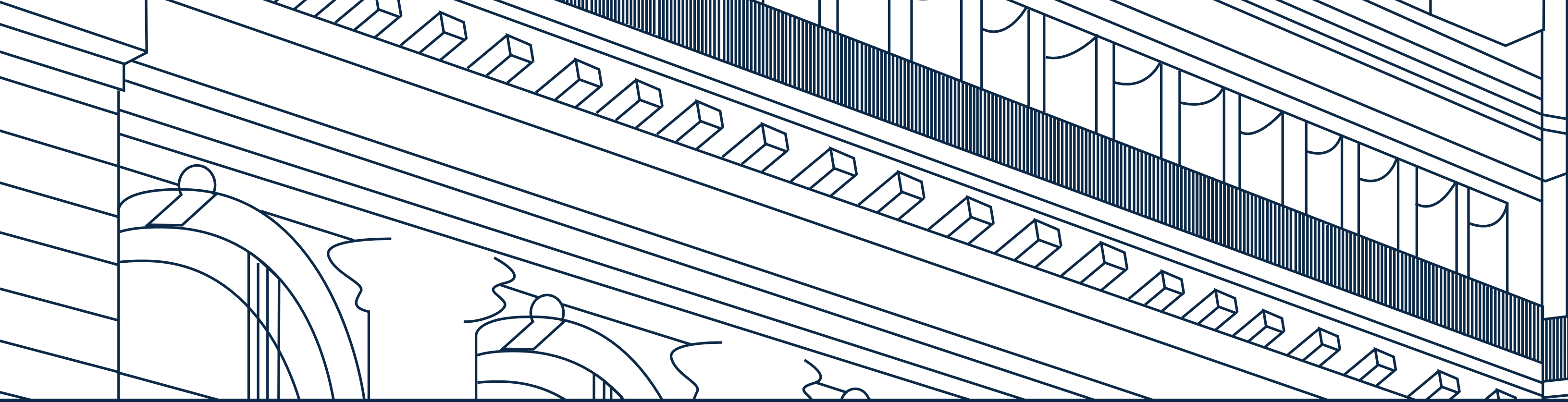

BANCO DE MÉXICO®

Minutes number 114

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on February 6, 2025

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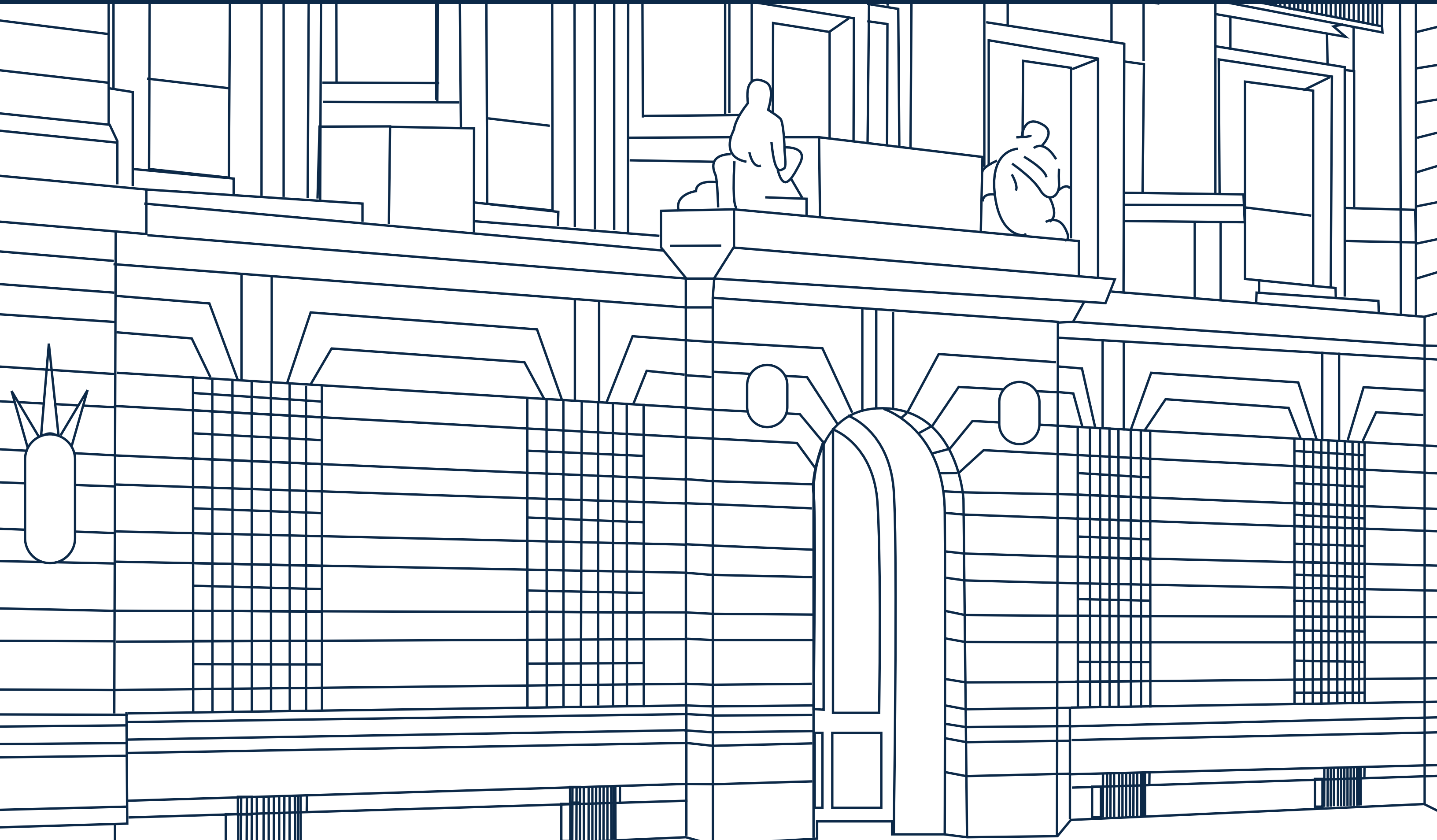

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: February 5, 2024.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- José Gabriel Cuadra, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Edgar Amador, Undersecretary of Finance and Public Credit.
- María Elena Méndez, Secretary of the Governing Board.

Prior to this meeting, preliminary work by Banco de México's staff analyzing the economic and financial environment as well as the developments in inflation and the determinants and outlook for inflation, was conducted and presented to the Governing Board (see Annex).

2. ANALYSIS AND RATIONALE BEHIND THE GOVERNING BOARD'S VOTING

International environment

Some members mentioned that world economic activity is expected to have grown in the fourth quarter of 2024 at a rate slightly lower than that registered throughout the year. They added that performance among countries remained heterogeneous. **One** member commented, from a sectoral perspective, that the Purchasing Managers' Indices for December show that services are expected to have continued expanding while manufacturing would have remained weak. He/she added that international merchandise trade indicators declined slightly in the two-month period ending in November compared to the third quarter of 2024. **Most members highlighted that the resilience of the US economy continued standing out. One** member pointed out that the dynamism of the US economy was mainly supported by private consumption. In this regard, he/she specified that consumption of services continued showing strength, while consumption of goods rebounded. He/she pointed out that this took place in a context in which household savings are below their pre-pandemic trend. He/she highlighted that, in contrast, the euro area's economy stagnated in the last quarter of the year. **Another** member noted that emerging economies are expected to grow at a rate similar to that of the third quarter. **One** member added that, excluding China, a lower dynamism is expected in this group of economies.

One member indicated that labor markets in a large number of advanced economies continued showing signs of easing. He/she mentioned the declining job vacancies, the unemployment gaps increasingly close to their equilibrium levels, and the more moderate increases in real wages. **Some** members mentioned the strength of the US labor market. **One** member noted that non-farm payrolls exhibited a solid performance, consistent with the average increases registered prior to the pandemic, albeit lower than those registered during the recovery years.

Some members indicated that disinflation advanced worldwide last year. They stated that, although core inflation has shown persistence in most countries, it subsided compared to the beginning of 2024. They noted that in some advanced economies headline inflation rebounded mainly due to higher energy prices. **One** member commented that a more gradual progress towards central banks' targets has been observed in these economies. He/she added that headline inflation in emerging economies exhibited a mixed behavior, reflecting the specific circumstances in each country. He/she expressed that the anticipated inflation trajectories in these economies adjusted upwards. Regarding international commodity prices, he/she mentioned that these rebounded, especially those of coffee and energy products. He/she attributed the latter to geopolitical conflicts in Eastern Europe and the Middle East, OPEC+ actions, and expectations on the balance between global supply and demand.

Most members noted that in its latest monetary policy decision, the US Federal Reserve left its reference rate unchanged. Some members underlined that the monetary policy statement of said decision highlighted the stabilization of the unemployment rate at low levels. **One** member added that the statement also underlined the solid economic expansion and that inflation remains relatively high. **Some** members stated that said central bank signaled caution and a more gradual pace of interest rate reductions. **One** member highlighted that, according to the chairman of that institution, the federal funds rate continues being significantly above the neutral rate. **Some** members noted that said central bank remains attentive to the risks on both sides of the balance. Regarding the central banks of other advanced economies, **one** member pointed out that they have expressed caution and support as to a more gradual process of reference rate reductions. **Another** member commented that the European Central Bank cut its reference rates by 25 basis points for the fourth consecutive meeting, reiterating that the monetary policy stance is still restrictive and that its effect continues being transmitted to some sectors of the economy. He/she also underlined that the Bank of Canada cut its target rate by 25 basis points. Regarding emerging economies, **one** member noted that the decisions of their central banks were heterogeneous. **Another** member stated that in Latin American economies the rate-cutting cycles implemented by their respective central banks place their monetary policy stances closer to neutral levels.

Most members highlighted that international financial markets were affected by the global uncertainty generated by the announcements of policy changes that the new US administration may adopt. One member recalled that on February 1, the United States announced the imposition of 25% tariffs on its imports from Mexico and Canada, except for those of Canadian energy products, which were imposed a 10% tariff. He/she added that the United States also imposed 10% tariffs on imports from China. He/she explained that the governments of Mexico and Canada reached an agreement with the United States to pause the entry into force of these tariffs for one month. **Another** member added that said volatility was also due to the release of various economic figures and their impact on monetary policy expectations. He/she highlighted that volatility mainly affected foreign exchange markets. In this regard, **some** members commented that the US dollar appreciated. **Most members highlighted the fluctuations in fixed-income markets. They emphasized the increases in the long end of the Treasury yield curve. One** member added that these increases also responded to the incorporation of higher political and fiscal risk premia. **Another** member mentioned that the short end and the intermediate part of said curve registered moderate decreases. Regarding equity markets, he/she indicated that changes were moderate, while **one** member noted that increases were observed in recent weeks.

Economic activity in México

All members pointed out that the weakness of the Mexican economy intensified in the fourth quarter of 2024. Most members stated that, according to the flash estimate, GDP contracted with respect to the previous quarter. They highlighted that annual GDP growth would have been 1.5% in 2024 as a whole, in contrast to the growth above 3% in each of the previous two years. One member mentioned that, in this context, the GDP output gap is negative. He/she specified that the slack indicator obtained through principal components analysis decreased and is practically at zero. He/she added that the component most related to consumption also decreased.

Regarding the performance of economic activity by sector, the majority noted that in the fourth quarter of 2024 the tertiary sector registered a lower dynamism compared to previous quarters. One member added that significant heterogeneity has been observed among its components. He/she stated that nearly half of the services sector has been stagnant since the end of 2023. He/she highlighted the negative contributions of wholesale trade in recent quarters. **Most members emphasized that secondary activities contracted during the aforementioned quarter. Some** members attributed the contraction to lower activity levels in the manufacturing, construction and mining sectors. **One** member pointed out that within the construction sector lower spending on civil engineering works was offset by that corresponding to building projects. However, he/she noted that the latter has lost dynamism at the margin. **Most members added that the performance of primary activities also contributed to the weakness of economic activity at the end of 2024. Some** members pointed out that after having registered a positive contribution during the second and third quarters of 2024, primary activities contracted significantly in the fourth quarter.

Regarding domestic demand, most members noted that private consumption continued moderating. One member mentioned that it has practically stagnated. **Some** members attributed this moderation to the weak performance of consumption of domestic goods and services and to the decline in consumption of imported goods. **One** member pointed out that, nevertheless, the latter remains at high levels. **Most members indicated that investment slowed down markedly in 2024. One** member recalled that sluggishness had already been observed since late 2023. He/she added that the construction component trended markedly downwards in recent months. **Another** member expressed that the only subcomponent that has shown dynamism is machinery and equipment. He/she noted that the fiscal consolidation process in 2025 could imply that domestic demand will continue moderating.

Regarding external demand, **one** member stated that automotive exports have exhibited a lateral trend since mid-2023 and some weakness at the end of 2024. He/she added that non-automotive exports showed some dynamism at high levels, and resumed their upward trend. He/she noted that the growth rate of manufacturing exports overall has been similar to that of 2023. **Another** member considered that, although they seem to have somewhat recovered in the second half of 2024, uncertainty prevails as to their future performance. **One** member mentioned that manufacturing exports showed some stagnation in the last quarter of 2024. Regarding the behavior of imports, he/she highlighted the fall in imports of consumer goods and the weakness of those of capital goods.

The majority anticipated that the Mexican economy will continue growing at low rates in 2025. One member stated that economic slack is expected to widen in the coming quarters, even more than previously anticipated. **Another** member commented that the cyclical position of the economy is compatible with a deeper-than expected slowdown. **Some** members mentioned that the balance of risks to growth is biased to the downside. **Some** members highlighted the uncertainty associated with trade and immigration disruptions that could arise from US economic policies. **Most members agreed that a possible impact on trade flows between Mexico and the United States would result in a decline in Mexican economic activity. One** member added that this would also have adverse effects for the United States. He/she argued that the impact on trade flows would be reflected in a further widening of slack conditions in Mexico.

Most members highlighted the lower dynamism in the labor market. They stated that employment slowed down. Some members added that this has been more noticeable in the formal sector of the economy. **One** member argued, however, that the unemployment rate has not increased. **The majority recalled that it continues being at historically low levels. In this regard, they stated that this has occurred in a context in which the labor force participation rate has declined. One** member noted that the reduction in the labor force is associated to a larger extent with the increase in pensioners and retirees, as well as in the number of individuals dedicated to domestic work, who are mostly women. He/she added that structural factors such as demographic shifts and the assignment of gender roles in caregiving duties could be having a significant impact on unemployment data. In this regard, he/she considered that although there are still signs of strength in the labor market these should be weighted in light of moderation in other economic variables.

Inflation in Mexico

All members agreed that there has been a significant progress in resolving the inflationary episode derived from the shocks of the pandemic and the war in Ukraine. Most members pointed out that the behavior of core inflation reflects the progress attained. They commented that the inflationary outlook seems more favorable than in the most critical moments of the inflationary episode. One member expressed that both the fading of the effects of global shocks and the monetary policy actions have contributed to the above. **Another** member noted that this improvement is reflected in various indicators. He/she mentioned that different core inflation metrics associated with supply factors are stable and close to the target. He/she pointed out that the distribution of price changes in the core component has improved significantly in the last two years in both merchandise and services other than housing and education. He/she stated that both the frequency and magnitude of price revisions have declined.

Most members noted that since the last monetary policy meeting, headline inflation decreased to 3.69% in the first fortnight of January 2025. One member stated that this is the lowest level since February 2021. **Most members highlighted that headline inflation returned to the 2-4% variability range for the first time since then. One** member underlined that seasonally adjusted annualized quarterly variations have been within this range since the fourth quarter of 2024. **Another** member added that annual headline inflation has declined 501 basis points since the peak of the current inflationary episode. **One** member asserted that, nevertheless, it remains above target. **Most members stated that the most recent decline in headline inflation was associated with the significant reduction in non-core inflation. One** member pointed out that it stood at 3.60% in the first fortnight of January. **Some**

members considered that this was due to the mitigation of supply shocks that affected some agricultural and livestock products last year. **One** member specified that, in particular, there was a significant fall in the price variations of fruits and vegetables. **Another** member highlighted that, as expected, the effect of the supply shocks was transitory and showed no signs of having contaminated the core component. He/she recalled that disinflationary processes do not tend to be linear, and that the current one has exhibited this feature in both Mexico and other countries. He/she pointed out that these more favorable headline inflation figures also reflect the levels reached by the core component.

The majority noted that in its most recent reading core inflation reached 3.72%. They commented that it has been below 4% for four and a half months. One member considered that this indicates that the reduction in inflation has been sustainable. **Some** members described that core inflation is around its pre-pandemic historical average. They pointed out that between 2003, when the 3% permanent target was set, and 2019, just before the pandemic shocks, core inflation averaged 3.65%. Meanwhile, **one** member highlighted that it is at levels similar to those registered in the first half of 2020. He/she indicated that it has declined 479 basis points from the peak registered in the current episode. **Some** members specified that it has trended downwards for two years. **One** member noted that while in the first half of 2024 core inflation averaged 4.44%, from July to date it averaged 3.81%. **Another** member added that approximately half of the core index CPI items currently exhibit annualized monthly price variations of less than 3%. **Some** members considered that this behavior within core inflation suggests that disinflation has become more generalized.

Some members pointed out that merchandise inflation stood at 2.75% in the first fortnight of January 2025. **Some** members mentioned that it increased somewhat since the last monetary policy meeting. **One** member noted that this explains the increase at the margin in core inflation. **Some** members underlined that, nevertheless, merchandise inflation is at particularly low levels, visibly lower than those registered prior to the pandemic. They recalled, as a reference, that this component fluctuated between 3.56 and 3.92% in 2019. **Some** members emphasized that it has been below the 3% target since September. **Some** members indicated that it is below its historical average between 2003 and 2019, close to 4%. **One** member stated that such levels have only been registered on very few occasions in the last 25 years. He/she added that the sharp decline in this component is what explains, to a great extent, core inflation's downward trend.

Some members described that services inflation stood at 4.82% in the first fortnight of January. **Some** members highlighted that it still remains at relatively high levels. **One** member noted that it remains above its 2003-2019 average of 3.4%. **Nevertheless, most members agreed that this component has declined and shown signs of some moderation. They added that this reduction has been observed after it had moved sideways, remaining above 5% for an extended period. One** member stated that services other than housing and education have shown the greatest signs of easing and that this indicates a lower margin for cost pass-through.

Most members emphasized the importance of the expectations channel in the transmission of monetary policy. They highlighted that these have remained anchored despite the complexity of the recent inflationary episode. They asserted that this is the result of Banco de México's firm response. In this regard, **one** member recalled that in other episodes in which inflation increased less, expectations were affected to a similar or greater extent than in this episode. He/she reflected on how this suggests that the expectations channel has strengthened in recent years. **Some** members noted that, since the previous monetary policy decision, inflation expectations for the medium and longer terms remained relatively stable. **One** member noted that, although expectations for the end of 2025 and for the next 12 months were revised marginally upwards, those for the end of 2026 remained stable. He/she highlighted that breakeven inflation has shown greater volatility and has increased slightly since December 2024, as a result of a rise in the risk premium, while implied inflation expectations have moved sideways.

Most members mentioned that inflation is expected to continue declining as previously anticipated. One member pointed out that the forecast for headline inflation converging to target in the third quarter of 2026 remains unchanged. **Another** member stated that annualized quarterly CPI variations are expected to remain within the variability range. Regarding core inflation, **one** member indicated that it is still expected to converge to the 3% target in the second quarter of 2026. **Most members specified that merchandise inflation is**

expected to increase somewhat from its low levels. Meanwhile, they noted that services inflation is expected to continue declining. One member recalled that the forecast published in the previous monetary policy decision incorporates greater persistence in the expected trajectory of this component.

Most members mentioned the possibility of a slower decline in services inflation than foreseen, such that it fails to offset the anticipated increase in merchandise inflation, which could turn out to be even higher than expected. They added that this poses a risk for the anticipated downward trend in core inflation. One member stated that even in an adverse scenario where services would decline at a slower-than-anticipated pace and where goods would increase at a faster pace, reaching their historical average towards the end of the year, core inflation would remain at levels similar to the current ones, which is consistent with the new stage of inflation. He/she clarified that these averages serve as a reference, but he/she does not consider it appropriate to use them to forecast the trajectory of inflation. **Another** member expressed that, although fluctuations cannot be ruled out, core inflation can be expected to continue decreasing. **Some** members stated that the slower pace of growth of economic activity estimated for 2025 will help mitigate pressures on inflation. In a related manner, **one** member mentioned that analysts' expectations do not predict an additional reduction in core inflation, as they estimate that it will remain practically at its current level by the end of this year and in 2026. He/she also highlighted the possibility that non-core inflation reaches levels higher-than-anticipated by Banco de México's forecasts. He/she warned that this subindex is highly volatile and is currently well below its historical average of around 6%. He/she added that, in his/her opinion the forecast suggests that this subindex has undergone a structural change which is difficult to understand. He/she pointed out that this forecast anticipates a non-core inflation average of less than half the average registered over the last 20 years, with a significant reduction in the standard deviation to one third of that observed historically. He/she stated that since there are no signs of such a change, an increase in this component should be anticipated at some point. **Another** member argued that, although shocks to non-core inflation cannot be ruled out, they tend to be short-lived and with a limited impact on core inflation.

Most members highlighted the risk associated with the possible effects of policies that could be implemented by the new US administration. They mentioned in particular the uncertainty related to the announcements of possible changes in trade and immigration policies. They stressed that the materialization of said risk could imply pressures on inflation on both sides of the balance. Some members pointed out that, on the one hand, there could be upward pressures from a currency depreciation and, on the other hand, downward pressures due to greater-than-expected slack conditions. **One** member added that risk scenarios do not suggest a process of accelerating inflation but rather a more gradual convergence process. **Some** members agreed that a complex and uncertain environment persists. **One** member mentioned that the current risks are of a different nature than those that led to the last inflationary episode.

One member underscored the risk of core inflation's persistence, although he/she noted that it has moderated. **Some** members mentioned the risk of a greater foreign exchange depreciation, although they commented that its pass-through to inflation could be lower than anticipated given the expected weakness of economic activity. **One** member noted the risk of greater cost-related pressures. He/she highlighted the 12% increase in the minimum wage and the growth of over 9% in average wages. Regarding risks to the downside, **some** members considered the possibility of a more sluggish economy than anticipated. In particular, **one** member detailed that such sluggishness would exert downward pressure on services inflation given the exhaustion of the delayed cost-related pass-through.

One member considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. However, **another** member underscored that the balance of risks is less adverse than in previous years.

Macrofinancial environment

The majority noted the volatility in Mexican financial markets, mainly driven by external factors. One member mentioned that this volatility was especially noticeable in the foreign exchange market. **Most members pointed out that the Mexican peso traded in a wide range, although it maintained an orderly behavior. They pointed out that after the announcement on the imposition of US tariffs, it showed a depreciation, although it later reverted due to the agreement to pause their entry into force. One** member indicated that additional episodes of volatility cannot be ruled out.

Most members noted that, since the previous monetary policy decision, government interest rates for all terms have decreased. One member added that these reductions were greater in the short-term segment. **Another** member stated that real interest rates also decreased across their different maturities. **One** member mentioned that sovereign risk premia remain at levels similar to those observed prior to the previous meeting. **Another** member observed that, in terms of capital outflows, speculative positions are at near neutral levels, while flows to the local fixed-income market continue showing volatility.

Regarding financing in the economy, **one** member noted the moderation in credit to businesses. He/she added that interest rates have remained at high levels in this segment. He/she also noted the slowdown in credit to households, which has contributed to a lower dynamism in private consumption. He/she pointed to a higher demand for term-deposit instruments from both households and businesses, which has been on the rise for two years. He/she argued that all of the above is associated with the proper functioning of monetary policy channels.

Some members mentioned that Mexico has sound macroeconomic fundamentals that will allow it to face the challenges ahead with resilience. They argued that it is important to maintain this strength. Among these fundamentals, they highlighted the sustainability of external accounts, an adequate level of international reserves, and a flexible exchange rate regime. They recalled that this regime allows to absorb the shocks faced by the Mexican economy in an orderly manner. **One** member commented that this has allowed monetary policy to focus entirely on its primary mandate. Among elements of the macroeconomic framework, he/she added the strength of the banking system, given its adequate liquidity and capitalization levels, and sound finances, which will be reinforced by the fiscal consolidation anticipated in 2025. He/she stated that Mexico stands out among emerging economies due to the strength of its macroeconomic framework.

Monetary policy

The Governing Board assessed the significant progress in resolving the inflationary episode derived from the global shocks. It determined that the fight against inflation is at a stage where the aim is to bring inflation from its current level, around its pre-pandemic historical average, to the 3% target. It considered that reference rate levels lower than those set as a result of the global shocks are consistent with the challenges posed by the present stage. Taking into account the current inflationary outlook and the prevailing level of monetary restriction, the Board deemed appropriate to implement a larger reduction of the reference rate. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 50 basis points to 9.50%.

The Board estimates that looking forward it could continue calibrating the monetary policy stance and consider adjusting it in similar magnitudes. It anticipates that the inflationary environment will allow to continue the rate-cutting cycle, albeit maintaining a restrictive stance. It will take into account the effects of the country's weak economic activity and the incidence of both the restrictive monetary policy stance that has been maintained and the stance prevailing in the future on the evolution of inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

One member noted that in view of the major global shocks associated with the pandemic and, later, the military conflict in Ukraine, Banco de México acted in a timely and forceful manner. He/she recalled that a clearly restrictive policy stance was attained and maintained for a year, after which the interest rate was gradually reduced as the disinflation process took hold and advanced. Given the significant progress in resolving the inflationary episode, he/she estimated that a stage has been reached in which the challenge is to bring inflation from its current levels, which are similar to its historical average, down to the 3% target. He/she considered that at this stage the level of monetary restriction required to confront the global shocks is no longer necessary. In this regard, he/she noted that currently the ex-ante real rate is still above 6%. He/she pointed out that even considering the rate reductions implemented last year, the reference rate remains significantly above the estimated neutral range. He/she noted that the ex-ante real interest rate gap is notably larger than both headline and core inflation gaps. He/she stated that, given the progress in disinflation and the current level of monetary restriction, the monetary policy stance should be recalibrated to align it with this new stage by lowering the reference rate by 50 basis points. He/she mentioned that a similar reference rate cut could be considered at the next monetary policy meeting. On the other hand, he/she expressed that, although the macrofinancial environment poses considerable challenges as seen in recent days, it is important not to overlook the progress made in the convergence to the inflation target. He/she added that it is important to avoid rushing ahead of events and making decisions without necessary information. He/she emphasized that, while a favorable inflation trend can be observed today, the implementation of tariffs is yet to take place. However, he/she stressed that the central bank should continue evaluating a range of potential scenarios and be prepared for any changes that may arise. He/she considered that a monetary policy focused on price stability is a crucial component of the country's macroeconomic policy framework. He/she emphasized that the Governing Board will continue making decisions with a firm commitment to achieving the 3% inflation target.

Another member considered that although headline inflation is still above the 3% target, it has returned to the variability range for the first time since February 2021. He/she pointed out that projections suggest that economic activity will be more moderate than anticipated, which means that this medium-term determinant of inflation will continue contributing to the convergence of inflation. He/she stated that monetary policy implementation has maintained inflation expectations anchored and that the inflation-at-risk measure, which indicates the extreme values that inflation could reach in one year, has shown significant progress since 2022, particularly in the highest percentiles of the distribution. He/she mentioned that the gradual approach adopted in 2024 allowed the level and estimated risks of inflation to evolve in a way more aligned with its historical behavior, thus reducing the likelihood of unexpected deviations in response to shocks. He/she estimated that monetary policy implementation must enter a new stage, in which monetary restriction can be calibrated more rapidly in some decisions, including the present one. He/she pointed out that based on various metrics, such as the ratio of the inflation gap to the ex-ante real interest rate gap, the positioning of various indicators within their historical distributions, and the result of different monetary policy rules, the level of monetary restriction can be moderated, without reaching a neutral stance. He/she indicated that this is consistent with the disinflationary progress and does not compromise the price stability goal. He/she commented that potential trade and immigration disturbances pose additional challenges. He/she stated that the impacts of such disruptions on inflation will depend on the counteracting effects of the exchange rate and economic dynamics, as well as the duration and magnitude of the shocks. He/she added that Mexico has sound macroeconomic fundamentals to address these situations. Hence, he/she considered that the reference rate should be set at an appropriate level to support the convergence of inflation, maintain inflation expectations anchored, and continue managing risks on both sides of the balance. He/she stated that communication should emphasize that, while the monetary policy stance will remain restrictive, the calibration process will continue in order to adjust it to the new phase of the monetary cycle.

One member argued that given the mitigation of global shocks, the progress in disinflation, and the current inflation levels —especially of the core component— Banco de México has entered a new stage in its fight against inflation. He/she underlined that in this stage the challenge is to reduce inflation from its current levels, similar to its averages between 2003 and 2019, to the 3% target. He/she estimated that, in this context, the level of monetary restriction required to face the global shocks is no longer needed. Regarding the monetary policy stance, he/she pointed out that the ex-ante real rate is currently at a level visibly higher than the estimated neutral range and its pre-pandemic average. Regarding the relative monetary policy between Mexico and the United States, he/she indicated that monetary policy decisions depend on the prevailing macroeconomic conditions in each economy and that these currently differ between Mexico and the United States. He/she commented that while the US economy has shown resilience, the Mexican economy shows a significant loss of dynamism, which would contribute to the decline in inflation. He/she reiterated that in Mexico the monetary policy stance is clearly restrictive, while in the United States it is closer to its neutral level. He/she pointed out that the current reference rate differential in real terms of Banco de México with respect to the Federal Reserve is above the pre-pandemic average. He/she noted that it is also larger than the differential corresponding to a stationary state, in which both reference rates would have reached neutral levels. He/she underlined that, from this perspective, there is a wide and restrictive differential. Taking into account all of the above, he/she considered that the monetary policy stance could be calibrated. He/she explained that this should be seen as an adjustment of the policy stance to the current inflationary environment. He/she assessed that the above would be consistent with a 50-basis-point reference rate cut made in this decision. He/she added that a rate cut of the same size could be considered at the next monetary policy meeting. He/she clarified that implementing these reference rate cuts does not imply that adjustments of 50 basis points would be adopted subsequently. He/she stressed that he/she does not anticipate a cycle of reductions of that same magnitude, which would bring the reference rate to a neutral level in the near future. He/she underlined that the monetary policy stance would remain restrictive even after this year's cuts, consistent with the forecast that inflation will remain above target during this period.

Another member expressed that inflation continues moving in the right direction of the 3% target, allowing room to continue with the cycle of reference rate reductions. He/she stated that the fact that headline inflation reached its historical average is evidence of the progress in the fight against inflation. However, he/she recalled that such level is not the central bank's inflation target. He/she pointed out that despite the disinflationary progress, in his/her opinion there are severe doubts that it can continue. He/she added that it is still required to ensure that progress in the core component is maintained, since achieving the target by merely fostering non-core inflation would be a short-lived success. He/she stated that genuine concerns over the economic slowdown should be a secondary consideration given the primary mandate. He/she stated that, given the uncertain path full of risks and challenges, caution and patience must be applied in the conduct of monetary policy, and therefore the pace of adjustment should not be accelerated until greater certainty is achieved. He/she underscored that the greatest contribution of monetary policy is to induce price stability in order to minimize inflation expectations, thereby helping to maintain low interest rates over the medium and long terms. He/she noted that sustaining a wide differential between Mexican and US reference rates is consistent with the environment of high uncertainty and the rise in risk premia. He/she indicated that the Federal Reserve may maintain its current monetary policy stance longer, and that, hence, there is uncertainty about the direction external monetary conditions may take. He/she estimated that, therefore, given the challenges at hand, the pace of reference rate cuts should not be hastened until there is greater certainty over the economic and political outlook. He/she added that the credibility of the central bank's commitment to the 3% target must be reinforced. He/she mentioned that during previous inflationary outbreaks, monetary tightening was eased prematurely, preventing the sustained convergence to the 3% target. He/she indicated that monetary policy easing should be very gradual in the coming months, in order for the ex-ante real interest rate to remain between 5 and 6%, without falling below the lower level of this range. He/she expressed that forward guidance should emphasize the need to act with caution in managing monetary policy under the current circumstances.

One member considered that the uncertainty generated by the possible implementation of the trade policy announced by the new US administration should not cloud judgement or lead to rushed decisions, and a clear focus should rather be maintained, continuing to adopt measures that are consistent with the convergence of inflation to the target. He/she highlighted that specific instruments are available to address more efficiently the potential impacts on various aspects of the economy. He/she stated that, in recent years, monetary policy has been decisive and forceful to address the challenges faced. He/she emphasized that a robust conduct of monetary policy allowed to handle the effects of tail shocks, which were clearly inflationary, on the price formation process and to keep expectations anchored. He/she added that subsequently, the adoption of a gradual approach allowed Banco de México to recognize the progress made in the inflationary outlook and responsibly address the challenges faced in 2024. He/she stated that given the notable progress in the disinflationary process, with risks of a different nature and which also affect both sides of the balance, the fight against inflation has now entered a new stage. For this reason, and considering the levels of monetary restriction, he/she considered it necessary to calibrate the policy stance in order to adjust it to the prevailing macroeconomic conditions. He/she also pointed out that the balance of risks is less adverse than that faced in previous years, despite the risks partly associated with possible changes in trade policy, which he/she indicated can be addressed with a lesser level of restriction. On the other hand, he/she argued that, when headline inflation has been historically between 3.5 and 4.0%, the nominal and ex-ante real interest rates averaged between 5.95 and 2.05%. However, he/she specified that having room to adjust the level of restriction does not imply returning the reference rate to historical levels, in which the monetary policy stance at some point was even in neutral territory with inflation above the 3% target. He/she considered that, going forward, it is necessary to continue calibrating the monetary policy stance that should seek to adopt a level of restriction consistent with the notable progress in disinflation and with both upside and downside risks, while ensuring that a restrictive level is maintained throughout the year.

3. MONETARY POLICY DECISION

The Governing Board assessed the significant progress in resolving the inflationary episode derived from the global shocks. It determined that the fight against inflation is at a stage where the aim is to bring inflation from its current level, around its pre-pandemic historical average, to the 3% target. It considered that reference rate levels lower than those set as a result of the global shocks are consistent with the challenges posed by the present stage. Taking into account the current inflationary outlook and the prevailing level of monetary restriction, the Board deemed appropriate to implement a larger reduction of the reference rate. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 50 basis points to 9.50%.

The Board estimates that looking forward it could continue calibrating the monetary policy stance and consider adjusting it in similar magnitudes. It anticipates that the inflationary environment will allow to continue the rate-cutting cycle, albeit maintaining a restrictive stance. It will take into account the effects of the country's weak economic activity and the incidence of both the restrictive monetary policy stance that has been maintained and the stance prevailing in the future on the evolution of inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

4. VOTING

Voting in favor of the decision were Victoria Rodríguez, Galia Borja, José Gabriel Cuadra, and Omar Mejía. Jonathan Heath voted in favor of lowering the target for the overnight interbank interest rate by 25 basis points to 9.75%.

ANNEX*

The information in this Annex was prepared for this meeting by the staff of Banco de México's Directorate General of Economic Research and Directorate General of Central Bank Operations. It does not necessarily reflect the considerations of the members of the Governing Board as to the monetary policy decision.

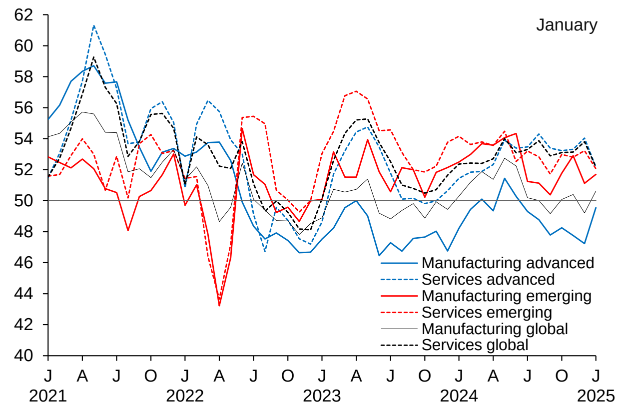
A.1. External conditions

A.1.1. World economic activity

World economic activity is expected to have grown in the fourth quarter of 2024 at a rate slightly lower than throughout the year. This performance would continue to be below that observed prior to the pandemic. Marked differences would have continued to be observed across countries. The United States continued exhibiting a solid and relatively more dynamic growth than the rest of the major advanced economies. January's Purchasing Managers' Indices point to a continued expansion, although at a slower pace, of the services sector at the global level. These indices also suggest that manufacturing activity would continue being sluggish, mainly in advanced economies (Chart 1).

Available world trade indicators practically suggested a stagnation in the last quarter of 2024. The outlook for world trade has become more uncertain after the US government announced the imposition of tariffs on its major trading partners. On February 1, 2025, the United States announced 25% tariffs on products from Mexico and Canada (except for Canadian energy products, which would face a 10% tariff) and 10% tariffs on products from China. However, the tariffs on Mexican and Canadian products did not go into effect, as the US government reached separate agreements with both countries, postponing their implementation for 30 days. China announced a 15% tariff on energy imports from the United States for an amount close to 5 billion dollars, as well as a 10% tariff on crude oil, agricultural equipment, vehicles and trucks from the United States. China's retaliatory measures would take effect on February 10. Given the escalation of trade tensions, global risks have increased. Among these the following stand out: the possible implementation of policies that revert global economic integration; the intensification of geopolitical turmoil; the protraction of inflationary pressures; and higher levels of volatility in financial markets.

Chart 1
Purchasing Managers' Index: production component for advanced, emerging and global economies
Diffusion index, s. a.1/



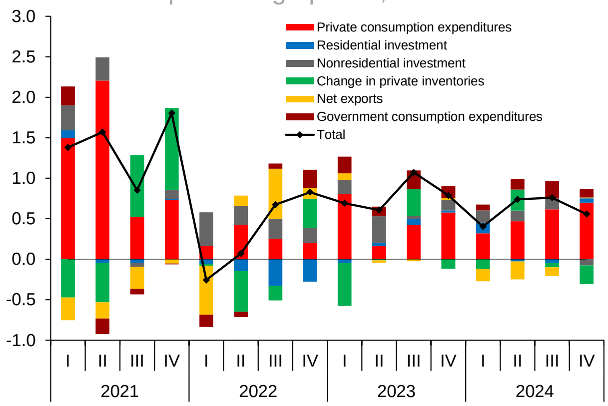
s. a. / Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points indicates an expansion and below 50 suggests a contraction. A reading equal to 50 points indicates no change.
Source: IHS Markit.

In the United States, economic activity registered solid growth during the fourth quarter of 2024, although lower than that observed in the previous quarter. Gross Domestic Product (GDP) grew at a seasonally adjusted quarterly rate of 0.6%, after having expanded 0.8% in the third quarter (Chart 2).[1] This progress was mainly supported by the strength of private consumption.

* Note: In the electronic version of this document the data to generate all the charts and tables can be obtained by clicking on them, except for those that are not produced or elaborated by Banco de México.

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 3.1% in the third quarter and 2.3% in the fourth quarter of 2024.

Chart 2
US: real GDP and components
Quarterly percentage rate and contribution in percentage points, s. a.



s. a. / Seasonally adjusted figures.
Source: Bureau of Economic Analysis (BEA).

US industrial production grew 0.9% at a seasonally adjusted monthly rate in December, after increasing 0.2% in November. The December rebound reflected progress in all sectors. Manufacturing grew 0.6%, mining 1.8%, and electricity and gas generation 2.1%. Despite the rebound in December, during 2024 industrial activity remained virtually stagnant for the second consecutive year. Purchasing Managers' Indices suggest that manufacturing production would have improved in January 2025.

The US labor market approached a situation of better balance between labor supply and demand throughout 2024. A broad number of indicators point in that direction. Non-farm payrolls fluctuated around the 2019 average. The number of job vacancies declined from 8.2 million in November to 7.6 million in December. This indicator has shown, in general, a downward trend since May 2022. Initial claims for unemployment insurance remained at low levels for most of the period. They stood at 207 thousand new claims in the week ending January 25. The unemployment rate decreased slightly from 4.2% in November to 4.1% in December. Lastly, wages moderated, such that the annual variation of average hourly wages decreased from 3.9% in November to 3.8% in December.[2]

In the euro area, its economy stagnated in the last quarter of 2024. This after the region's GDP had increased at a seasonally adjusted quarterly rate of 0.4% in the previous quarter.[3] Recent available indicators point to a slowdown in the services sector and a continued weakness in manufacturing activity. The labor market remained resilient, although it has shown signs of moderation. The unemployment rate increased slightly from 6.2% in November to 6.3% in December 2024, although it remains at historically low levels. The job vacancy rate has decreased and is approaching its pre-pandemic levels.

Regarding the rest of the major advanced economies, these are expected to expand at a faster pace compared to the previous quarter. In some of these economies, labor markets have shown signs of easing, although they have overall continued exhibiting strength.

In the last quarter of 2024, the main emerging economies as a whole are expected to have grown at a similar rate to that of the third quarter. However, in the particular case of China, in the fourth quarter of 2024 GDP grew at a seasonally adjusted quarterly rate of 1.6%, after having increased 1.3% in the third quarter.[4] During the fourth quarter, Chinese exports rose compared to the previous quarter. Likewise, retail sales and industrial production showed a relatively more dynamic performance, while fixed investment accumulated throughout the year decreased. This took place in a context in which Chinese authorities implemented various stimuli throughout the year and have continued announcing additional monetary, financial, and fiscal measures to boost growth. Despite this, the Chinese economy continues facing significant challenges derived from the weakness of its real estate sector and its domestic demand.

Since Mexico's last monetary policy decision, international commodity prices overall trended upwards. In the case of oil, prices rose partly due to new sanctions imposed on Russian crude oil and the expectation of a greater demand in several countries. This trend partially reversed in mid-January 2025 due to the announcement of the new US administration to boost crude oil production in the United States and the expectation of lower energy requirements by technology companies for the development of new artificial intelligence technologies. Throughout the period, prices were sensitive to the release of economic data from the United States and China, as

[2] Average hourly earnings of production and non-supervisory employees.
[3] Expressed as a seasonally adjusted quarterly rate, the change in euro area GDP was 0.03% in the fourth quarter of 2024. Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 1.6% in the third quarter and 0.12% in the fourth quarter of 2024.
[4] Expressed as an annual rate, China's GDP growth was 4.6% in the third quarter and 5.4% in the fourth quarter of 2024.

well as to announcements of additional economic stimuli by the latter country.

Natural gas reference prices increased from the levels observed since Mexico's last monetary policy decision due to the expectation of higher demand in several countries. In the particular case of Europe and Asia, as of the end of December 2024, prices registered additional upward pressures partly due to the interruption of Russian gas supplies to Europe. Meanwhile, towards the third week of January 2025, US prices registered a sharp and transitory increase as a result of a winter storm in that country.

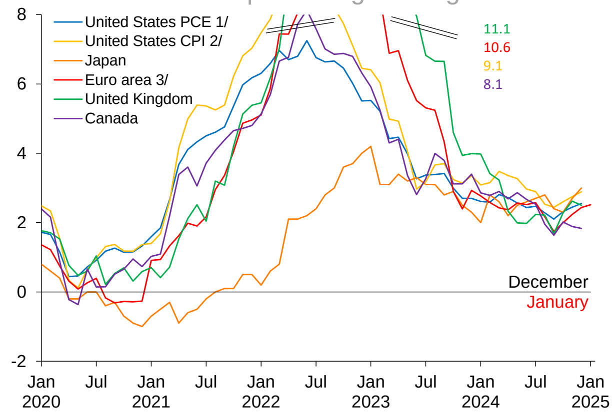
Grain prices rose in general due to expectations of lower corn and soybean production in 2025. In particular, soybean prices increased due to droughts in some South American countries. Likewise, coffee prices reached historical highs in early February 2025 in light of adverse weather conditions and uncertainty regarding the imposition of tariffs by the United States on Colombian products.

Finally, industrial metals prices were above the levels registered in mid-December 2024. These prices showed sensitivity to the uncertainty regarding the possible application of tariffs by the US government to several of its trading partners. Similarly, precious metals prices rose from January 2025 onwards, driven by a greater demand for safe-haven assets caused by the uncertainty surrounding various policy changes in the United States. Thus, gold reached an historical high in the first week of February 2025.

A.1.2. Monetary policy and international financial markets

Disinflation advanced worldwide in 2024. Progress was made in the convergence of inflation to central bank targets, mainly in advanced economies, although in several of these countries annual headline inflation has increased in recent readings (Chart 3). These increases reflected, to a large extent, higher energy inflation. Annual core inflation has shown, in general, persistence in both advanced and emerging economies. However, it is below the levels registered at the beginning of 2024 in most countries.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



1/ The personal consumption expenditures price index (PCE) is used.
2/ The consumer price index (CPI) is used.
3/ Preliminary figures for January 2025.
Note: The series includes data up to December 2024, except for the euro area, whose latest available data corresponds to January 2025. The chart's range was adjusted to facilitate its reading. Figures in the chart denote the respective maximum levels of each series.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

In the United States, annual headline inflation measured by the personal consumption expenditures price index (PCE) rose from 2.4% in November to 2.6% in December. This increase was the result of lower energy deflation and a rise in food inflation. Annual core inflation remained at 2.8% for the third consecutive month and was below the 3.1% level registered at the beginning of 2024. In terms of monthly variation, the headline index registered an increase from 0.1 to 0.3%, largely due to higher energy inflation. Likewise, core inflation rose from 0.1 to 0.2%, reflecting an increase in services inflation, which was partially offset by the higher deflation in goods. Annual inflation measured by the consumer price index rose from 2.7% in November to 2.9% in December 2024. Annual core inflation decreased from 3.3 to 3.2% during the same period, after having been at 3.3% in the previous three consecutive months. The current level continues to be below those registered in early 2024.

In the euro area, annual headline inflation rose from 2.2% in November 2024 to 2.5% in January 2025. This increase reflected a rise in energy inflation, which was partially offset by a decline in food inflation. Annual core inflation remained at 2.7% in January 2025 for the fifth consecutive month, level below those registered in early 2024.

Analysts' inflation forecasts for most major advanced economies anticipate a continued convergence to these countries' respective central banks inflation targets throughout 2025. Longer-term inflation expectations drawn from financial instruments for these economies have shown moderate fluctuations since Mexico's last monetary policy decision and, currently, in some cases, are slightly above the levels registered around Mexico's last monetary policy decision.

In emerging economies, headline inflation continued exhibiting, in general, a differentiated behavior across countries in recent readings, reflecting specific circumstances in each of them. In several of these economies, headline inflation increased. Annual core inflation was persistent, with moderate increases in various cases. In some of these economies, particularly in the Asian region, headline inflation was within the variability range of each central bank. In China, headline and core inflation remained at low levels throughout 2024. In particular, annual headline inflation decreased from 0.2% in November to 0.1% in December 2024, its lowest level in nine months. Annual core inflation in said country rose from 0.3 to 0.4% during the same period.

In this context, since Mexico's last monetary policy decision, some central banks in the main advanced and emerging economies continued lowering their reference rates. Others left them unchanged, some of them after having previously cut them. In the main advanced economies, various central banks continued to gradually reduce their securities' holdings. Regarding future actions, central banks have stated, in general, that rate adjustments will continue depending on economic data and its implications for the inflation outlook.

At its January meeting, the US Federal Reserve left the target range for the federal funds rate unchanged, after having cut it in previous decisions by a total of 100 basis points (bps). The target range is thus currently between 4.25 and 4.50%. The Federal Open Market Committee (FOMC) reiterated that the risks to achieving its employment and inflation goals are roughly in balance. However, it again indicated that the economic outlook is uncertain and that the Committee is attentive to risks for both sides of its mandate. It reiterated that, in considering the extent and timing of additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. Additionally, the Federal Reserve continued reducing the size of its balance sheet.

During the press conference, the chairman of the US Federal Reserve stated that now that their monetary policy stance is significantly less restrictive than before and that the economy remains strong, they do not need to be in a hurry to adjust their monetary policy stance. He mentioned that, in order to consider further adjustments in the monetary policy interest rate, they will focus on seeing real progress on inflation or, alternatively, some weakness in the labor market. Regarding the implications of possible changes in different policies derived from the new administration in the United States, he indicated that he believes that the Committee must wait until they are implemented before they can assess their implications for the economy, and thus they will monitor them carefully. The minutes of the December 2024 decision indicated that all participants considered that uncertainty about the scope, timing and economic effects of potential policies was high. In this regard, some of them indicated that they incorporated, to some extent, provisional assumptions in their projections. Many participants suggested that the recent high inflation readings, the continued strength in spending, the reduced downside risks for the outlook of the labor market and economic activity, and the rising upside risks to the inflation outlook indicated the need for a cautious approach to monetary policy decisions in the coming quarters.

The European Central Bank (ECB) continued lowering its reference rates. In its January decision, it announced a 25-bps cut, after having lowering them in the same magnitude in its three previous decisions. Thus, its key deposit, refinancing and lending rates currently stand at 2.75, 2.90 and 3.15%, respectively. The Governing Council of said central bank reiterated that inflation data signal that the disinflationary process is on track, and that it will continue to follow an economic and financial data-dependent approach to determine the appropriate monetary policy stance. It reaffirmed that it is not pre-committed to a particular monetary policy path. It also noted that the size of its asset purchase program (APP) and pandemic emergency purchase program (PEPP) portfolios is declining at a measured and predictable pace, as they have no longer reinvested the principal payments from maturing securities.

At the press conference of the January decision, the president of said central bank stated that the reference rates are still in restrictive territory and that the Governing Council members have not yet discussed when they will stop reducing them as it would be premature to do so now. She pointed out that they know in which direction they will conduct monetary policy, but that the pace, sequence, and magnitude of the adjustments will be determined based on the new data. Regarding the trade environment, she mentioned that although they are analyzing the framework within which trade takes place and the uncertainty associated with it as a potential risk, they do not have clear information to be considered in determining monetary policy. She added that they will continue to be guided by an analysis based on three elements: the inflation outlook, core inflation, and the transmission of monetary policy.

Regarding other advanced economies, since Mexico's last monetary policy decision, the central banks of Canada and Sweden continued lowering their reference rates, although to a lesser extent than in previous decisions. The Bank of Canada also announced a plan to complete the normalization of its balance sheet.[5] The Bank of England decided not to adjust its monetary policy rate in its December decision, after having previously cut it. In contrast, the Bank of Japan raised its reference rate again in January, after making no adjustments in the three previous decisions.[6]

In the main emerging economies, central banks made differentiated decisions in their monetary policy statements. Various of them lowered their reference rates, some of them after having kept them unchanged in some previous decisions. Some of them left their reference rates unchanged in their latest decision, after having previously lowered or raised them. Others continued without making adjustments. In the case of China, the central bank announced that the one- and five-year loan prime rates (LPRs) remained unchanged for the third consecutive month in January, after having declined by 25 bps in October. Nevertheless, the central bank of said country continued to carry out outright reverse repurchase operations through the new monetary policy tool implemented in October. Brazil's central bank continued raising its reference rate by announcing an additional 100 bp increase in January.

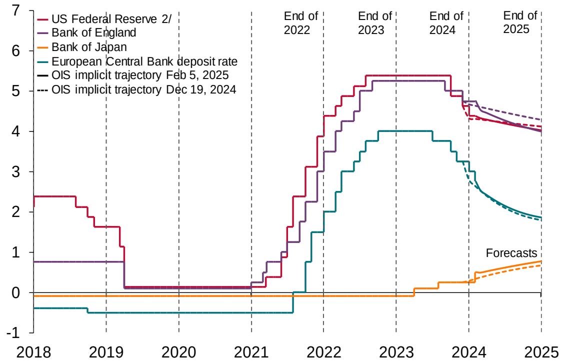
As for market expectations for monetary policy rates in the major advanced economies, those implicit in market instruments for the end of 2025 fluctuated during the reporting period. During the first weeks of January, these expectations were revised upwards due to the possibility of a lower easing by the US Federal Reserve and the uncertainty associated with possible economic policies by the new US administration. This increase, however, subsequently reversed in some cases, partly due to the release of better-than-expected inflation data. Thus, comparing the most recent information with respect to the level forecast in Mexico's last monetary policy decision, in the case of the United States, the anticipated level for the federal funds rate at the end of 2025 decreased from 4.0 to 3.9%. Similarly, the expected level for the reference rate at the end of 2025 was lowered from 2.9 to 2.4% for Canada, and from 4.1 to 3.9% for the United Kingdom. In contrast, the expected level for the euro area and Japan increased from 1.8 to 1.9% and from 0.7 to 0.8%, respectively (Chart 4).

In this context, global financial conditions remained at a level similar to that observed during Mexico's last monetary policy decision (Chart 5). At the beginning of February, there was a sharp increase in volatility due to the announcement of the US government's imposition of 25% tariffs on Mexico and Canada and an additional 10% tariff on China. This increase in volatility partially reversed with the agreements to pause the implementation of the tariffs on Mexico and Canada for 30 days. Meanwhile, long-term (10-year) and, to a lesser extent, medium-term (2-year) rates in most of the advanced economies decreased (Chart 6). In this context, the slope of the US yield curve (defined as the spread between 10-year and 2-year government bond rates) registered a limited variation and remained at positive levels. Meanwhile, stock markets in advanced and emerging economies showed a mixed performance (Chart 7).

[5] The Bank of Canada announced a plan to complete the normalization of its balance sheet, ending its quantitative tightening. It stated that it will resume asset purchases in early March, starting gradually to allow its balance sheet to stabilize and then grow modestly, in line with the growth of the economy.

[6] The Bank of Japan raised its reference rate by 25 basis points in its January 2025 decision, setting it at 0.5%, its highest level in 17 years. This, after making no adjustments in the three previous consecutive decisions and raising it by 15 basis points in July 2024. It also decided to change the interest rates applicable to its complementary deposit facility and basic loan rate, which it set at 0.50 and 0.75%, respectively. In connection with its Fund-Provisioning Measure to Stimulate Bank Lending, it announced that new loan disbursements will not be made after June 30, 2025, as scheduled. It also indicated that the future conduct of monetary policy will depend on the evolution of economic activity, prices and financial conditions. It added that, given that real interest rates are at significantly low levels, if its economic and price outlook materializes, the Bank will raise the monetary policy rate and adjust the degree of monetary accommodation.

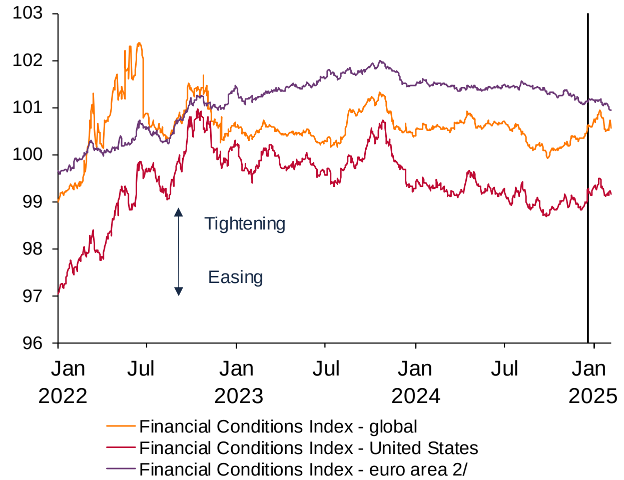
Chart 4
Reference rates and trajectories implied in OIS curves[1/]
Percent



1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the United States, the average interest rate of the target range of the federal funds rate is used.
Source: Bloomberg.

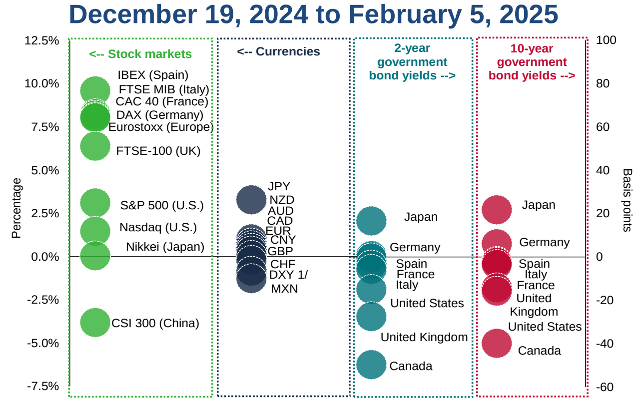
In emerging economies, long-term (10-year) and medium-term (2-year) rates declined overall. Regarding foreign exchange markets, the US dollar depreciated slightly against most advanced and emerging market currencies. The US dollar temporarily appreciated at the beginning of February due to the aforementioned tariff announcements. Lastly, capital flows remained at levels similar to those observed since Mexico's last monetary policy decision. There were outflows in equity assets, while inflows were registered in fixed-income assets.

Chart 5
Financial Conditions Index[1/]
Units



1/ The financial conditions index is constructed considering the effect of five variables on economic activity: the reference interest rate, the 10-year government bond, the spread of investment grade bonds over the government debt bond with equivalent maturity, the ratio of a stock index with 10-year average earnings per share, and the trade weighted exchange rate.
2/ In the case of the euro area, the spread between the sovereign bonds of France, Italy, Spain, the Netherlands, Belgium, Austria, Portugal and Finland over the German 10-year bond is also considered. The vertical black line indicates Banco de México's last scheduled monetary policy meeting.
Source: Bloomberg and Goldman Sachs.

Chart 6
Change in selected financial indicators from December 19, 2024 to February 5, 2025



DXY: a weighted average estimated by the Intercontinental Exchange (ICE) of the nominal exchange rate of the main six currencies operated globally with the following weights: EUR: 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%.
Source: Bloomberg.

Chart 7
Selected emerging economies: financial assets performance starting on December 13, 2024
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-2.27%	-0.10%	-31	-24	4
	Brazil	4.16%	0.74%	33	36	0
	Chile	1.47%	7.49%	16	49	5
	Colombia	3.28%	9.43%	-6	25	10
	Peru	0.32%	-1.50%	-28	7	8
Emerging Europe	Russia	6.29%	17.40%	10	-190	N.A.
	Poland	0.56%	5.51%	17	4	2
	Turkey	-2.73%	-4.01%	-356	-207	4
	Czechia	-1.60%	6.14%	-14	-21	-1
	Hungary	-0.36%	5.02%	16	28	-3
Asia	China	0.02%	-4.79%	7	-16	-4
	Malaysia	0.60%	-2.13%	0	0	2
	India	-3.14%	-4.70%	-11	-7	1
	Philippines	0.63%	-5.07%	-12	23	3
	Thailand	1.59%	-10.12%	2	0	5
	Indonesia	-1.81%	-4.10%	-20	-9	4
Africa	South Africa	-3.85%	-0.60%	7	22	21

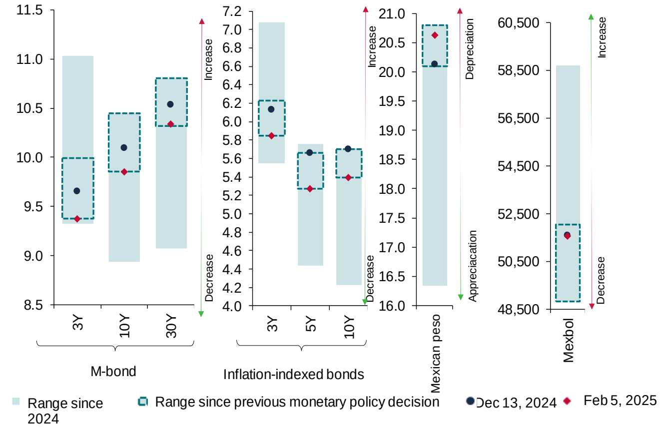
Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, the 2-year swap rate was used, while for Russia, the swap rates for both terms were used. The latest CDS data for Russia is as of June 1, 2022.
Source: Bloomberg.

A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

Since Mexico's last monetary policy decision, the Mexican peso has traded in a broad range, without exhibiting a clear trend and while maintaining an orderly behavior (Chart 8). Following the announcement on the imposition of US tariffs on imports from Mexico, the peso depreciated significantly, which reverted once the agreement to pause the tariffs was negotiated. Likewise, government bonds interest rates declined for all terms.

Chart 8
Mexican markets' performance
Percent, MXN/USD and index



Source: *Proveedor Integral de Precios* (PIP) and Bloomberg.

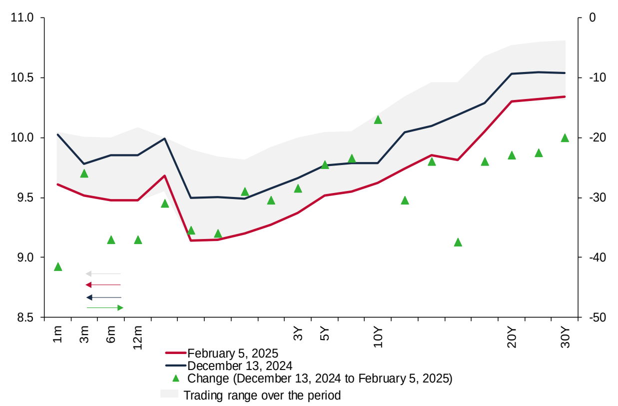
The Mexican currency traded in an end-of-day range of between MXN/USD 20.10 and 20.61 since the previous monetary policy decision (Chart 9) and reached an intraday high of MXN/USD 21.33 in early February 2025 before the US tariff announcement. During this period, the currency depreciated 2.27%, mainly due to the uncertainty associated with the new US administration's trade policies, as well as to adjustments in the expected trajectory of the US Federal Reserve's monetary policy. Trading conditions remained at suboptimal levels, mainly affected by year-end seasonality.

Chart 9
Mexican peso exchange rate
MXN/USD

Source: Banco de México.

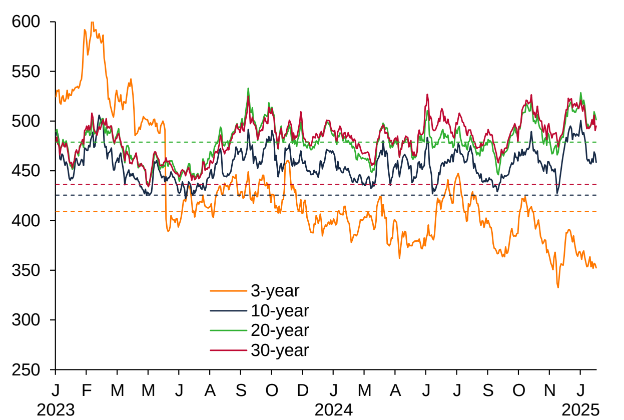
Interest rates on government securities decreased between 17 to 42 bps along the entire curve (Chart 10). Yields on real rate instruments registered a positive trend with decreases of between 14 and 50 bps in all maturities. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments increased slightly in the medium- and long-term segments (Chart 11).

Chart 10
Nominal yield curve of government securities
Percent, basis points



Source: *Proveedor Integral de Precios* (PIP).

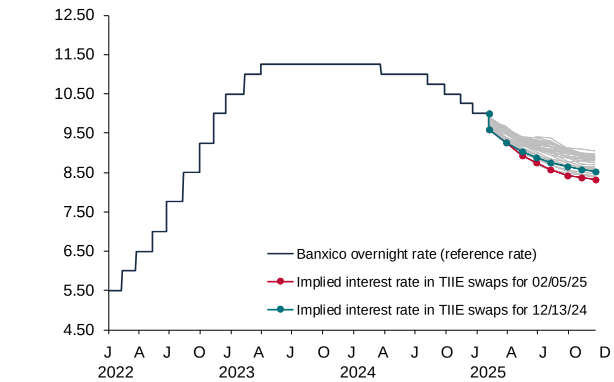
Chart 11
Breakeven inflation and inflation risk implied in government securities' yields
Basis points



Note: Horizontal lines refer to the respective averages observed from September 2008 to date.
Source: *Proveedor Integral de Precios* (PIP).

Regarding expectations for the path of the reference rate, information implicit in the interest rate swap curve includes a rate cut in the February decision and a level of 8.30% at the end of 2025 (Chart 12). Most analysts surveyed by Citi Mexico anticipate a 50-bp cut at the February meeting. For 2025 and 2026 year-ends, they estimate rates of 8.50% and 7.50%, respectively.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent



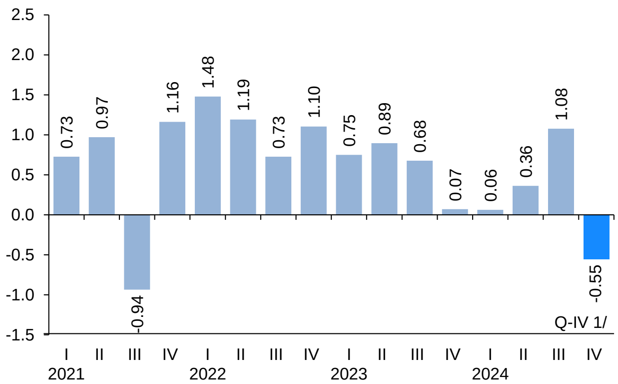
Note: Grey lines represent the range since the last monetary policy decision.
Source: *Proveedor Integral de Precios* (PIP).

A.2.2. Economic activity in Mexico

According to the flash estimate published by INEGI, in the fourth quarter of 2024, Mexico's GDP contracted by 0.55% based on seasonally adjusted figures (Chart 13). Thus, the weakness that national economic activity has been registering since the end of 2023 intensified.

Regarding domestic demand, private consumption continued decelerating during the period October-November 2024. Consumption of domestic goods and services remained sluggish, while consumption of imported goods decreased with respect to the third quarter of 2024. Meanwhile, gross fixed investment remained stagnant. Investment in construction continued trending downwards, while spending on investment in machinery and equipment partially offset said trend as it continued exhibiting a positive trajectory. As for external demand, the growth in the value of manufacturing exports slowed down during the fourth quarter of 2024 compared to previous quarters. This reflected a loss of dynamism in non-automotive exports, as well as the continued stagnation of automotive exports (Chart 14).

Chart 13
Gross Domestic Product
Quarterly percentage change, s. a.

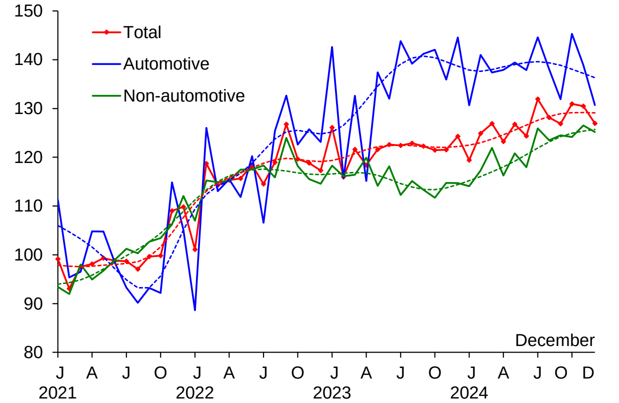


s. a. / Seasonally adjusted figures.
1/ The figure for the fourth quarter of 2024 refers to the timely estimation of quarterly GDP published by INEGI.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

On the production side, the three main sectors of the economy exhibited weakness during the period October-November 2024 (Chart 15). Industrial activity contracted and maintained a certain downward trend. This was mainly the result of falls in the manufacturing and construction sectors, combined with a downward trend in mining (Chart 16). Primary sector activities decreased significantly during the period, while services slowed down.

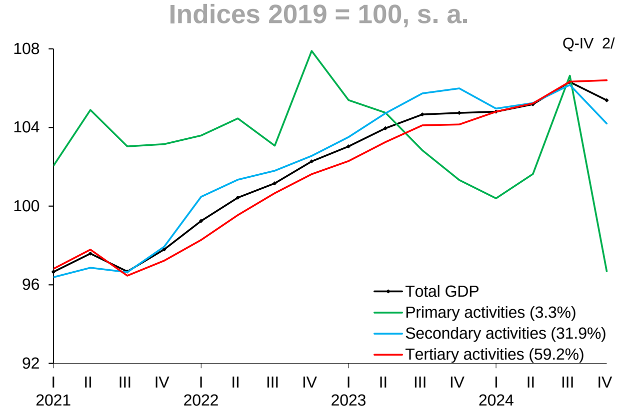
Regarding the cyclical position of the economy, the point estimate for the output gap became negative in the fourth quarter of 2024 (Chart 17). Between late 2024 and early 2025, labor market indicators continued showing signs of moderation. Specifically, employment has decelerated. Based on seasonally adjusted figures, in December 2024 and January 2025, formal job creation measured by the number of IMSS-insured workers continued showing weakness. However, as a reflection of a slightly greater reduction in workers' participation rate compared to the decline in the employment to working-age population ratio, both national and urban unemployment rates declined in December 2024 with respect to the previous month (Chart 18). Both remained at historically low levels. Lastly, in November 2024, unit labor costs in the manufacturing sector continued trending upwards (Chart 19).

Chart 14
Manufacturing exports
Indices 2021 = 100, s. a.



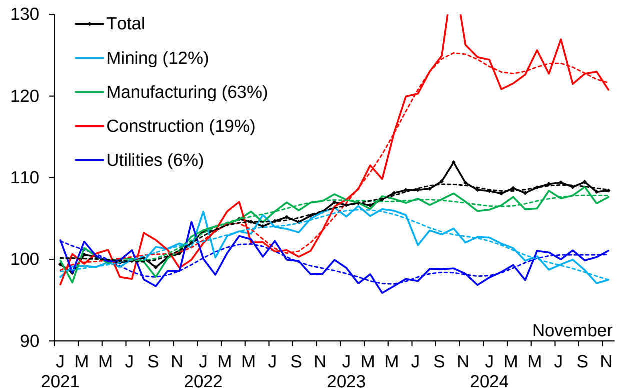
s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from the Tax Administration Service (SAT, for its Spanish acronym), the Ministry of the Economy (SE, for its Spanish acronym), Banco de México, the National Institute of Statistics and Geography (INEGI, for its Spanish acronym). Mexico's Merchandise Trade Balance. The National System of Statistical and Geographical Information (SNIEG, for its Spanish acronym). Information of national interest.

Chart 15
Total GDP and by sector of economic activity[1/]
Indices 2019 = 100, s. a.



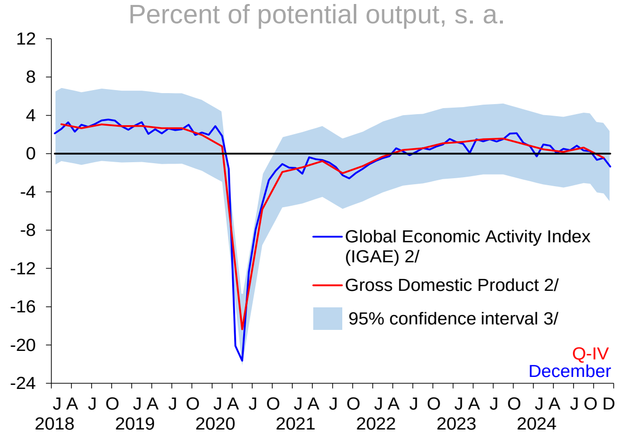
s. a. / Seasonally adjusted figures.
1/ The estimated percentage share of each sector in 2023 is reported in parentheses.
2/ The figure for the fourth quarter of 2024 refers to the timely estimation of quarterly GDP published by INEGI.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 16
Industrial activity[1/]
Índices 2021 = 100, a. e.



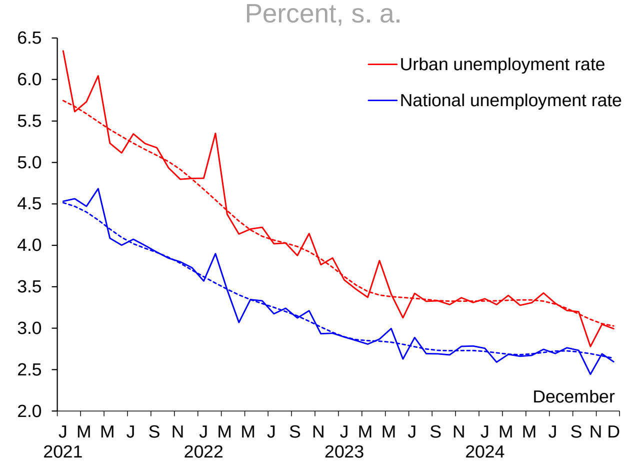
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 17
Output gap estimates[1/]
Percent of potential output, s. a.



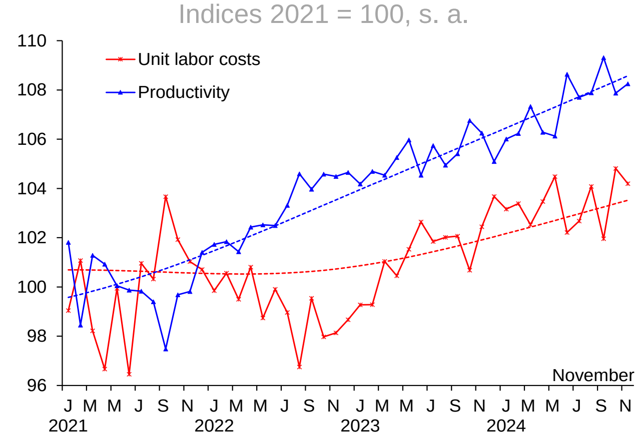
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ Figures for the GDP flash estimate for the fourth quarter of 2024 and implied IGAE for December 2024 are consistent with this timely GDP figure.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and urban unemployment rates
Percent, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with ENOE data, INEGI.

Chart 19
Productivity and unit labor costs in the manufacturing sector[1/]
Indices 2021 = 100, s. a.



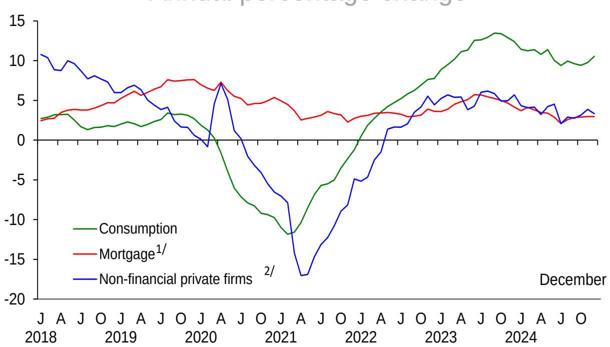
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly Manufacturing Industry Survey and industrial activity indicators of Mexico's System of National Accounts (*Sistema de Cuentas Nacionales de México*, SCNM), INEGI.

Domestic financing to the private sector continued expanding in December 2024, although to a lesser extent with respect to the dynamism observed in 2023. Regarding its components, commercial bank lending to the private sector continued growing at different rates across its various portfolios (Chart 20). Notably, the growth rate of credit for consumption remained at elevated levels, although below those registered in 2023.

As for the cost of financing, interest rates on bank credit to firms decreased in December 2024 compared to the previous month. Despite the above, they remained at high levels. Its evolution continued reflecting the pass-through of the reference rate to bank interest rates in the segment. Credit intermediation margins did not exhibit significant changes during that month. Interest rates on commercial bank mortgage lending remained at levels similar to those observed prior to the pandemic, despite having increased in December 2024. Finally, interest rates on bank consumer loan portfolio remained at relatively high levels, although they declined slightly in some segments in August 2024.

As for portfolio quality, delinquency rates of bank credit to firms and households did not exhibit significant changes in December 2024. Thus, the indices of different private sector loan portfolios remained at low levels in relation to their historical behavior.

Chart 20
Performing credit from commercial banks to the private sector
Annual percentage change



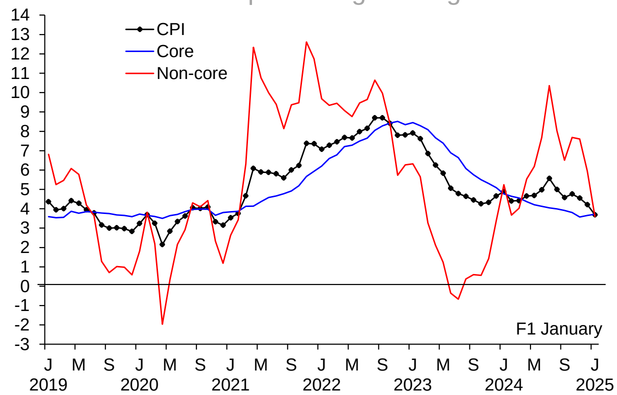
1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation decreased from 4.55% in November 2024 to 3.69% in the first fortnight of January 2025. This downward pattern derived from the decline in non-core inflation (Chart 21 and Table 1).

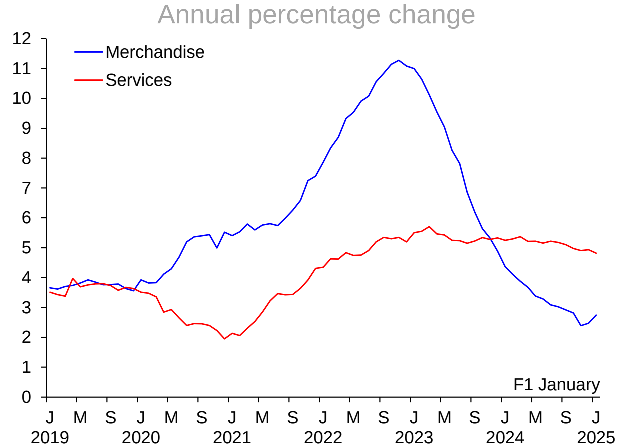
Annual core inflation shifted from 3.58 to 3.72% between November 2024 and the first fortnight of January 2025. This performance reflected an increase from 2.39 to 2.75% in merchandise inflation (Chart 22), which was associated, in turn, with an increase from 3.56 to 3.83% in food merchandise inflation and growth from 1.19 to 1.68% in non-food merchandise inflation (Chart 23). The conclusion of the "*El Buen Fin*" sales campaign that took place in November 2024 contributed to the increase in merchandise inflation. In turn, annual services inflation decreased from 4.90 to 4.82% during said period. Among its components, the decline from 5.73 to 5.59% in the annual variation of the prices of services other than education and housing was noteworthy.

Chart 21
Consumer Price Index
Annual percentage change



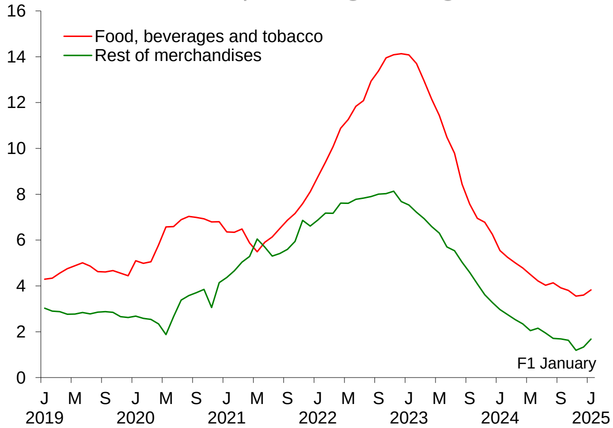
Source: INEGI.

Chart 22
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

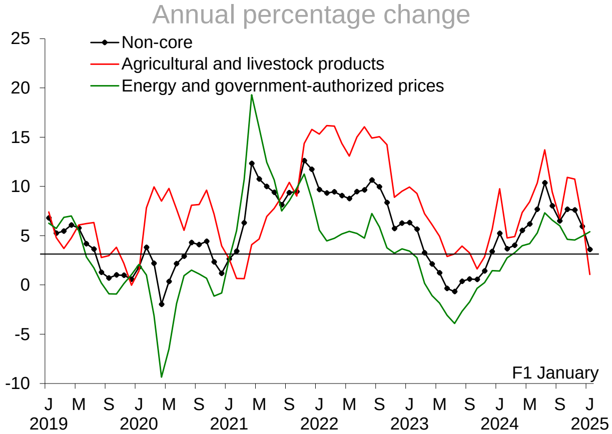
Chart 23
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Annual non-core inflation decreased from 7.60% in November 2024 to 3.60% in the first fortnight of January 2025 (Chart 24 and Table 1). Regarding its components, annual inflation of agricultural and livestock products declined from 10.74 to 1.06% in the same period, supported by the reduction from 16.81% to -6.11% in fruit and vegetables' inflation, reflecting the fading effects of the supply shocks that had affected some of its components. This decrease counteracted the increase from 5.14 to 7.03% in livestock products' prices. Energy inflation rose from 5.25 to 6.42% during the referred period, mainly influenced by the increase in the annual variations of gasoline and electricity prices.

Chart 24
Non-core price index
Annual percentage change



Source: INEGI.

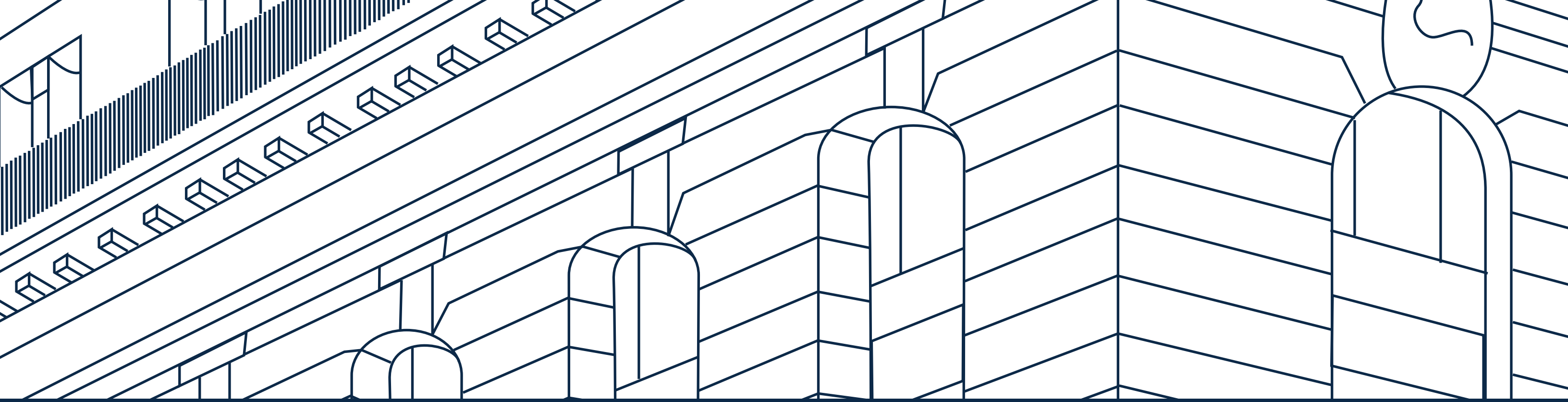
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between December 2024 and January 2025, the medians for expected headline and core inflation at the end of 2025 increased slightly from 3.80 to 3.83% and from 3.72 to 3.74%, respectively. Expectations for headline and core inflation for the end of 2026 remained unchanged. The median of headline inflation expectations continued at 3.70%, while that of core inflation remained at 3.60%. Expectations for headline inflation over the next four years remained practically unchanged. The median of headline inflation expectations adjusted from 3.72 to 3.70%, while that of core inflation expectations remained at 3.60%. Headline and core inflation expectations for the long term (5 to 8 years) also remained stable. The corresponding medians stood at 3.60 and 3.50%, respectively. Finally, compensation for inflation and inflationary risk has exhibited volatility. Its monthly average in January 2025 increased slightly with respect to December 2024. This is explained by a moderate increase in the inflation risk premium, as inflation expectations implicit in market instruments remained stable.

Headline inflation is still expected to converge to the target in the third quarter of 2026. Announcements regarding economic policy changes by the new US administration have added uncertainty to the projections. Their materialization could imply pressures on inflation on both sides of the balance. Additionally, forecasts are subject to the following risks. On the upside: i) persistence of core inflation; ii) greater foreign exchange depreciation; iii) disruptions associated with geopolitical conflicts or trade policies; iv) greater cost-related pressures; and v) climate-related impacts. On the downside: i) lower-than-anticipated economic activity; ii) a lower pass-through effect from some cost-related pressures, and iii) a lower-than-anticipated effect of the exchange rate depreciation on inflation. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. Nevertheless, the inflationary episode derived from the effects of the pandemic and the outbreak of war in Ukraine has been resolving.

Table 1
Non-core price index
Annual percentage change

Item	November 2024	December 2024	1st fortnight Jan. 2025
CPI	**4.55**	**4.21**	**3.69**
Core	**3.58**	**3.65**	**3.72**
Merchandise	**2.39**	**2.47**	**2.75**
Food, beverages and tobacco	3.56	3.60	3.83
Non-food merchandise	1.19	1.33	1.68
Services	**4.90**	**4.94**	**4.82**
Housing	3.96	4.01	3.93
Education (tuitions)	5.79	5.79	5.73
Other services	5.73	5.77	5.59
Non-core	**7.60**	**5.95**	**3.60**
Agricultural and livestock products	**10.74**	**6.57**	**1.06**
Fruits and vegetables	16.81	6.05	-6.11
Livestock products	5.14	6.27	7.03
Energy and government-authorized prices	**4.55**	**4.97**	**5.41**
Energy products	5.25	5.73	6.42
Government-authorized prices	**3.83**	**4.12**	**4.05**

Source: INEGI.



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