

Press Release

Monetary Policy Statement

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

Since the second half of 2018, world economic activity has exhibited a downward trend, although a moderate recovery was observed during the first quarter of 2019 in some of the major economies, such as the United States, the United Kingdom, the euro area and China, to a large extent associated with short run factors. Labor markets in the major advanced economies continued to exhibit strength and certain wage increases. Although headline inflation in these economies has rebounded due to the increase in energy prices, core inflation has decreased in several of them, in some cases due to transitory factors and methodological changes. This environment has strengthened expectations that the central banks of the major economies will adopt a more accommodative monetary policy strategy. In its May meeting, the US Federal Reserve left the target range for the federal funds rate unchanged and reiterated its message that it will be patient in making adjustments to the range. Among the risks that still persist and are worth highlighting are an escalation of trade tensions between the U.S. and its main trade partners; a more prolonged weakening of some of the major economies than expected; new episodes of volatility in financial markets; and, the intensification of certain political and geopolitical risks. Due to the aforementioned, the balance of risks for the global economy continues biased to the downside.

As for domestic financial markets, the peso exchange rate appreciated compared to the levels observed during the last monetary policy decision, while exhibiting higher levels of volatility. Interest rates on government securities increased, mainly those for the medium and long terms. Looking ahead, risks persist which might have a significant effect on the performance of financial assets in Mexico. In particular, uncertainty regarding the external environment might lead to portfolio adjustments, and investors remain alert to domestic issues such as the credit perspectives for Pemex and for the economy in general.

The current environment continues to pose significant risks in the medium and long terms that could affect the country's macroeconomic conditions, its potential growth, and the economy's price formation process. In this regard, it is particularly important that, in addition to a prudent and firm monetary policy, measures to foster an environment of confidence and certainty for investment and higher productivity are adopted, and public finances are consolidated in a sustainable way. In this context, it is especially relevant that the fiscal targets set in the Economic Package for 2019 are attained. Strengthening the rule of law, tackling corruption, and fighting insecurity are equally imperative.

The latest information suggests that during the first quarter of 2019 the weak performance the Mexican economy had been exhibiting since the previous quarter intensified, due to both external and domestic factors, some of which are transitory. Thus, economic slack increased towards the end of 2018 and the early part of 2019. The balance of risks for growth has become more uncertain and remains biased to the downside.

Between March and April, headline inflation rose from 4.00% to 4.41%, due to increases in its core and non-core components, with core inflation's contributing in greater measure. As for non-core inflation, it increased from 5.47% to 6.08%, partly reflecting that since the second week of February 2019, the downward path in energy price increases reverted, due largely to the evolution of their international references. As for core inflation, it rose during this period, from 3.55% in March to 3.87% in April. This was due to continued increases in the rate of change of food merchandise prices, while that for services prices rebounded during the same period. Services prices were partly influenced by the effect on their annual variations of the Easter holiday, which this year took place in April, while in 2018 it did so in March. Nevertheless, even after excluding this effect, the annual variation of services prices increased. Thus, core inflation has remained at high levels, and recently has increased further. Headline and core inflation expectations increased for both the short and medium terms, while those for the long term remained unchanged, all of them remaining clearly above the 3% permanent target. As for information drawn from market instruments, after having followed a downward trend, the medium- and long-term inflationary risk premium has increased over the last weeks, remaining at high levels.

As for inflation risks, the possibility that the peso exchange rate comes under pressure stemming from external or domestic factors stands out. Should the economy require adjustments either to the real exchange rate or to medium- and long-term interest rates, Banco de México will contribute to orderly adjustments, in an effort to prevent second-round effects on the economy's price formation process. Inflation could also be affected if additional pressures on energy prices or on agricultural and livestock product prices arise, if an escalation of protectionist and compensatory measures worldwide materializes or in case public finances deteriorate. Moreover, given the magnitude of the increases to the minimum wage, in addition to their possible direct impact, there is the risk that these bring about high wage revisions in several sectors. In fact, in some sectors these have exceeded productivity gains and could give rise to cost pressures, thus affecting formal employment and contributing to keep core inflation at high levels. In order to raise the purchasing power of wages sustainably, the role of other public policies must be considered, in particular, fostering competition in those sectors of goods and services with a high share in the consumption basket of the segments of the population with the lowest income. Also, the persistence shown by core inflation could imply a greater downward resistance of medium- and long-term inflation expectations. Finally, another risk is that the greater economic slack does not translate into lesser pressures on inflation, given the factors that have been putting upward pressure on core inflation. As for downside risks, the prices of certain goods included in the non-core subindex could register lower variations or economic slack could widen more than expected. Thus, although there has been an intensification of certain downside risk factors, like the greater slack in the economy, there are others that could make inflation remain at high levels and, therefore, deviate it from its foreseen path, given the factors that have restrained core inflation from decreasing. For this reason, in an environment of high uncertainty, it is deemed that the balance of risks for inflation relative to its forecasted trajectory still remains to the upside.

To guide its monetary policy actions, Banco de México's Governing Board follows closely the development of inflation vis-à-vis its forecasted trajectory, taking into account the monetary policy stance and the time frame in which monetary policy operates as well as available information on all inflation determinants and on medium- and long-term inflation expectations, including the balance of risks for such factors. Monetary policy must respond prudently if for any reason the uncertainty faced by the economy increases considerably. Although headline and core inflation have increased, these developments are considered to be transitory and the current monetary policy stance consistent with the convergence of inflation to its target within the time frame in which monetary policy operates. For this reason, Banco de México's Governing Board has decided unanimously to leave the target for the overnight interbank interest rate unchanged at 8.25%. Considering the risks to consolidate a low and stable inflation as well as those the economy's price formation is subject to, the Governing Board will continue to follow closely

all factors and elements of uncertainty that have an impact on both inflation and its outlook, and will take the necessary actions so that the reference rate is kept at a level consistent with the convergence of headline inflation to Banco de México's target within the period in which monetary policy operates.

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