchanged at their latest meetings. One member stated that they have maintained a cautious tone. **Most members noted that the Federal Reserve left the target range for the federal funds rate unchanged in a context of higher-than-expected inflation levels and resilient economic activity. One** member stated that it kept its target range constant for the sixth consecutive meeting. and that it also announced a decrease in the rate of reduction of its balance sheet starting in June. He/she added that the press release mentioned that the risks to attaining its employment and inflation goals have moved to a better balance. **Most members underlined that the chairman of that institution indicated that progress in disinflation has not been sufficient and that they need to observe further progress before lowering the reference rate. One** member pointed out that said officer highlighted that according to the Committee monetary policy is sufficiently restrictive and there is evidence that it is influencing aggregate demand. Meanwhile, with respect to the European Central Bank, he/she indicated that it left its reference rate unchanged for the fifth consecutive time, and communicated that if confidence increases about inflation being on a trajectory towards its target, a reference rate cut would be appropriate. **Another** member added that most central banks in South America and some in Eastern Europe continued with their normalization cycles.

Regarding expectations about the future behavior of reference rates, **some** members noted the decline in the expected number of federal funds rate cuts this year. **One** member indicated that markets went from anticipating six rate cuts at the beginning of the year, to expecting between one and two. **Another** member pointed out that the date on which the first downward adjustment is expected to take place has been postponed. **One** member stated that the expectation is that the first reference rate cut will take place at the end of the third quarter of 2024, with two rate cuts of 25 basis points accumulating by the end of that year. As for the European Central Bank, **some** members expressed that it could implement the first rate cut during the summer. **One** member argued that this has been supported by the sustained decline of inflation in the euro area.

Most members pointed out that, given the change in the outlook for monetary policy in the United States, government bond yields increased worldwide. However, **some** members noted that such increases partially reversed in recent days following the release of US labor market figures suggesting a lower-than-expected dynamism. **The majority highlighted that since Mexico's last monetary policy decision, international financial markets exhibited volatility. One** member argued that this partly resulted from the increase in the expected level of the Federal Reserve's reference rate, given the systemic importance of the US economy. **Some** members added that said volatility was exacerbated by the intensification of geopolitical tensions. **In this regard, most members pointed out that since the last monetary policy decision, markets were also affected by greater risk**

aversion. The majority mentioned that, in this episode, the US dollar appreciated against a large number of currencies. One member considered that the increase in US government bond yields, the resilience of economic activity in that country, and the role played by financial instruments issued in the United States as safe haven assets during episodes of risk aversion all contributed to the appreciation of the dollar. **Some** members underlined that, since Mexico´s last monetary policy decision, several stock market indexes declined. However, **one** member noted that stock markets exhibited a heterogeneous behavior.

Economic activity in Mexico

Most members pointed out that the GDP flash estimate for the first quarter of the year showed that the weakness of economic activity registered in the last quarter of 2023 extended into the first quarter of 2024. One member stated that the flash estimate registered a low quarterly growth of 0.2%, although higher than for the previous quarter. **Some** members pointed out that these figures were lower than anticipated. **One** member highlighted that the heterogeneity in the signals of indicators and the uncertain environment have impeded an adequate assessment of the economic activity's performance during the first quarter of 2024. **Another** member stated that since September 2023 the economy seems to have entered into a trajectory of slower growth than what was being observed before.

Regarding the behavior of the productive sectors, **some** members noted that secondary activities contracted during the quarter. **Some** members mentioned that, nevertheless, a reactivation is expected in March. **One** member warned that, looking ahead, their performance appears uncertain. He/she pointed out that, within its components, manufacturing exhibited sluggishness, which seems to be in line with the stagnation of US manufacturing. **Another** member stated that although some components, such as transportation equipment, have rebounded at the margin, the trends have not reversed. **One** member underlined that construction registered high levels due to the performance of civil engineering public projects. However, he/she indicated that this sector has not shown a clear trend since mid-2023. He/she highlighted that in its most recent readings private construction has lost momentum. **Some** members pointed out that after the weakness exhibited at the beginning of 2024, services showed some reactivation in February and March. **Some** members commented that services components continued exhibiting heterogeneity. **One** member highlighted that in some subsectors, such as mass media information, transportation and health care, an upward trend was observed. He/she stated that the remaining subsectors exhibited a greater weakness, in particular, accommodation and food preparation services, which have still not regained their pre-pandemic levels. **Some** members expressed that the behavior of economic activity at the beginning of the year was also influenced by a decline in primary activities. However, **one** member considered that these seem to have recovered after having fallen sharply in January.

Regarding domestic demand, **some** members stated that investment registered a low dynamism. **One** member noted that such behavior has prevailed for some months, although it remains at high levels. In this regard, **another** member indicated that gross fixed investment grew at an annual rate of 10.7% in February, driven by construction and machinery and equipment. **Some** members pointed out that private consumption has maintained a positive trend. **One** member particularly noted the high growth in the consumption of imported goods. However, **some** members indicated that private consumption moderated somewhat. **One** member highlighted that leading indicators show mixed signals about this component, with credit card spending growing at elevated levels, while sales of light vehicles and of the Mexican Association of Supermarkets and Department Stores (ANTAD, for its acronym in Spanish) exhibiting a loss of dynamism. **Another** member argued that forward-looking indicators of services consumption suggest that it could expand at a slower pace.

Regarding external demand, most members pointed out that manufacturing exports remained at high levels, although they continued showing a low dynamism. Some members underlined that after having remained stagnant for several months, the value of non-automotive exports improved in March. **One** member indicated that external demand is expected to remain sluggish in light of the prevailing weakness in the US manufacturing sector, which could extend the low dynamism of domestic manufacturing production.

Most members noted that a reactivation of economic activity is expected for the second and third quarters of the year. One member commented that the economic boost that is typically observed in election years seems to be materializing with a certain lag, and thus the spillover effects of increased public spending during these episodes could possibly be observed in the coming months. **Another** member added that the reactivation of economic activity observed in February and March points toward the possibility of a greater dynamism in the second quarter of 2024, supported by the expansion of private consumption and investment. He/she stated that for the third and fourth quarters of the year, growth would moderate as some of the factors that would provide greater momentum to economic activity in the second quarter would dissipate. **One** member stated that there is a risk that the boost in public spending this year and the following one is greater than expected. He/she added that, given the strong rebound anticipated in US industrial production, greater levels of external demand can be expected to stimulate economic activity in Mexico.

Most members mentioned that the output gap remained in positive territory during the fourth quarter of 2023, although it declined. One member pointed out that it has narrowed for two consecutive quarters. **Some** members considered that it continues without being statistically different from zero. **One** member indicated that it is expected to gradually approach zero over the forecast horizon. **Another** member commented that the slack indicator obtained through principal components was also less positive. He/she noted that while the indicator associated with the labor market remains at high levels, the one related to consumption is close to zero. He/she stated that, given the mixed signals of economic activity figures, attention must continue to be paid to the cyclical conditions of the economy due to their relevance for inflation dynamics.

Most members highlighted that the labor market remained strong. They emphasized that unemployment rates remain at historically low levels. One member underlined that even after correcting for the population that is available to work, the unemployment rate is considerably below the Non-accelerating Inflation Rate of Unemployment (NAIRU). **Another** member noted that participation levels are similar to those observed prior to the pandemic. **One** member added the increase in newly created IMSS-insured jobs. However, **another** member expressed that this year formal job creation has grown at lower rates than those observed in 2022 and 2023. **The majority agreed that wage increases remained high. One** member stated that, with figures up to March, the annual increase in the daily wage associated with IMSS-insured workers was around 10%, while contractual wage revisions for private firms were at 9.4%, and for public ones at 4.2%. **Another** member pointed out that real wage increases are of a magnitude unseen in many years. He/she added that, as a result of low unemployment and wage increases, the wage bill continues advancing at much higher rates than those prior to the pandemic. However, **some** members noted that wage increases in formal employment seem to be moderating at the margin. **One** member commented that this was observed in particular for the upper quartiles of the wage distribution.

Inflation in Mexico

Most members pointed out that annual headline inflation rose from 4.40 to 4.65% between February and April. One member highlighted that despite the fluctuations registered in 2024, headline inflation has remained clearly below the peak of 8.70% reached in August 2022. **Another** member noted that since last October, there was an interruption of the downward trajectory that headline inflation had been exhibiting since September 2022. He/she stated that therefore, the progress in disinflation observed during that period becomes less relevant.

Most members underlined that the recent increases in headline inflation have been driven by an increase in the non-core component. One member indicated that, without minimizing the increase in headline inflation, which the inflation target is based on, it is important to acknowledge that its upward adjustment is due to the non-core component. He/she argued that the latter is subject to shocks that can cause abrupt and sudden adjustments in several of its items, both to the upside and to the downside, and therefore its behavior does not indicate the direction in which headline inflation could shift in the medium term. **Another** member recalled that the non-core component is usually affected by supply-related shocks, the effect of which tends to dissipate relatively quickly. He/she specified that, as anticipated, disinflation is taking place in a non-linear and heterogeneous way. **One** member stated that relative price adjustments are being faced rather than a generalized increase in the price level. He/she pointed out that the ten CPI items with the highest variation in the first fortnight of April, corresponding to the fruits and vegetables subcomponent, contributed with nearly 60 basis points to headline inflation. Finally, **another** member stated that the recent increase in headline inflation should not be interpreted as a sign that disinflation has come to a halt.

Most members noted that core inflation continued decreasing at the margin, having declined from 4.64 to 4.37% between February

and April. Some members highlighted that this component has therefore decreased for 15 consecutive months. They underlined that core inflation better reflects the medium-term inflation trend. They considered that its downward trajectory reflects the progress in disinflation. **One** member argued that by analyzing this component it is possible to assess the process by which the shocks stemming from the pandemic and the military conflict on inflation fade away. **Another** member underlined that the contribution of core inflation to disinflation has been evident, as it accounts for 276 of the 405 basis points of the decline that headline inflation has registered since its peak of this inflationary episode. **One** member highlighted that it has reached levels even lower than those observed in June 2021, when the tightening cycle began. **Another** member added that in the last four fortnights its variations have been smaller than one standard deviation from its average behavior between 2005 and 2019. However, **some** members noted that the pace of decline of core inflation has slowed down. **One** member pointed out that the atypical origin of shocks resulted in a very different dynamic of its components from that observed in other episodes.

As part of the analysis of core inflation's components, the majority underlined the decline in merchandise inflation. One member highlighted that it has declined for seventeen consecutive months. He/she considered that both the central bank's monetary policy stance and the mitigation of shocks have contributed to this reduction. He/she pointed out that both food and non-food merchandise inflation have decreased significantly, and that the latter is even below 3%. **Another** member stated that food merchandise inflation, however, remains at high levels. **One** member recalled that food merchandise inflation was at double-digit levels at the beginning of 2023 and that it showed a high resistance to decline. He/she pointed out that, since then, it has fallen significantly and it is now practically at its historical average. He/she specified that non-food merchandise inflation is already below its respective historical average. In this regard, he/she indicated that the persistence of food and non-food merchandise increased significantly and that, in the disinflation phase, it has been decreasing, approaching its historical norm.

Most members highlighted that services inflation has remained at high levels without showing a downward inflection point. Some members expressed concern about this behavior. **One** member noted that, although data points to a moderation at the margin, its trajectory has been above expectations. **Some** members mentioned that it has remained above 5% despite the monetary tightening. **Some** members argued that the atypical shocks of the pandemic and the military conflict continue affecting inflation, especially services prices. **One** member stated that after the pandemic, the increased mobility of the population and the recovery of demand for services have allowed costs to be passed on to prices, which has taken longer than anticipated to materialize. In this regard, **another** member noted that the shocks have broadly affected both services and merchandise, although with a greater lag on services. He/she mentioned that as consumption patterns have normalized, the persistence of services, which are typically the most persistent component within core inflation, has been increasing towards its usual levels, after having declined due to the weak demand faced by services, particularly housing services. He/she added that the subindex of other services shows a persistence greater than historically observed, and that unlike other subindices that have registered a clear reversal, it still does not show a clear reversal to its typical levels. He/she commented that since a normalization of merchandise persistence has been observed, he/she expects that the persistence corresponding to the other services subindex will also moderate, given the relationship between these two components strengthened. **One** member asserted that the prices of housing services, which constitute the item with the highest weight in the CPI, have shown unusually high seasonally adjusted and annualized variations, and the presence of new shocks has more than offset the favorable base effects, resulting in cumulative inflation remaining above its pre-pandemic average. He/she expressed that the prices of other services such as car insurance, personal care or food-related ones show pressures that could be attributed to a cost pass-through. **Another** member stated that demand-related pressures, the current wage policy, and the continued decline in labor productivity have contributed to the resistance of services inflation to decline.

Regarding the increase in non-core inflation, most members noted that it reached 5.54% in April. Some members indicated that this reading is close to its historical average. **One** member pointed out that this component has increased since last year after having registered historically low figures. **Another** member noted that the observed variations of the prices within the non-core component have reached more than three standard deviations from their average behavior between 2005 and 2019. **Most members highlighted the upward pressures**

on agricultural and livestock product prices and on energy prices. Some members noted that fruit and vegetable prices have been affected by climate-related factors.

Most members mentioned that long-term inflation expectations remained stable. Similarly, **some** members pointed out that medium-term expectations have also remained stable. **Some** members pointed out that they continued at levels above target. **One** member underlined that a significant challenge is that these expectations show resistance to decline. Regarding short-term expectations, **another** member considered their evolution as relatively stable. **Some** members stated that those corresponding to the end of 2024 and 2025 increased at the margin. **One** member highlighted that they are above the central bank's forecasts. Regarding expectations drawn from market instruments, **another** member pointed out that short-term breakeven inflation remained below the upper limit of the variability interval, while for longer terms it remained around 450 basis points above its historical average. He/she argued that the above suggests a certain resistance to decrease in both implied inflation expectations and the inflation risk premium. **One** member noted that expectations drawn from market instruments corresponding to the 1-5 year average increased slightly and those of 6-10 years remained at 3.3%.

All members highlighted that, considering that inflationary shocks are foreseen to take longer to dissipate, the forecasts for headline and core inflation have been revised upwards. Most members stated that services inflation is foreseen to show more persistence, as compared to what had been previously anticipated. One member mentioned that it is expected to exhibit a downward trend as of the fourth quarter of 2024. **Some** members indicated that the revision of forecasts reflects the materialization of certain risks. **One** member acknowledged that the prevision of the atypical shocks of the pandemic and the military conflict on services prices has been complex. He/she noted that there is no quantitative information available on similar past episodes that could have been used as a reference in this period to assess the magnitude and duration of such impacts. **Another** member added that the difficulty in predicting the speed at which the persistence of services will return to its historical norm is what has made forecasting its evolution more challenging. He/she considered that, for this reason, the latest adjustments to the inflation forecast are mainly due to upward revisions in the forecasts for this component. **Some** members pointed out that the adjustment in headline inflation forecasts also reflects an increase in price variations of energy, as well as of agricultural and livestock products. **All members mentioned that headline inflation is now expected to converge to the target in the fourth quarter of 2025. Some** members stated that this means that the disinflation process will continue, but at a more gradual pace. **One** member highlighted that reductions in core inflation are still foreseen.

Most members considered that the balance of risks for the foreseen inflation trajectory in the forecast horizon remains biased to the upside. However, **one** member estimated that, in view of forecast revisions, the balance of risks takes on a less negative tone. He/she added that certain factors of the external environment of this balance have not shown relevant changes compared to what was observed in previous monetary policy decisions. He/she indicated that domestically, the expectation of an economic growth lower than previously anticipated has gained relevance, which has implications for slack conditions. He/she added that, due to the significant reduction of inflation from its peaks during this episode, a risk that has clearly been mitigated is that inflation could have settled at the referred high levels. **Another** member warned that the balance of risks has deteriorated due to domestic-related pressures associated with the dynamism of the economy, a tight labor market, significant wage increases, and uncertainty regarding the effects of the expansionary fiscal policy. He/she considered that the inflationary environment is much more complex than that faced at the beginning of last year.

Among upward risks, the majority mentioned the persistence of core inflation, specifically its services component. One member highlighted the risk of economic activity showing greater-than-expected resilience. **Some** members expressed uncertainty as to the potential effect of fiscal policy. **Some** members added the possibility of greater cost-related pressures of various nature. In particular, **one** member pointed out the potential effects of the tightening of the labor market and wage increases. **Another** member underlined the risk of an exchange rate depreciation.

Some members added as upward risks for inflation the possibility that non-core inflation tends to settle at its long-term average. **One** member stated that climate-related shocks have been increasingly severe and frequent and could exert significant pressure on said component. He/she noted that the forecasts estimate that non-core inflation returns to 3% in 2025, a level below its historical average, and that for this reason future forecasts could be adjusted upwards. **Another** member indicated that variations in relative prices of certain agricultural and livestock products are more likely to affect consumer inflation expectations and that monetary policy should avoid these second-round effects.

As for risks to the downside, **one** member pointed out the possibility of an economic slowdown. **Another** member underlined the possibility that lower exchange rate levels compared to those observed in the early months of last year may contribute more than anticipated to mitigate certain pressures on inflation.

Macrofinancial environment

The majority mentioned that domestic financial markets experienced bouts of volatility, as was the case for international ones. The majority stated that the foreign exchange market exhibited volatility and that the Mexican peso registered a depreciation. Some members noted a temporary deterioration in trading conditions. **One** member added that these conditions have been gradually improving. **Some** members pointed out that part of the volatility resulted from the liquidation of long positions. **One** member added that it was also due to the unwinding of carry trade strategies and other technical factors. **Some** members highlighted the high sensitivity of the Mexican peso to the global environment of risk aversion. **One** member pointed out that this caused the Mexican peso to be among the currencies with the highest depreciation in some trading sessions. **Some** members noted that prospective information anticipates possible exchange rate depreciations in the coming months. **One** member highlighted that, despite all of the above, the Mexican peso has remained below the levels observed in 2023. He/she recalled that in the first months of the year, the Mexican peso appreciated visibly, reaching in late March and early April levels unseen since 2015.

Some members expressed that the Mexican peso continues standing out among emerging economies' currencies that have exhibited greater resilience. **One** member stated that this has contributed to the restriction of monetary conditions. **Another** member expressed that the resilience of the Mexican peso has been aided by the monetary policy actions implemented by the central bank, which have contributed to maintaining a volatility-adjusted interest rate spread between Mexico and the United States that remains attractive. He/she added that other factors have also influenced the evolution of the exchange rate, such as the favorable outlook associated with the nearshoring phenomenon and the country's sound macroeconomic fundamentals. **One** member mentioned that the liquidation of long positions on the Mexican peso, sound macroeconomic fundamentals and the high volatility-adjusted interest rate spread can contribute to reduce the possibility of a sudden adjustment in the exchange rate.

The majority noted that, since the last monetary policy meeting, government bond yields have increased along the entire yield curve. One member mentioned that this was due to the high correlation with US markets and to a greater risk aversion. **Another** member stated that interest rates exhibited greater volatility after the March meeting. He/she added that in May, however, these registered a certain downward adjustment, in line with international markets. **One** member pointed out that the dynamics of short-term interest rates have also responded to revisions in expectations regarding Mexico's monetary policy. He/she specified that neither markets nor analysts anticipate a change in the reference rate in May, while the former expects it to reach 10.2 and the latter 10.0%, by the end of the year. **Another** member argued that short-term interest rates in domestic markets have also been subject to pressures stemming from the increasing cost that Pemex has faced to issue debt. Regarding capital flows, **one** member pointed out that there were outflows of foreign investors in *M-bonos*, which were partially offset by inflows in *Udibonos*. **Another** member noted that stock markets performed favorably.

Some members highlighted that total financing continued expanding. **The majority indicated that credit granted by commercial banks maintained its dynamism. One** member expressed that commercial bank financing to businesses, mortgage lending, and consumer credit grew during the first quarter of 2024. However, **some** members observed that lending to businesses and consumer credit continued moderating. **One** member added that, according to the survey of banks, lending standards remained tight. **Another** member mentioned that, regarding credit risk, delinquency levels remain low and stable.

Monetary policy

The Governing Board evaluated the easing of the effects of the shocks on inflation and its determinants, the behavior of medium- and long-term inflation expectations, and the disinflationary process. It stated that challenges and risks prevail, which requires monetary policy to continue being managed prudently. It took into account the expectation that the effects of the shocks will affect inflation longer than had been anticipated. Concurrently, it estimated that said shocks will continue easing. Based on the above, with the presence of all its members, the Board decided unanimously to leave the target for the overnight interbank interest rate unchanged at 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. Looking ahead, it will assess the inflationary environment in order to discuss reference rate adjustments. It will also consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

One member pointed out that during this inflationary episode, there have been different stages, each of them entailing alternative implications for monetary policy conduction. He/she highlighted how, given its commitment to its primary mandate, Banco de México raised the reference rate by 725 basis points to a level of 11.25%. He/she recalled that when the reference rate was last increased in March 2023, headline inflation was at 6.85% and core inflation was at 8.09%. He/she commented that at that time it was evident that before considering reference rate cuts, it was necessary to observe a significant advance of the ongoing disinflation process. He/she argued that, in contrast, in 2024 both headline and core inflation have remained at levels noticeably lower than their peak levels during this inflationary episode, and the disinflationary process has advanced. He/she considered that the current environment, while still challenging, is less adverse than in 2022 and early 2023. He/she deemed that, consequently, we are now entering a new stage where it is possible to assess the possibility of reference rate cuts on a meeting-by-meeting basis, depending on the evolution of the inflation outlook. He/she explained that for this reason the last monetary policy meeting the reference rate was reduced by 25 basis points, given the progress in disinflation. However, he/she considered that subsequent reductions should be gradual given the higher-than-anticipated persistence in services inflation, and that the effects of inflationary shocks are now expected to dissipate more gradually than previously anticipated. He/she stated that, given this outlook it is appropriate to make a pause at this monetary policy meeting. He/she indicated that the inflationary environment is such that it allows to consider potential reference rate cuts going forward, with decisions contingent on the inflation outlook. He/she stated that a continued assessment of all inflation determinants will be necessary. He/she underlined that it is essential to continue weighing the undeniable progress achieved in Mexico’s disinflationary process against the challenges that still prevail. He/she highlighted that it will be important to consider that the restrictive policy stance that has been maintained and the one prevailing in the future will impact the evolution of inflation within the planning horizon. He/she emphasized that monetary policy decisions will continue to be such that the monetary policy stance leads annual headline inflation to converge to the 3% target in the forecast period.

Another member expressed that it is valid to acknowledge the progress made in the disinflationary process, attributable to a sound, timely, and effective monetary policy. However, he/she pointed out that looking into the past does not guarantee the convergence of inflation within the planning horizon. He/she argued that the inflation forecast targeting regime requires looking into the future and ensure that monetary conditions remain at the levels required to achieve such convergence. He/she warned that, in view of the risks faced and the slowdown in the disinflationary process, the achieved monetary restriction should be firmly maintained. In particular, he/she reiterated his/her concern about the potential effects on the inflation trajectory of a divergence of public finances from what is expected or being affected by the situation of Pemex. He/she also reiterated the challenges that will be faced in 2025 regarding the synchronization of fiscal and monetary policies, given that the expectation of a decline in inflation is subject to the Public Sector Borrowing Requirements (PSBR) being reduced by 2.9 points of GDP in a single year, which, if it does not materialize, would exert greater-than-expected pressures on aggregate demand and debt markets. He/she also indicated that the inflation forecast was revised upwards, as he/she had warned could occur during the previous meeting. He/she argued that the reduction in the reference rate in the March decision, which he/she considered premature, incurred a social cost, as it required extending the monetary restriction for a longer period. He/she mentioned that. looking ahead, commitment to the primary goal must be strengthened and that a forward-looking and data-dependent approach should be prioritized, avoiding any premature adjustments. In this regard, he/she deemed that communication with the markets should prioritize institutional messages and avoid generating volatility. Finally, he/she argued that it is important for the central bank to intensify its efforts in reviewing exhaustively its forecasting tools that allow the inclusion of the changes observed in recent years in both global and Mexican economies and that might have generated structural changes, in addition to other factors, such as climate change, which have become increasingly relevant in understanding price formation and that have implied less precision. This will contribute to a more efficient attainment of the price stability objective for the benefit of the population, especially its lowest-income segment.

One member emphasized that the current disinflationary process is complex and not devoid of difficulties. He/she underlined that despite the progress in core inflation, non-core inflation has reversed considerably, while the central bank's forecasts now consider a greater persistence of the services component. He/she mentioned that the main upward risk to inflation indicated in the balance for inflation has materialized and, consequently, timely convergence to the target has been delayed by two quarters. He/she added that, although most recent data indicate that the economic cycle has lost momentum, demand is expected to recover significantly during the second quarter of the year. He/she considered that synchronization between a higher expected persistence in inflation and the temporary dynamism of economic activity suggests that it is prudent to make a pause to the adjustments in the reference rate, in order to have more information on inflation determinants and on the performance of the monetary policy transmission channels. He/she commented that, although the ex-ante real interest rate decreased in the last monetary policy decision, the real exchange rate continued appreciating, reaching levels unseen since 2008, while interest rates implied by market instruments increased considerably. In this regard, he/she stated that monetary conditions remain notably restrictive. He/she highlighted that the difference between the ex-ante real interest rate and the central estimate of the neutral rate is approximately three times the difference between observed inflation and its target. He/she pointed out that this proportion is unprecedented in Mexico and has facilitated the effective operation of all the monetary policy transmission channels throughout the cycle. However, he/she warned that the effects of such transmission are not symmetrical across inflation components, resulting in differentiated lags in price adjustments between goods and services. He/she explained that this suggests that the pace and scale of possible adjustments in the monetary policy stance should continue to be gradual to ensure the transmission to less sensitive components without causing disorderly deviations in those that are more reactive to different transmission channels. Looking ahead, he/she judged that if the evolution of macroeconomic conditions is consistent with updated inflation forecasts, it may be appropriate to reassess any space for recalibrating the level of monetary restriction once again. He/she argued that the data-dependent approach relying on forecasts and on a decision-by-decision basis, is the best way to ensure a prudent implementation of monetary policy based on the complexity of the disinflationary process, and fully complying with the constitutional mandate and seeking to achieve an orderly adjustment of the economy and financial markets.

Another member expressed that, given the stagnation of inflation, a deteriorated balance of risks and the expectation of inflation above target for a longer period, no additional fine-tuning of the target rate can be made, either now or in the following months, and a restrictive stance should be maintained for an extended period. He/she considered that the moderate reductions in core inflation and the risks that non-core inflation reaches its historical average, demand a restrictive stance that avoids indirect effects of the non-core component on core inflation. He/she argued that a monetary easing cycle appears distant, and thus the fine-tuning of the previous decision needs to be interpreted correctly, considering that changes to the nominal rate seek to maintain the monetary policy stance relatively constant in a range of restriction for the ex-ante real rate between 7 and 7.5%. He/she mentioned that the weakness and low efficiency of most transmission channels in Mexico supports the case for maintaining the level of restriction for a longer period, and therefore adjustments to the reference rate should be more spaced out and more gradual than as anticipated by analysts. He/she pointed out that the vigorous growth of bank lending reflects the weakness of the credit channel, and that the high liquidity of the Mexican peso results in exchange rate fluctuations that are beyond monetary policy and limit the extent of the exchange rate transmission channel. He/she argued that the expectations channel is the one that operates with greater effectiveness. He/she judged that analyzing the output gap, delinquency rates, or the economic slowdown becomes relevant only to the extent that they contribute to understanding how monetary policy can anchor inflation expectations. He/she stated that inflation expectations above 3% should not be tolerated for any term, and therefore intermediate targets focused on returning these expectations to their historical averages should be discarded. Instead, advantage should be taken of the high monetary restriction to continuously, forcefully and unrestrictedly converge to 3%. He/she indicated that in subsequent decisions, the signals sent and their effects on inflation expectations should be carefully assessed. In this regard, he/she added that the direction of adjustments of the target rate is an even stronger signal than the level of the reference rate *per se*. For example, he/she underlined that, on this occasion, lowering the rate from 11 to 10.75% would send a premature signal of complacency with the observed trajectory of inflation. On the contrary he/she noted that maintaining the target rate unchanged signals that the central bank is not satisfied with inflation levels, that inflationary risks are acknowledged, and that there is a commitment to the 3% target. For this reason, he/she added that the central bank communication must assure that the bank is determined to attain the target at all costs. He/she suggested that for the upcoming decisions, not only should the current level of monetary restriction be maintained as long as core inflation, especially its services component, does not show a clear downward trend, but this intention should be explicitly stated in the forward guidance. He/she commented that in the second half of the year there would be greater clarity to make fine adjustments, even more gradual than anticipated, and only if conditions warrant it. He/she affirmed that monetary policy decisions should remain independent of the decisions made by the Federal Reserve and that it is not possible to compare Mexico's interest rate spreads with those of other countries since the target rates respond to contexts and needs that are not entirely comparable. He/she cautioned that if inflation and its expectations remain persistently outside the variability range, the possibility of assessing the degree of monetary restriction required to achieve the 3% target should be considered.

One member considered that, in light of the revision of the inflation forecast resulting from a greater persistence of the services component, it is appropriate to leave the reference rate unchanged on this occasion. He/she stated that this allows to reinforce a stance conducive to preventing inflation expectations from becoming contaminated. In this context, he/she deemed it relevant for the conduction of monetary policy to assess the dynamics within services inflation. He/she mentioned that the subindex of other services shows greater persistence compared to its historical norm. He/she added that, as its relationship with the merchandise component strengthened, it continues to reflect in a lagged manner the multiple shocks that gave rise to the atypical inflationary episode. He/she highlighted that other components of services inflation, such as housing, and which initially exhibited less persistence, have been reverting to their typical behavior. He/she added that monetary policy is transmitted heterogeneously to different components of inflation, with a more lagged effect on services, as this sector is less capital-intensive and more labor-intensive. He/she pointed out that these elements should be taken into account in monetary policy implementation since they do not indicate new pressures, but rather that disturbances observed over the previous years continue to dissipate, albeit at a slower pace. He/she argued that the described phenomenon requires maintaining an adequate monetary restriction given a less adverse risk outlook than that faced in 2023, and thus it does not require keeping the monetary policy stance at historically restrictive levels. He/she stated that a gradual approach will allow adjusting the monetary restriction, ensuring it continues to be transmitted to other sectors where its impact has been less pronounced. He/she commented that the monetary policy stance should consider the trends in the inflation outlook overall and avoid adopting an overly data-dependent approach or focusing on a single variable. He/she stated that progress in the inflationary outlook is undeniable given the significant reductions in inflation, the gradual mitigation of the risk of inflation settling at high levels, and that, looking ahead, there is the expectation that it will continue decreasing, albeit at a slower pace. Considering all of the above, he/she sustained that an adjustment to the policy rate at the next meeting could be considered if the intermediate inflation targets, such as the inflation forecast, are met. He/she expressed that the current policy stance is highly restrictive and that, even with additional adjustments, it will remain robust despite changes in the relative stance compared to other economies. He/she emphasized that continuing with rate adjustments does not imply abandoning a restrictive stance. He/she warned that such stance will remain necessary throughout the forecast horizon, given the challenges that still prevail.

3. MONETARY POLICY DECISION

The Governing Board evaluated the easing of the effects of the shocks on inflation and its determinants, the behavior of medium- and long-term inflation expectations, and the disinflationary process. It stated that challenges and risks prevail, which requires monetary policy to continue being managed prudently. It took into account the expectation that the effects of the shocks will affect inflation longer than had been anticipated. Concurrently, it estimated that said shocks will continue easing. Based on the above, with the presence of all its members, the Board decided unanimously to leave the target for the overnight interbank interest rate unchanged at 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. Looking ahead, it will assess the inflationary environment in order to discuss reference rate adjustments. It will also consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

4. VOTING

Victoria Rodríguez, Galia Borja, Irene Espinosa, Jonathan Heath, and Omar Mejía voted in favor of leaving the overnight interbank interest rate unchanged at 11.00%.

ANNEX[*]

The information in this Annex was prepared for this meeting by the staff of Banco de México's Directorate General of Economic Research and Directorate General of Central Bank Operations. It does not necessarily reflect the considerations of the members of the Governing Board as to the monetary policy decision.

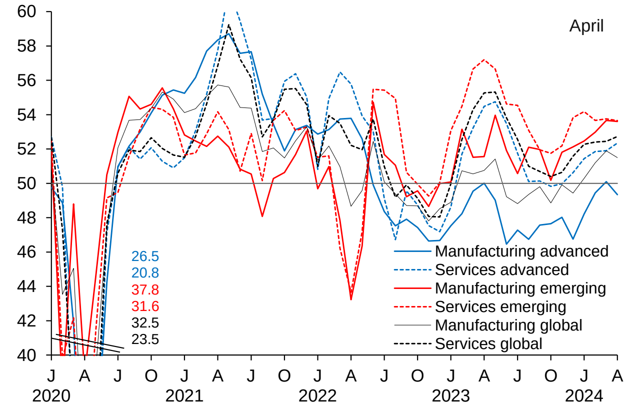
A.1. External conditions

A.1.1. World economic activity

During the first quarter of 2024, world economic activity would have expanded at a faster pace than that observed in the previous quarter and heterogeneity in the pace of growth among countries would have persisted. Overall, there would have been greater dynamism in the main emerging economies. In contrast, most advanced economies continued showing sluggishness, with the United States being an exception. Purchasing Managers' Indices point to a modest growth in the services sector and manufacturing activity at the global level in the beginning of the second quarter (Chart 1). However, manufacturing production, on the contrary, would have remained weak in a large number of advanced economies. In February, world trade indicators continued reflecting the stagnation that has been observed since the third quarter of 2023. Among global risks, the following stand out: the intensification of geopolitical turmoil, the prolongation of inflationary pressures, tight financial conditions, and, to a lesser extent, challenges to financial stability.

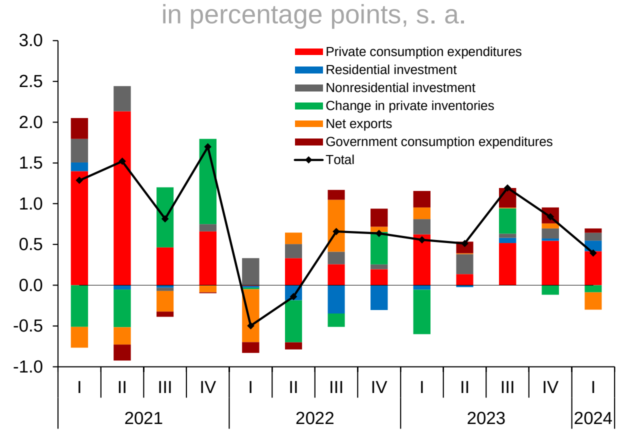
In the United States, the pace of expansion of economic activity moderated during the first quarter of 2024, after the robust growth observed in the previous two quarters. GDP grew at a seasonally adjusted quarterly rate of 0.4%, after having done so 1.2 and 0.8% in the third and fourth quarters of 2023, respectively.[1] Such moderation reflected the negative contributions of net exports and the accumulation of inventories. The components of domestic demand, nevertheless, continued showing resilience, with the dynamism of private consumption standing out (Chart 2).

Chart 1
Purchasing Managers' Index: production component for advanced, emerging and global economies
Diffusion index, s. a.[1/]



s. a. / Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points indicates an expansion and below 50 indicates a contraction. A reading equal to 50 points indicates no change.
Note: Figures in the chart correspond to respective minimum levels of each indicator, in the same order as the labels.
Source: IHS Markit.

Chart 2
US: real GDP and components
Quarterly percentage rate and contribution in percentage points, s. a.



s. a. / Seasonally adjusted figures.
Source: Bureau of Economic Analysis.

In March, US industrial production grew at a seasonally adjusted monthly rate of 0.4%, the same rate of expansion as that registered in February. This result is attributed to the progress in manufacturing and in electricity and gas generation. The 0.5% growth in manufacturing production was driven, in

[*] Note: In the electronic version of this document, you can obtain the data to generate all the graphs and tables included in it by clicking on them, except for those that are not produced or elaborated by Banco de México.

[1] Expressed as a seasonally adjusted quarterly rate, the change in US GDP was 1.6% in the first quarter of 2024, and 3.4 and 4.9% in the fourth and third quarters of 2023, respectively.

part, by an increase in vehicle production. Purchasing Managers' Indices point to a slight increase in manufacturing activity in April.

The US labor market remained tight, despite the moderation shown by various indicators. After having expanded by 303 thousand new jobs in March, the non-farm payroll moderated its growth rate, by increasing by 175 thousand positions in April. The latter was the lowest monthly increase since October 2023. Initial claims for unemployment insurance remained at low levels, registering 208 thousand new claims in the week that ended on April 27. The unemployment rate increased from 3.8% in March to 3.9% in April. New vacancies decreased from 8.8 million in February to 8.5 million in March, although they remain above pre-pandemic levels. Most wage growth indicators moderated. In April, average hourly wages grew at an annual rate of 4.0%, after having increased 4.2% in March.[2]

In the euro area, economic activity registered slight growth in the first quarter of 2024, after having contracted in the previous two quarters.[3] This, in an environment of financial conditions that remain tight. The labor market in this region remained robust. The unemployment rate stood at 6.5% between January and March, remaining at a historically low level. The above in a context in which the labor participation rate has been increasing.

For the rest of the major advanced economies, overall, moderate growth is expected during the first quarter of 2024. In particular, economic activity in the United Kingdom is expected to have recovered, after having contracted in each of the previous two quarters. Labor markets in this group of economies would have remained tight, despite the moderation shown by some indicators.

Most of the major emerging economies are expected to show greater dynamism in the first quarter of the year compared to the previous quarter, mainly in Latin America and Eastern Europe. Meanwhile, Emerging Asia would have registered a more marked heterogeneity in the pace of growth among countries. In the particular case of China, economic activity grew at a faster pace compared to the previous quarter. In this context, its GDP grew at a seasonally adjusted quarterly rate of 1.6%, after having increased 1.2% in the fourth quarter of 2023.[4] However, in March, retail sales and industrial production slowed their pace of growth. Said economy continues facing difficulties due to the weakness of its real estate sector and low confidence by economic agents. This, despite the diverse stimuli implemented by its authorities to boost growth.

Since Mexico's last monetary policy decision, international commodity prices registered a mixed behavior. Oil prices exhibited volatility. During most of the period, prices rose due to geopolitical tensions in the Middle East and Russia, as well as the agreement reached in March between the members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+) to extend production cuts until the second quarter of 2024. However, in early May, crude oil prices declined due to lower demand for fuels in several countries, which was reflected in higher-than-expected inventory levels in the United States. Likewise, natural gas reference prices exhibited a volatile and upward-biased behavior for most of the period. Prices in Europe and Asia were subject to upward pressures in April due to the possibility of gas supply disruptions caused by the attacks on storage infrastructure in Ukraine and the conflict in Middle East. Likewise, in early May, reference gas prices increased due, in part, to lower US gas production. Grain prices showed an overall upward behavior. In particular, wheat and soybean prices increased in late April due to uncertainty regarding adverse weather conditions in the United States, Russia and Brazil. Additional upward pressures were registered on wheat prices due to attacks on grain storage infrastructure in Ukraine. Metal prices, in general, trended upwards. Industrial metal prices increased due to expectations of a greater demand from China and, in mid-April, by restrictions imposed on Russian metals by the US and British stock exchanges. Precious metal prices rose due to the diversification of central banks' reserves and diverse geopolitical tensions. Gold prices reached historical highs in April. However, this trend partially reversed in the fourth week of April due to a moderation in the perception of geopolitical risk in the Middle East.

A.1.2. Monetary policy and international financial markets

[2] Average hourly earnings of production and nonsupervisory employees.

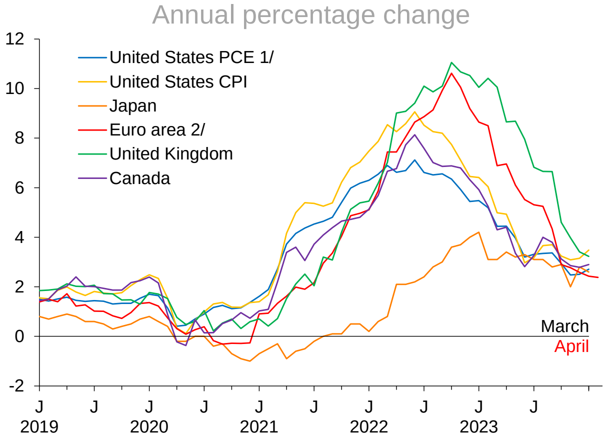
[3] Expressed as a seasonally adjusted quarterly rate, the change in euro area GDP was 0.3% in the first quarter of 2024 and -0.1% in the fourth and third quarters of 2023.

[4] Expressed as an annual rate, China's GDP growth was 5.3% in the first quarter of 2024 and 5.2% in the fourth quarter of 2023.

Since Mexico's last monetary policy decision, annual headline inflation declined in most advanced economies (Chart 3). However, in some cases, its most recent reading rebounded due to, in general, higher pressures on energy prices. Core inflation continued registering gradual reductions, although in some cases it registered slight increases due to greater pressures on services prices. In the United States, annual headline inflation measured by the Personal Consumption Expenditures Price Index (PCEPI) rose from 2.5% in February to 2.7% in March. This increase mainly reflected a rise in energy and food inflation, as annual core inflation remained practically unchanged, by registering 2.84 to 2.82% between such months. The monthly variation of the core index remained at high levels of around 0.3% in the last two months in light of continued pressures on services prices. Annual headline inflation measured by the Consumer Price Index (CPI) increased from 3.2% in February to 3.5% in March. Its core component went from 3.75 to 3.80% during the same period.

Analysts' inflation forecasts for main advanced economies foresee a moderation in headline inflation throughout 2024 from its current levels. However, they estimate that it will remain at levels above their central banks' inflation targets in 2024. Longer-term inflation expectations for these economies drawn from financial instruments for these economies increased slightly as compared to those registered in the third week of March.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change

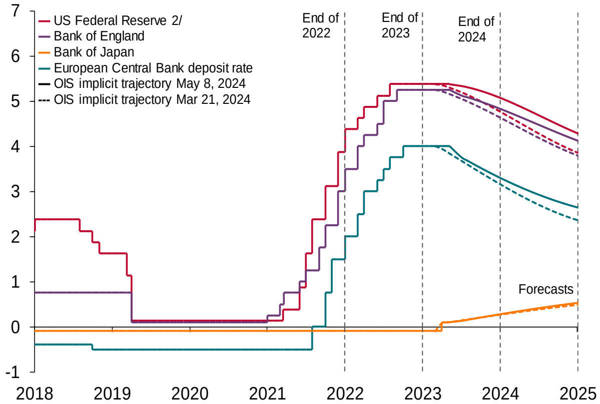


1/ The personal consumption expenditures price index is used.
2/ Preliminary figures as of April.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

Annual headline inflation declined in a large number of emerging economies. However, in some cases it rebounded, partly as a result of higher pressures on energy and, in certain cases, food prices. Although in most of these economies headline inflation remained above their respective central banks' targets, in various inflation was within each central bank's variability interval. In China, annual inflation decreased from 0.7% in February to 0.1% in March, after the February figure reflected both a comparison base effect and changes in demand associated with the Lunar New Year holiday, which for the first time since the onset of the pandemic was not affected by factors related to activity and mobility restrictions. Core inflation declined in most main emerging economies.

In this context, since Mexico's last monetary policy decision, the central banks of the major advanced and emerging economies made decisions regarding their reference rates in a heterogeneous manner, depending on the evolution of inflation and other economic indicators in each country. Regarding future actions, overall, central banks indicated that their decisions will remain dependent on the evolution of inflation and other economic data. Some of these institutions anticipate that reference rates will remain at restrictive levels for some time and communicated that they are prepared to make additional adjustments, if necessary, in order to bring inflation back to target. Others highlighted the need to be more confident that inflation is returning to target before relaxing their monetary policy stances. In the main advanced economies, most central banks left their reference rates unchanged and continued reducing their securities' holdings gradually (Chart 4).

Chart 4
Reference rates and trajectories implied in OIS curves[1/]
Percent



1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the U.S., the average interest rate of the target range of the federal funds rate (5.00%- 5.25%) is used.
Source: Bloomberg.

At its May meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the sixth consecutive decision. Thus, it remains between 5.25 and 5.50%. It reiterated that, when considering any adjustment to the target range for the federal funds rate, the Federal Open Market Committee (FOMC) will carefully assess incoming data, the evolution of the economic outlook and the balance of risks. It indicated that the Committee judges that risks associated with achieving its employment and inflation goals have been showing a better balance. It reiterated that the Committee does not expect it to be appropriate to reduce the target range for the federal funds rate before it has greater confidence that inflation is moving sustainably toward 2%. It underlined that the Committee would be prepared to adjust the monetary policy stance if risks emerge that could impede the attainment of its goals. The Federal Reserve continued reducing the size of its balance sheet. In this regard, in its press release it mentioned that starting in June, the Committee will begin to slow the pace of reduction.[5]

During the press conference for the May decision, the Federal Reserve chairman noted that so far this year, inflation data have not generated greater confidence among FOMC members that inflation is converging toward 2%, pointing out that inflation readings have exceeded expectations. He added that it is likely that it will take longer than expected to achieve this increased confidence and that they are prepared to maintain the current interest rate target range for as long as appropriate. He indicated that they are also prepared to respond to an unexpected weakening of the labor market. Most recent expectations drawn from financial instruments suggest that the federal funds rate would stand at 4.9% at the end of 2024 and 4.2% by the end of 2025.

Similarly, the European Central Bank (ECB) left its reference rates unchanged in April for the fifth consecutive decision. Thus, its refinancing, key lending and key deposit rates remained at 4.50, 4.75 and 4.00%, respectively. The Governing Council pointed out that it considers interest rates to be at levels that are making a substantial contribution to the disinflationary process, and reiterated that its future decisions will ensure that its reference rates will remain at sufficiently restrictive levels for as long as necessary. It added that if the inflation outlook core inflation dynamics, and the strength of monetary policy transmission reinforce its confidence that inflation is converging to its target on a sustained basis it would be appropriate to reduce the current level of its monetary policy tightening. In this regard, it again indicated that it will maintain a data-dependent approach to determine the appropriate duration and degree of such tightening and added that it is not committing to a particular monetary policy path.

At the press conference, the president of said institution pointed out that inflation declines will not be linear and will fluctuate around the current level in the coming months to subsequently decline to the inflation target during 2025. Regarding its Pandemic Emergency Purchase Program (PEPP), the Governing Council continued with the normalization of its balance sheet and reiterated that it expects to conclude the reinvestments of maturing securities purchased under said program by the end of 2024.

Regarding market expectations for monetary policy rates, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) registered a moderation in expectations of rate cuts. These anticipate a decrease of at least 25 basis points for the third quarter for the euro area, Canada and the United Kingdom, and for the fourth quarter of 2024 for the United States.

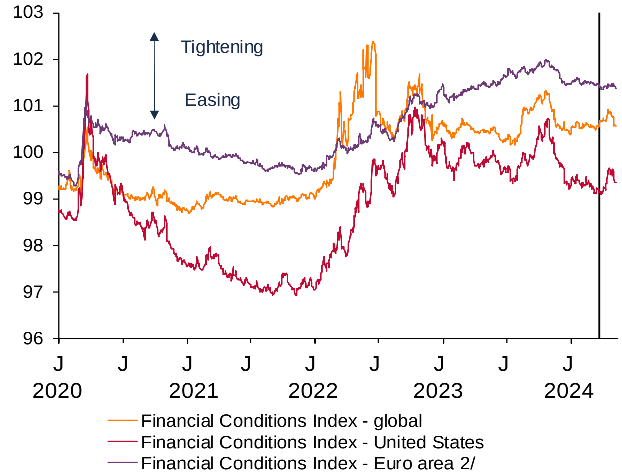
[5] The Federal Reserve will reduce the monthly redemption limit on Treasury securities from 60 to 25 billion dollars starting in June. Likewise, the Committee will maintain the monthly redemption limit on agency debt and agency mortgage-backed securities at 35 billion dollars, and will reinvest in Treasury securities any principal payments above this limit.

Since Mexico's last monetary policy decision, the central banks of the main emerging economies made decisions on their monetary policy rates in a differentiated manner, considering the specific economic circumstances of their countries. Some central banks, mainly in Latin America and Eastern Europe, cut their reference rates in their most recent decisions. In some cases, such as Chile, Hungary and Brazil, they moderated the pace of rate cuts. Others, in turn, decided not to adjust their reference rate, after having done so in previous decisions. In China, the central bank left its interest rates unchanged in April, including the 1- and 5-year Loan Prime Rates (LPRs). Meanwhile, the Central Bank of Indonesia raised its reference rate by 25 basis points at its April meeting, after having kept it unchanged for five consecutive meetings since October 2023.

Financial conditions deteriorated since the beginning of April 2024. This was associated with the threat of an escalation of the geopolitical conflict in the Middle East and with new data suggesting that the US labor market remains tight and inflation has some persistence, leading to expectations of a more prolonged restrictive monetary policy stance in that country than previously anticipated (Chart 5). More recently, starting in May, given labor data suggesting a moderation in the dynamism of employment in the United States, there was an improvement in financial conditions that partially reversed the tightening registered in April.

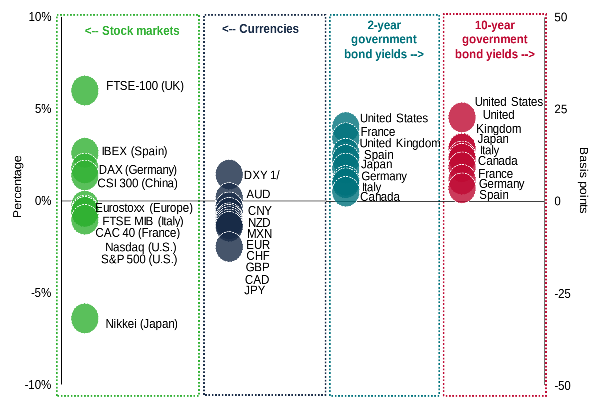
In line with the evolution of financial conditions, medium and long-term rates in the main advanced and emerging economies increased with respect to the level registered in the last monetary policy decision. (Chart 6 and Chart 7). Stock markets in advanced and emerging economies registered mixed results. In the foreign exchange markets, the US dollar appreciated against the currencies of emerging and advanced countries. Lastly, since the last monetary policy decision, capital outflows to emerging economies have been registered. However, these flows exhibited a differentiated behavior among asset classes, with net outflows of equity assets and slight inflows from fixed-income assets during most of the reporting period.

Chart 5
Financial conditions index[1/]
Units



1/ The financial conditions index is constructed considering the effect of five variables on economic activity: the reference interest rate, the 10-year government bond, the spread of investment grade bonds over the government debt bond with equivalent maturity, the ratio of a stock index with 10-year average earnings per share, and the trade weighted exchange rate.
2/ In the case of the euro area, the spread between the sovereign bonds of France, Italy, Spain, the Netherlands, Belgium, Austria, Portugal and Finland over the German 10-year bond is also considered. The vertical black line indicates the last calendarized monetary policy meeting of Banco de México.
Source: Bloomberg and Goldman Sachs.

Chart 6
Change in selected financial indicators from March 21 to May 8,2024
Percent; basis points



1/ MSCI Emerging Markets Index, which includes 24 countries.
2/ DXY: a weighted average estimated by the Intercontinental Exchange (ICE) of the nominal exchange rate of the main six currencies operated globally with the following weights: EUR: 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%.
Source: Bloomberg.

Chart 7
Selected emerging economies: financial assets performance as of March 14, 2024

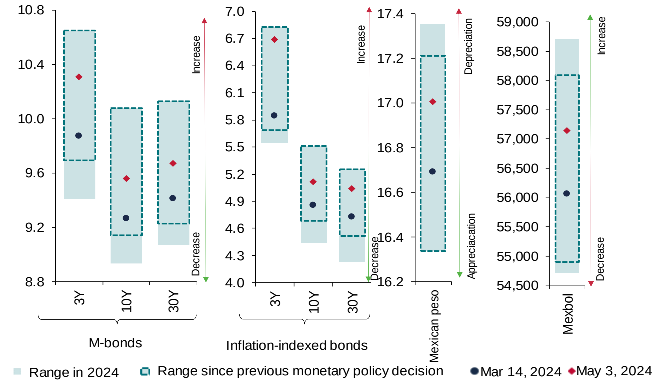
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-1.30%	1.92%	42	29	11
	Brazil	-1.89%	0.64%	57	54	16
	Chile	1.07%	1.52%	7	27	9
	Colombia	-0.50%	7.98%	64	44	27
	Peru	-1.03%	-0.71%	7	10	17
Emerging Europe	Russia	0.48%	4.39%	15	8	N.A.
	Poland	-1.39%	3.19%	18	21	4
	Turkey	-0.39%	15.68%	-3	166	-15
	Czechia	-0.05%	2.26%	41	32	3
	Hungary	0.76%	4.64%	56	36	-5
Asia	China	-0.13%	2.19%	-18	-4	-3
	Malaysia	-1.14%	2.97%	11	10	6
	India	-0.81%	1.07%	8	11	3
	Philippines	-3.29%	-5.06%	50	73	6
	Thailand	-3.28%	-1.79%	25	26	2
	Indonesia	-2.84%	-4.02%	58	52	4
Africa	South Africa	1.84%	4.21%	21	16	9

Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year swap rates were used. The latest CDS data for Russia is as of June 1, 2022.
Source: Bloomberg.

Chart 8
Mexican markets' performance

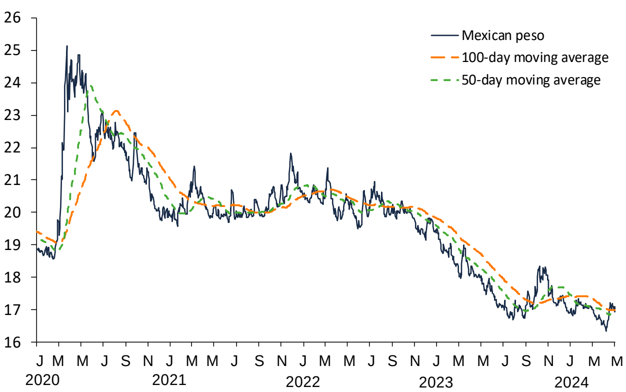
Percent, MXN/USD and index



Source: Bloomberg and PIP.

Chart 9
Mexican peso exchange rate

MXN/USD



Source: Banco de México.

A.2. Current situation of the Mexican economy

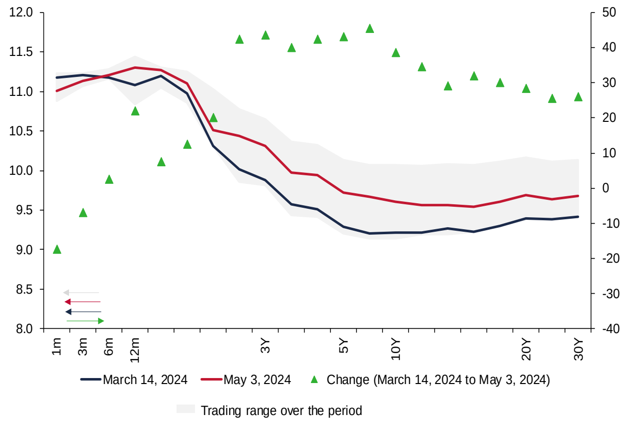
A.2.1. Mexican markets

In the international context described, since Mexico's last monetary policy decision, the exchange rate of the Mexican peso against the US dollar exhibited episodes of volatility and slightly depreciated. Meanwhile, interest rates on government securities exhibited generalized increases (Chart 8).

The Mexican peso traded in an intraday range between 16.26 and 18.25 pesos per US dollar since the last monetary policy decision. During this period, it depreciated by 1.30%, mainly due to the global decrease in risk appetite, escalating geopolitical tensions in the Middle East, and the liquidation of long Mexican peso positions (Chart 9). In general, trading conditions deteriorated during the period.

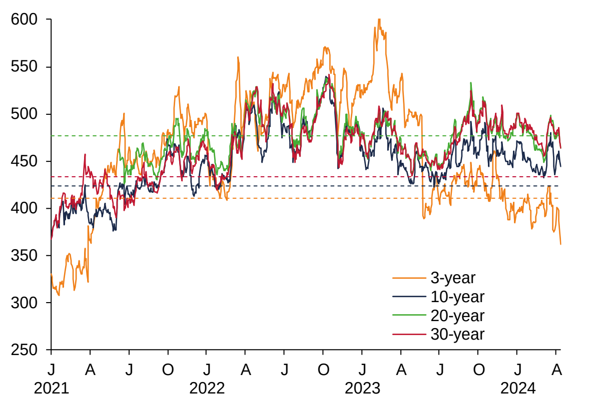
Interest rates on government securities increased up to 44 basis points in the medium-term segment, while in the long term they rose up to 32 basis points (Chart 10). The yields on real rate instruments exhibited a negative behavior with increases across all terms. They reached their highest levels since 2001 for the 3-year term and since 2008 for the 10- and 30-year terms. Breakeven inflation implicit in spreads between nominal and real rates of market instruments decreased in the short term and registered limited variations in longer-term nodes (Chart 11). These movements occurred in an environment in which trading conditions deteriorated.

Chart 10
Nominal yield curve of government securities
Percent, basis points



Source: PIP.

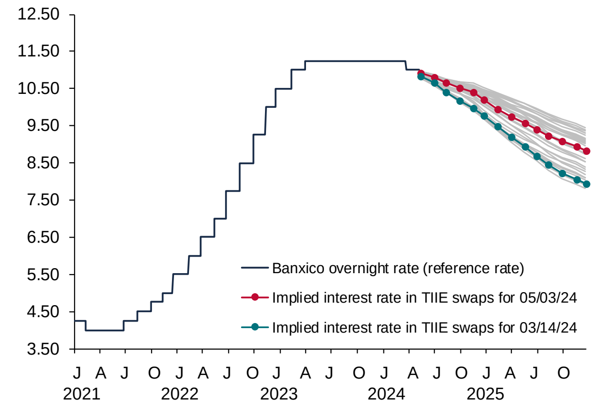
Chart 11
Breakeven inflation and inflation risk implied in interest rates of government securities
Basis points



1/ Horizontal dashed lines refer to the respective averages observed from September 2008 to date.
Source: PIP.

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve does not incorporate any movement in May 2024. It shows an expectation of 10.21% and 8.83% for the target rate at the end of 2024 and 2025, respectively (Chart 12). On the other hand, a small segment of analysts surveyed by Citibanamex anticipates a reduction in the reference rate in May, although the consensus projects a rate cut of 25 basis points in June to reach a level of 10.75%. They estimate the rate to close the year at 10.00%.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent

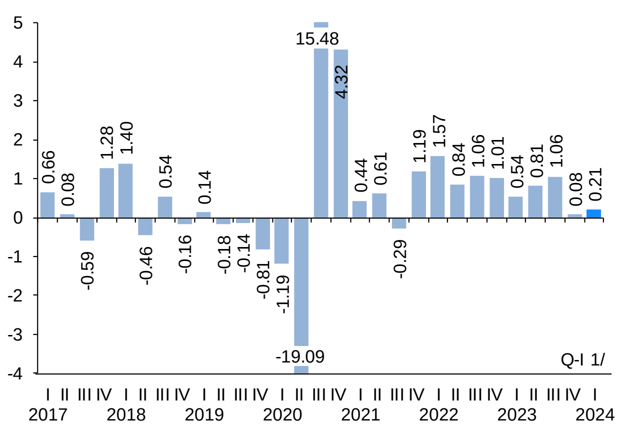


Note: Shaded areas represent the daily trajectories since the last monetary policy decision.
Source: PIP.

A.2.2. Economic activity in Mexico

According to Mexico's GDP flash estimate published by INEGI, the low dynamism that economic activity exhibited in the last quarter of 2023 extended into the first quarter of 2024. GDP registered a seasonally adjusted quarterly variation of 0.21% (Chart 13).

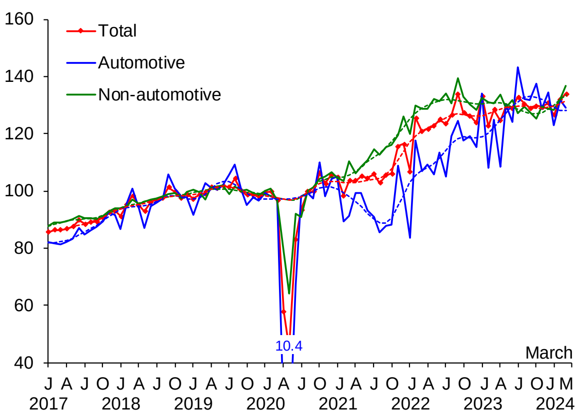
Chart 13
Gross Domestic Product
Quarterly percentage change, s. a.



s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
1/ The figure for the first quarter of 2024 refers to the timely estimation of quarterly GDP published by INEGI.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the evolution of domestic demand, private consumption reactivated in February 2024, reversing the fall observed in the previous month and trending upwards. The category of imported goods continued exhibiting dynamism, while consumption of services continued reactivating with respect to the stagnation registered in the fourth quarter of 2023. In contrast, consumption of domestic goods remained weak. In February, gross fixed investment remained at high levels, despite showing sluggishness at the margin. Spending on construction was weak, although it remained at high levels. In contrast, investment in machinery and equipment rebounded, supported by the component of transportation equipment. Regarding external demand, in the first quarter of 2024, the average value of manufacturing exports in US dollars improved somewhat compared to the fourth quarter of 2023, reflecting a reactivation in the non-automotive component (Chart 14).

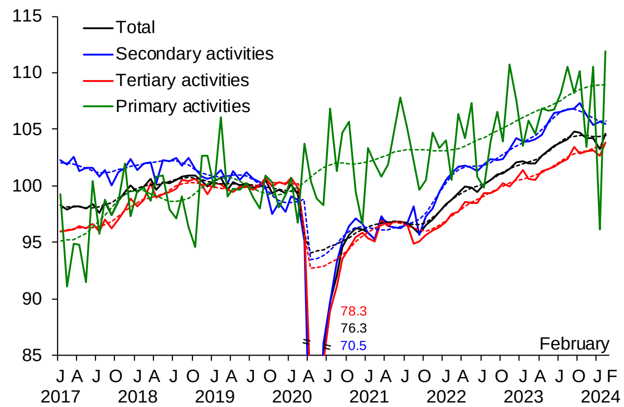
Chart 14
Manufacturing exports
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Prepared by Banco de México with data from the Tax Administration Service (SAT, for its Spanish acronym), the Ministry of the Economy (SE, for its Spanish acronym), Banco de México, the National Institute of Statistics and Geography (INEGI, for its Spanish acronym). Mexico's Merchandise Trade Balance. The National System of Statistical and Geographical Information (SNIEG, for its Spanish acronym). Information of national interest.

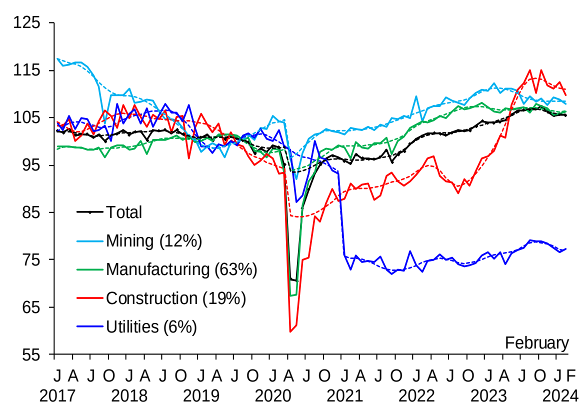
On the production side, in a context of persistent drought conditions reported across a number of agricultural production regions, primary activities fell markedly in January, and then reactivated in February. Similarly, after the contraction in January, services reactivated in February (Chart 15). According to preliminary information, these sectors are expected to have continued expanding in March. During the period of January-February 2024, industrial activity remained weak. Within its components, the weakness of manufacturing activity intensified (Chart 16). However, despite remaining at high levels, construction decreased compared to the fourth quarter of 2023. Preliminary information suggests that industrial activity may have performed better in March.

Chart 15
Global Indicator of Economic Activity
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 16
Industrial activity [1/]
Indices 2019 = 100, s. a.

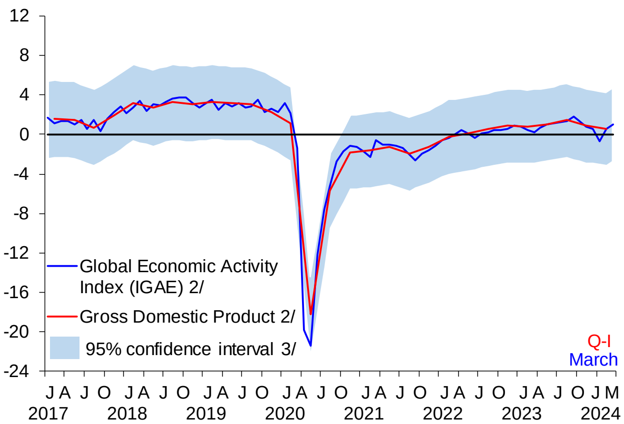


s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the cyclical position of the economy, based on preliminary information, during the first quarter of 2024, the point estimate of the output gap decreased for the second consecutive quarter due to the economic slowdown observed in the last quarter of 2023 and the first quarter of 2024. The estimate remained in positive territory, although not statistically different from zero (Chart 17).

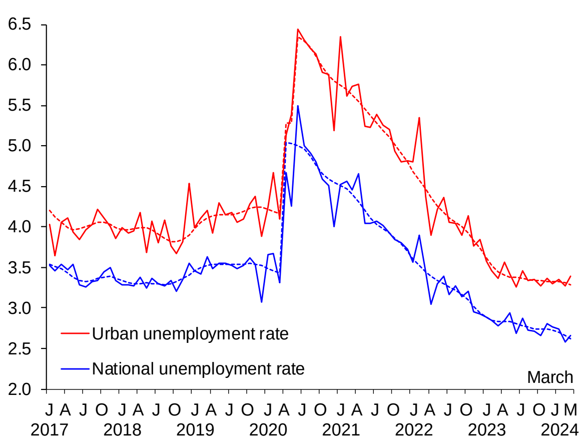
In March 2024, the labor market continued to show strength. The national and urban unemployment rates remained at historically low levels (Chart 18). With information up to April and with seasonally adjusted data, the number of newly created formal IMSS-insured jobs continued trending upwards. Lastly, in February 2024, unit labor costs in the manufacturing sector partially reversed the decrease exhibited during the previous month and remained at relatively high levels (Chart 19).

Chart 17
Output gap estimates 1/
Percent of potential output, s. a



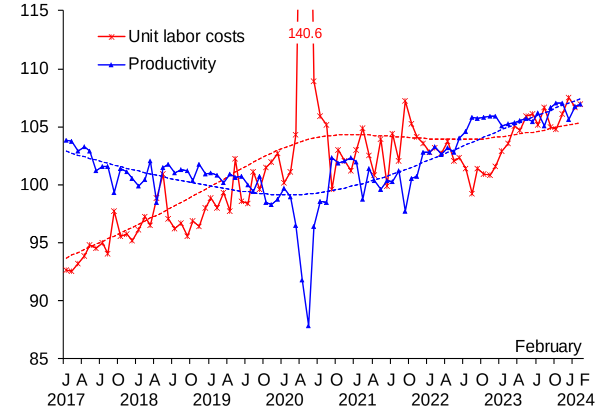
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ Figures for the timely GDP for the first quarter of 2024 and IGAE for March 2024 are consistent with this timely GDP figure.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and urban unemployment rates
Percent, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: INEGI.

Chart 19
Productivity and unit labor cost in the manufacturing sector 1/
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly Manufacturing Industry Survey and industrial activity indicators of Mexico's System of National Accounts (*Sistema de Cuentas Nacionales de México*, SCNM), INEGI.

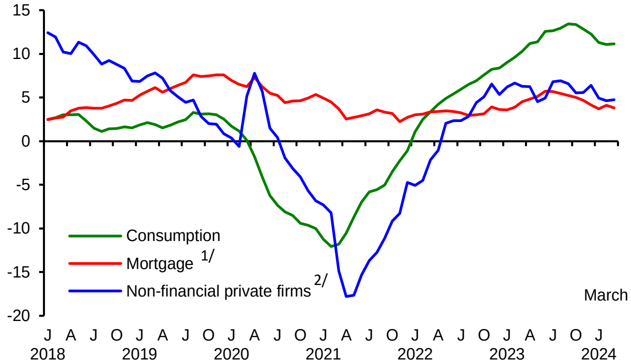
Domestic financing to the private sector continued growing in March 2024, albeit with some moderation compared to the dynamism observed in the second half of 2023. Regarding its components, bank lending to firms and households registered a slightly slower pace of expansion than that observed at the end of the previous year (Chart 20). Nevertheless, growth rates in some segments remained high, especially in credit for consumption.

As for the cost of financing, interest rates on bank credit to firms did not change significantly compared to the previous month, remaining at high levels. Meanwhile, credit intermediation margins in this segment increased slightly and reached levels similar to those observed prior to the pandemic. Interest rates on mortgages remained at levels similar to those observed prior to the health emergency. Lastly, within consumer credit, credit card interest rates remained high and increased slightly in December 2023, while interest rates on payroll loans have remained relatively stable since August 2021.

As for portfolio quality, in March 2024, delinquency rates of bank credit to the private sector remained at low levels. In the case of consumer portfolio, these indicators remained stable, thus stopping the upward trend observed since the first half of 2023.

Chart 20
Performing credit from commercial banks to the private sector

Annual percentage change



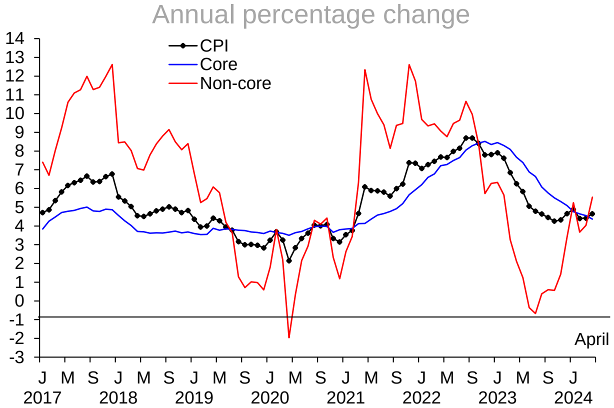
1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation rose from 4.40 to 4.65% between February and April 2024. This result stemmed from the increase in non-core inflation. At the same time, core inflation continued to decline (Chart 21 and Table 1).

Chart 21
Consumer Price Index

Annual percentage change



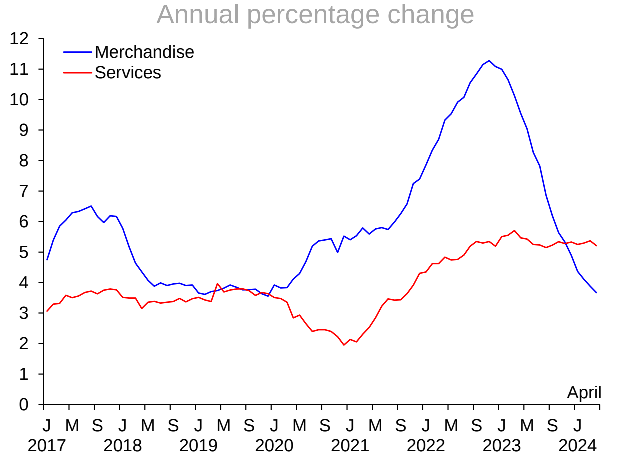
Source: INEGI.

Annual core inflation decreased from 4.64% in February to 4.37% in April 2024. Regarding its components, annual merchandise inflation continued declining (Chart 22). Between the same months, it decreased from 4.11 to 3.67%. This performance was associated with the easing of pressures associated with the pandemic and the war in Ukraine, as well as the lower levels of the exchange rate compared to those observed at the beginning of 2023. Specifically, annual food merchandise inflation decreased from 5.54 to 4.79% and non-food merchandise inflation from 2.75 to 2.34% during the referred period (Chart 23). Annual services inflation shifted from 5.30 to 5.21% during the same period. Thus, it remained at high levels and continued without showing a clear downward trend, still affected by pressures related to operating costs, their pass-through to consumer prices, and the recovery in demand for services.

Annual non-core inflation increased from 3.67 to 5.54% between February and April 2024 (Chart 24 and Table 1). This was the result of an increase in the annual inflation of agricultural and livestock products and energy products. The former rose from 4.77 to 7.35%, driven by the increase in the annual variation of fruit and vegetable prices from 15.00 to 18.57%, and in livestock products' prices from -3.23% to -1.13%. During the same period, annual inflation of energy products increased from 2.28 to 4.38%, driven mainly by the increase from -2.18 to 4.73% in the annual variation of L.P. gas prices and from 3.86 to 4.86% in gasoline prices.

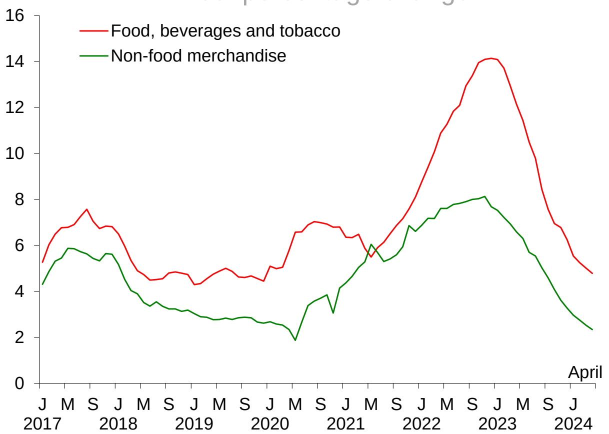
Chart 22
Merchandise and services core price subindex

Annual percentage change



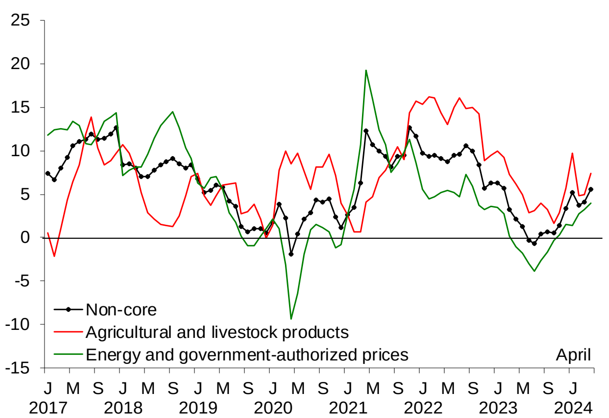
Source: INEGI.

Chart 23
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Chart 24
Non-core price subindex
Annual percentage change



Source: INEGI.

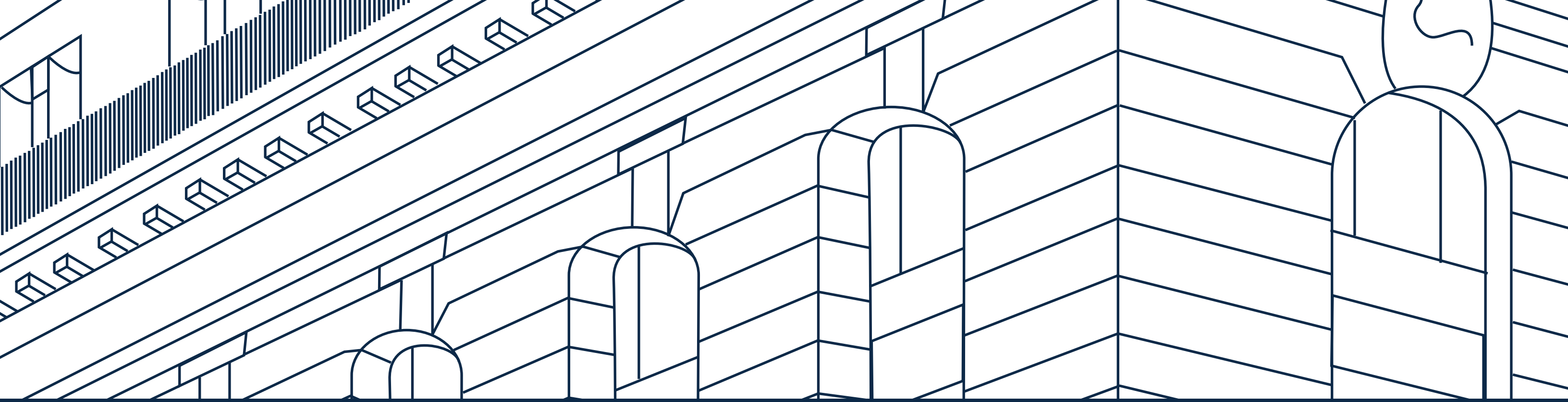
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between February and April 2024, the medians for expected headline and core inflation for the end of 2024 increased from 4.10 to 4.20% and from 4.06 to 4.10%, respectively. Expectations for headline inflation for the end of 2025 increased marginally. The median of headline inflation expectations adjusted from 3.70 to 3.71%, while that of core inflation shifted from 3.69 to 3.72%. At the same time, the median of headline inflation expectations over the next four years remained at 3.68%, while expectations for core inflation for the same horizon decreased from 3.68 to 3.63%. The medians of headline and core inflation expectations for the long term (5 to 8 years) remained stable. Both medians lied at 3.50%. Lastly, breakeven inflation showed a tendency to increase as compared to the level observed in Mexico's previous monetary policy decision. Within its components, inflation expectations implicit in market instruments registered limited adjustments while the inflation risk premium was revised upwards.

The disinflationary process in Mexico is expected to continue. However, inflationary shocks have taken longer to dissipate. In particular, services inflation is foreseen to show more persistence, as compared to what had been previously anticipated. Consequently, the forecasts for both headline and core inflation indicate a more gradual decline than previously expected. Thus, headline inflation is currently estimated to converge to the target in the fourth quarter of 2025. In turn, core inflation is expected to reach 3% in that same quarter. These projections are subject to risks. On the upside: i) persistence of core inflation; ii) foreign exchange depreciation; iii) greater cost-related pressures; iv) a greater-than-expected resilience of the economy; v) climate-related impacts, and vi) the intensification of geopolitical conflicts. On the downside: i) a lower-than-anticipated global economic activity; ii) a lower pass-through from some cost-related pressures, and iii) that Mexico's exchange rate levels mitigate certain pressures on inflation. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.

Table 1
Consumer Price Index and components
Annual percentage change

Item	February 2024	March 2024	April 2024
CPI	**4.40**	**4.42**	**4.65**
Core	**4.64**	**4.55**	**4.37**
Merchandise	**4.11**	**3.88**	**3.67**
Food, beverages and tobacco	5.25	5.01	4.79
Non-food merchandise	2.75	2.53	2.34
Services	**5.30**	**5.37**	**5.21**
Housing	3.73	3.78	3.73
Education (tuitions)	6.39	6.36	6.36
Other services	6.36	6.46	6.19
Non-core	**3.67**	**4.03**	**5.54**
Agricultural and livestock products	**4.77**	**4.92**	**7.35**
Fruits and vegetables	15.00	12.25	18.57
Livestock products	-3.23	-0.78	-1.13
Energy and government-authorized prices	**2.75**	**3.29**	**3.98**
Energy products	2.28	3.25	4.38
Government-authorized prices	3.87	3.38	3.08

Source: INEGI.



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