

## Monetary Policy Statement

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### **Banco de México's Governing Board decided to maintain the target for the overnight interbank interest rate at 7.75%.**

During the second quarter of 2018, the world economy continued to grow at a moderate pace, and the divergence among the main advanced economies' performance increased. Indeed, in contrast with the Eurozone, Japan and the U.K., which have grown below expectations, economic activity in the U.S. exhibited higher growth, partly in response to the fiscal stimulus implemented. Under conditions of reduced slack in the economy, this could exert greater pressure on inflation. As expected, in September the Federal Reserve raised the target range for the federal funds rate and reiterated its forecast of increasing it gradually, thus leading to an increase in interest rates for all terms. The world economy continues to be subject to a high degree of uncertainty due to risks associated mainly with a further intensification of international trade disputes, a further tightening of financial conditions, and with geopolitical factors. In this environment, international financial markets have recently undergone episodes of volatility and the prices of emerging economies' assets have performed negatively. Nevertheless, differences related to each country's macroeconomic fundamentals and to idiosyncratic factors have been observed. Thus, since the last monetary policy decision, the Mexican peso has been more resilient than other emerging market currencies. In addition to Mexico's prudent macroeconomic management, this result was also associated with the favorable developments related to the trade negotiation with the United States and Canada. Concerning interest rates in Mexico, those of short tenors fluctuated slightly while those of medium and long tenors increased.

The latest information suggests that at the beginning of the third quarter of 2018 economic activity in Mexico expanded, after having contracted during the second quarter. Slack conditions in the economy are estimated to have remained similar to those observed during the previous quarter. Given the complex environment the Mexican economy faces, Banco de México's Governing Board considers that the balance of risks for growth continues biased to the downside. This bias has decreased at the margin as a result of the recently approved trade agreement with the United States and Canada.

The Mexican economy is well poised to cope with adverse external and domestic scenarios due to the central bank's monetary policy stance adopted to keep medium- and long-term inflation expectations anchored, the fiscal commitments, and the financial system's resilience. In this regard, despite the decreased uncertainty associated with Mexico's trade relationship with the U.S. and Canada, the Mexican economy continues facing a complex environment characterized, among other factors, by the risk of tighter external financial conditions. Under these circumstances, it is particularly relevant that, in addition to following a prudent and robust monetary policy, measures to foster greater productivity are adopted and public finances are consolidated sustainably.

Since June, higher-than-expected rises in the prices of energy-related products have been observed, mainly of gasoline and L.P. gas. Although these shocks are transitory, they have affected the rate at which core inflation has been declining, due to the indirect effects of these price increases on production costs, and they have also delayed the convergence of headline inflation to its target. In this regard, although these price increases stem from higher international references, the gradual adjustment of

domestic gasoline prices has made such increases more persistent. This has contributed to keep non-core inflation high for a long period. Although core inflation has been subject to the aforementioned indirect effects, projections that it will continue decreasing within monetary policy's period of influence are maintained. In this context, expectations for headline inflation for the end of 2018 have been adjusted from 4.25% in July to 4.50% in September, while those for the end of 2019 have increased from 3.60% to 3.70%, respectively. Expectations for core inflation for the end of 2018 decreased from 3.60 to 3.53% during the same months and those for the end of 2019 remained practically unchanged. Expectations for headline inflation for the medium and long terms remain around 3.50%.

The expected evolution of inflation continues to be subject to risks and to a high degree of uncertainty. Among the upside risks are pressures on the peso exchange rate due to an environment of higher external interest rates and to other external or domestic factors. In this regard, should there be a real exchange rate depreciation, Banco de México will make sure this takes place in an orderly manner and with no second-round effects on the economy's price formation process. On the other hand, the following risks persist: additional upward pressures on energy prices, as indicated by the futures prices of some of these products; escalating protectionist measures worldwide that could affect inflation negatively; and, greater-than-anticipated levels of public expenditure. In addition, if wage negotiations are not consistent with productivity gains, inflationary pressures on the economy could also appear. As for downside risks, the ratification of the new trade agreement with the U.S. and Canada could have a favorable impact on markets and on the Mexican peso exchange rate. Considering all of the above, the balance of risks to the forecasted trajectory of inflation remains biased upwards, in an environment of uncertainty.

To guide its monetary policy actions, Banco de México's Governing Board follows closely the development of inflation vis-à-vis its anticipated trajectory, taking into account the monetary policy stance adopted 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. Given the Mexican economy's recent developments, that the shocks that have affected inflation recently are of a transitory nature, and that the expected trend for core inflation remains downward, Banco de México's Governing Board has voted by majority to maintain the target for the overnight interbank interest rate unchanged at 7.75%. One member voted for increasing the rate by 25 basis points. The Governing Board will monitor the potential pass-through of the shocks that have affected non-core inflation as well as other factors that could affect the evolution of core inflation, which is particularly relevant in the present scenario, since this indicator is still above 3%. In this regard, the central bank will take the necessary actions, specifically, maintaining or possibly strengthening the current monetary policy stance so that headline inflation converges to Banco de México's target within monetary policy's period of influence.

Banco de México's Governing Board will maintain a prudent monetary policy stance and will continue to follow closely the potential pass-through of exchange rate fluctuations to prices, the monetary policy stance relative to that of the U.S. under an adverse external environment, and the conditions of slack 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 robust 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.