

September 26, 2019

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 7.75%.**

Available information suggests that the moderation of world economic growth continued during the third quarter of the year. Likewise, the outlook for global growth has continued to be revised downwards, in an environment where headline and core inflation in the main advanced economies are below their central banks' targets. In this context, several central banks have loosened their monetary policy stances. In its September meeting, the US Federal Reserve cut the target range for the federal funds rate by 25 basis points. The European Central Bank also implemented several monetary policy easing measures. During this period, episodes of volatility in financial markets have taken place, mainly associated with trade tensions between the United States and China, although they have recently diminished. The world economy also faces other political and geopolitical risks. Thus, the balance of risks for world economic activity remains biased to the downside.

Domestic financial markets have reflected the effects of lower interest rates for all terms in the main advanced economies as well as episodes of volatility with exchange rate adjustments, although these have diminished over the last weeks. In this regard, interest rates on government securities for all terms have continued to decrease. 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 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 as well as achieving both the fiscal targets for 2019 and the goals set in the 2020 Economic Package are necessary. Strengthening the rule of law, tackling corruption, and fighting insecurity are equally imperative.

Although economic activity in the previous quarters and in July remained stagnant, it is expected to recover slightly over the rest of the year. Slack conditions in the economy during the early part of the quarter remained at levels similar to those of the previous one, with a persistent negative output gap. In an environment of significant uncertainty, the balance of risks for growth remains biased to the downside.

Between July and the first fortnight of September, headline inflation fell from 3.78% to 2.99%, due mainly to a decline of the non-core component, which went from 3.64% to 0.57%, reflecting the lower increases of energy, agricultural and livestock product prices. Core inflation has remained persistent around 3.8%. As for inflation expectations from surveys, short-term expectations have followed the latest data, while longer term ones 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 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 this risk has dissipated somewhat; that energy prices or agricultural and livestock product prices increase; weak public finances; and that global protectionist measures escalate. In addition, given the magnitude of various 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. 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 act prudently if for any reason the uncertainty faced by the economy increases significantly. In this context, considering the reduction of headline inflation, the ample slack in the economy, and the recent behavior of external and domestic yield curves, Banco de México's Governing Board decided by majority to lower the target for the overnight interbank interest rate to 7.75%, taking into account 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. Two members voted for lowering said target to 7.50%. 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 and sustained 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.