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 maintain the target for the overnight interbank interest rate at 8.25%.

Available indicators suggest that during the fourth quarter of 2018 the world economy decelerated, as evidenced by the lower dynamism in most advanced and some emerging economies, such as the Eurozone, China, and, to a lesser extent, the United States. This reflects, among other factors, the effects of trade disputes, declining business confidence, and transitory shocks. This environment of lower dynamism of economic activity led to downward revisions in the outlook for world growth for 2019 and 2020, and, together with the decrease in crude oil prices, contributed to ease inflationary pressures in the main economies. The latter has been reflected in expectations of a slower normalization of monetary policy in the major economies, and in lower short- and long-term interest rates in the United States. As expected, in January the Federal Reserve left the target range for the federal funds rate unchanged. Also, it modified significantly its message, stating that it will be patient in making future adjustments to the target range for the federal funds rate and that it could adjust the details of its balance sheet normalization program if necessary. In this context, financial markets in both advanced and emerging economies have exhibited a more favorable performance. As for the risks to the global economy, the uncertainty regarding trade disputes between the U.S. and China, a disorderly Brexit process, a lower-than-expected growth of the Chinese economy, and an escalation of political and geopolitical turmoil in different regions stand out.

Since the last monetary policy decision, the prices of financial assets in Mexico have exhibited a more favorable performance. The Mexican peso appreciated and exhibited lower volatility. Additionally, sovereign risk premia and interest rates for the medium and long terms decreased, partly reverting the increases exhibited in the last months of 2018, although they still remain at high levels. Among the factors contributing to a better performance of domestic markets were the reduction in interest rates in the United States and the weakening of the US dollar, the Economic Package approved for 2019, and investors' consent to the New Mexico City International Airport bond buyback offer. Nevertheless, in view of Pemex's challenges, Fitch downgraded its credit rating, which will imply greater financing costs for Mexico's state-owned oil company.

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 following 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 sustainably. In this context, it is especially relevant that the fiscal goals set in the Economic Package for 2019 are attained. Strengthening the rule of law and tackling corruption are equally imperative.

During the fourth quarter of 2018, Mexico's economic activity decelerated significantly as compared to the third quarter and this pattern could continue at the beginning of 2019 as a result of the slowdown of the world economy, some weakness in domestic demand, and to factors of a transitory nature that might affect growth in the first quarter of the year, including those associated with fuel distribution and with the blocking of transportation routes. Thus, slack conditions in the economy loosened towards the end of 2018 and the early part of this year. Due to the latter, the balance of risks for growth is biased to the downside.

Inflation fell from 4.72% in November 2018 to 4.37% in January 2019, mainly due to a reduction in non-core inflation, as core inflation continued to exhibit a resistance to decline, going from 3.63% in November to 3.60% in January. During such period, non-core inflation fell from 8.07% to 6.81%, mirroring the lower increases in energy and in livestock product prices. These results were partially offset by greater increases in fruit and vegetable prices. Headline inflation expectations for 2019 and 2020 showed a marked deterioration in December and some improvement in January. Those corresponding to the end of 2019 went from 3.71% in October to 3.89% in December, and then decreased to 3.80% in January. As for core inflation expectations for the end of 2019, these adjusted from 3.45% in October to 3.50% in December and January. Headline inflation expectations for the medium and long terms continue to be above the 3% target, at around 3.50%. As for information drawn from market instruments, medium- and long-term inflationary risk premia decreased, but still remain at high levels.

Regarding the risks for inflation, 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 making such adjustments occur in an orderly manner, in an effort to prevent second-round effects on the economy's price formation process. Inflation could also be affected if new pressures on energy prices or on agricultural product prices arise, if an escalation of protectionist and compensatory measures worldwide materializes, or in case public finances deteriorate. Considering the magnitude of the recent minimum wage increases, in addition to their possible direct impact, there is also the risk that these bring about wage revisions that exceed productivity gains and give rise to cost pressures, affecting formal employment and prices. 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 give rise to a greater resistance of long-term inflation expectations to decline. As for downside risks, those that stand out are possible lower price increases in some of the goods included in the non-core subindex or a greater-than-foreseen widening in slackness conditions. Considering all of the above, the balance of risks for the forecasted path of inflation remains biased to the upside, in an environment of high uncertainty.

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 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. Monetary policy must respond prudently if for any reason the uncertainty faced by the economy increases considerably. In this context, considering that the recent developments in inflation and its main determinants have not changed significantly with respect to their foreseen path, that the cyclical position of the economy has loosened somewhat, and that the current monetary policy stance is consistent with the convergence of inflation to its target, 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 low and stable inflation as well as those the economy's price formation is subject to, the Governing Board 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 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, the monetary policy stance relative to that of the U.S., under an external environment that it is still subject to risks, and to the behavior of 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 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.