

December 19, 2019

Press Release

Monetary Policy Statement

Banco de México's Governing Board has decided to lower the target for the overnight interbank interest rate by 25 basis points to 7.25%.

During the fourth quarter of 2019, the world economy continues to decelerate and its growth outlook has been revised downwards. This, in an environment in which headline and core inflation in the main advanced economies remain at low levels and below their central banks' targets. In this context, these institutions have maintained accommodative monetary policy stances. In its December meeting, the US Federal Reserve left the target range for the federal funds rate unchanged and highlighted that such range is appropriate to achieve its goals. Financial markets in advanced economies adjusted slightly, while financial assets of emerging economies exhibited volatility, especially those of Latin America, due to idiosyncratic factors. Some risks to the global economy have subsided recently in view of the preliminary trade agreement attained between China and the U.S., the election results in the United Kingdom, and signs of stabilization in certain leading indicators, which has led to greater risk appetite among investors. Nevertheless, the balance of risks for world economic activity remains biased to the downside.

Although domestic financial markets in Mexico underwent episodes of volatility associated with social developments in certain Latin American countries, financial assets in Mexico and the peso exchange rate have recently exhibited positive results. The agreement to approve the USMCA together with the monetary policy stance have contributed to such results. As for the risks that could affect the performance of domestic financial assets, there is still uncertainty over the credit rating outlook for Pemex and Mexico's sovereign debt as well as a possible contagion from emerging economies, mainly from Latin America.

The current environment continues to pose 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, strengthening the credit rating outlook for the sovereign and Pemex's debt, as well as achieving 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 available information for the fourth quarter of 2019 is limited, the weakness that economic activity has been exhibiting for several quarters is expected to persist. This implies that negative slack conditions have widened with respect to those observed in the previous quarter. The growth outlook is in line with the one published in Banco de México's Quarterly Report July-September 2019. In an environment of significant uncertainty, the balance of risks for growth remains biased to the downside.

In November, headline inflation was 2.97%. The annual change of the non-core component was particularly low, reaching 0.98%, while that of the core component has remained persistent, albeit decreasing slightly at 3.65%. Short-term inflation expectations have moderated, while those for longer terms remain above 3%. Expectations for headline inflation for the end of 2019 could be below the forecasts of the Quarterly Report July-September 2019. For 2020, core and headline inflation will reflect

both the greater amount of slack in the economy and the cost-related pressures resulting from the recent minimum wage revisions, which could locate them moderately above the levels anticipated in the last quarterly report.

Regarding inflation risks, those to the upside are: i) core inflation's persistence; ii) that the recent minimum wage increase leads to wage revisions that exceed productivity gains in different segments of the employed population and that this generates cost-related pressures, thus affecting formal employment and prices; iii) that the peso exchange rate comes under pressure from external or domestic factors, although the easing of certain external tensions and progress in ratifying the UMSCA have reduced such risk; iv) possible tariff and compensatory measures, although this risk has diminished; v) increases in agricultural, livestock or energy prices greater than expected; and, vi) that public finances deteriorate. As for downside risks: i) a greater appreciation of the peso exchange rate, which could be associated with a context of greater risk appetite in international financial markets or with the final steps towards ratifying the trade agreement with the United States and Canada; ii) a widening of slack conditions or its impact on core inflation greater than foreseen; and, iii) that the prices of certain goods included in the non-core subindex register lower rates of change. In this context, uncertainty still persists regarding the risks that could make inflation deviate from the described trajectory.

To guide its monetary policy actions, Banco de México's Governing Board follows closely the development of inflation vis-à-vis its forecasts, 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 lower levels registered by headline inflation, its outlook within the time frame in which monetary policy operates, the more ample slack in the economy, as well as 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 by 25 basis points to 7.25%. One member voted for lowering the target to 7.00%. 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 relative monetary policy stance 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 an orderly and sustained 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.