BANCO DE MÉXICO

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Press Release

Monetary Policy Statement

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Banco de México's Governing Board has decided to lower the target for the overnight interbank interest rate by 25 basis points to 8.00%.

World economic activity decelerated during the second quarter of the year due to moderation of growth in the main advanced and emerging economies. In this environment, the outlook for growth for the world economy has been revised downwards once more. Likewise, disputes arose between the United States and other economies related both to trade as well as to issues associated with migration, technology and exchange rate policy. Headline and core inflation in the main advanced economies have remained at low levels and below their central banks' targets. In this context, a large number of central banks have adopted more accommodative monetary policy stances. In its July meeting the US Federal Reserve cut the target range for the federal funds rate by 25 basis points and anticipated the end of its balance sheet reduction. Episodes of volatility in financial markets associated with the tensions between the United States and China, and with a greater than expected deceleration in some economies, have taken place. This environment has led to expectations of further monetary policy easing by several central banks. The risks faced by the global economy have increased: escalation of trade disputes, a disorderly Brexit, and the worsening of certain political and geopolitical risks stand out. For this reason, the balance of risks for world economic activity has deteriorated.

Domestic financial markets have been influenced by the effects of lower interest rates for all terms in the major advanced economies and by episodes of volatility. Thus, while the peso exchange rate fluctuated under these episodes, interest rates on government securities have decreased, including longer term ones. Regarding the risks that may affect the performance of financial assets in Mexico, uncertainty persists with respect to the bilateral relationship between Mexico and the United States and to the credit rating outlook both for Pemex's debt and for Mexico's sovereign debt.

The current environment continues to pose significant medium- and long-term risks that could affect the country's macroeconomic conditions, its ability to grow, 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 that public finances are consolidated in a sustainable way. In this context, addressing the deterioration of both the sovereign's and Pemex's credit ratings and achieving the fiscal targets for 2019 are necessary. It is also important that the Economic Package for 2020 generates confidence. Strengthening the rule of law, tackling corruption, and fighting insecurity are equally imperative.

The latest information suggests that during the second quarter of 2019, the stagnation of economic activity in Mexico observed in the previous quarters continued, due to a further weakening of most of the components of aggregate demand. Thus, slack conditions in the economy have continued to loosen, even more than expected, widening the negative output gap. In an environment of significant uncertainty, the balance of risks for growth remains biased to the downside.

Between June and July, headline inflation fell from 3.95% to 3.78%, due mainly to a decline of the non-core component, which went from 4.19% to 3.64%, reflecting the lower increases especially in the prices of energy products and in fruits and vegetables prices as well, while the rate of growth of livestock product prices has increased at the margin. As for core inflation, it has remained persistent around 3.8%. Inflation expectations for different terms from surveys and financial markets have remained relatively stable, although at levels above 3%.

As for upside inflation risks, core inflation may continue to show persistence and there is the possibility that the peso exchange rate comes under pressure stemming from external or domestic factors. Should the economy require an adjustment of the real exchange rate, Banco de México will contribute to an orderly process, preventing second-round effects on the economy's price formation process. Additional risks are the threat by the United States to impose tariffs on Mexican imports and the adoption of compensatory measures, although these have dissipated somewhat; that energy prices revert their trend or that agricultural and livestock product prices exhibit increases; weak public finances; and, that global protectionist measures escalate. In addition, given the magnitude of several wage revisions, that cost-related pressures arise, insofar as such revisions exceed productivity gains. Regarding downside risks, the peso exchange rate may appreciate, possibly associated with a context of more accommodative monetary policy stances and lower interest rates worldwide, or in case greater certainty arises regarding the trade relation with the United States. Another downside risk is that the prices of certain goods included in the non-core subindex register lower rates of change, as observed in the case of energy goods, due to the greater weakness exhibited by the world economy, which would also contribute to reduce core inflation. In addition, that slack conditions widen more than anticipated, which would impact the behavior of core inflation. Given the aforementioned, high uncertainty still persists regarding the risks that might affect inflation. In this context, Banco de México will be alert to the possible materialization of inflation risks, both to the downside and 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. In this process, it uses available information on all inflation determinants as well as on medium- and long-term inflation expectations, including the balance of risks for such factors. Monetary policy must also respond prudently if for any reason the uncertainty faced by the economy increases significantly. In this context, considering that headline inflation has decreased as foreseen by Banco de México, the greater than expected widening in the amount of slack in the economy, and the recent behavior of the external and domestic yield curves at various terms, Banco de México's Governing Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 8.00%, considering that under the current environment such level is consistent with the convergence of headline inflation to the central bank's target within the time frame in which monetary policy operates. One member voted to maintain the target at 8.25%. In order to consolidate a low and stable inflation, in an environment in which price formation and slack conditions in the economy are subject to risks, the Governing Board will continue to follow closely all factors and elements of uncertainty that have an impact on inflation and its outlook, and will take the required actions based on incoming information so that the policy rate is consistent with the orderly convergence of headline inflation to Banco de México's target within the time frame in which monetary policy operates.

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