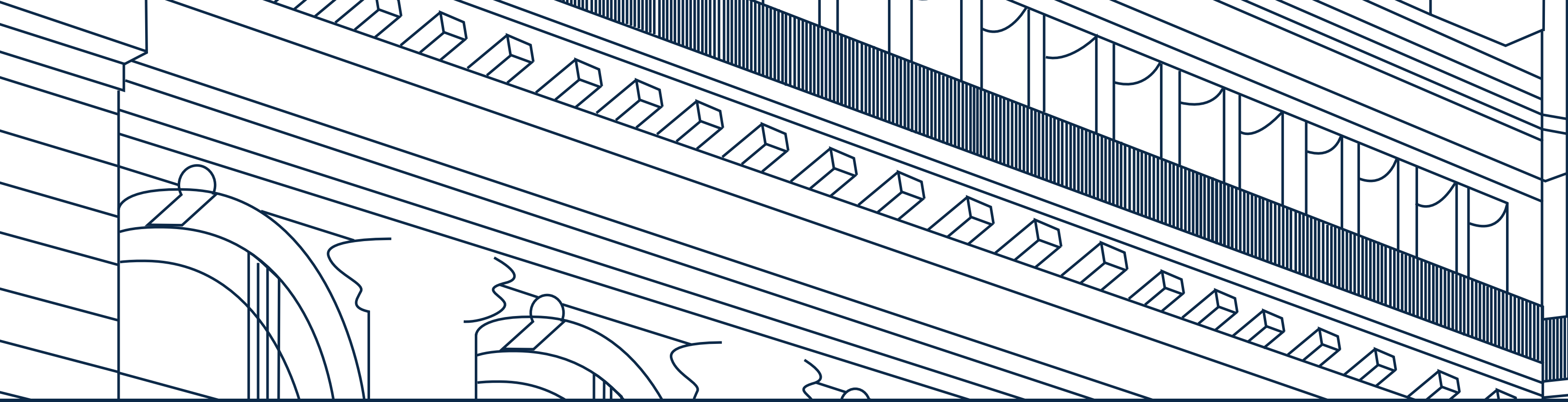
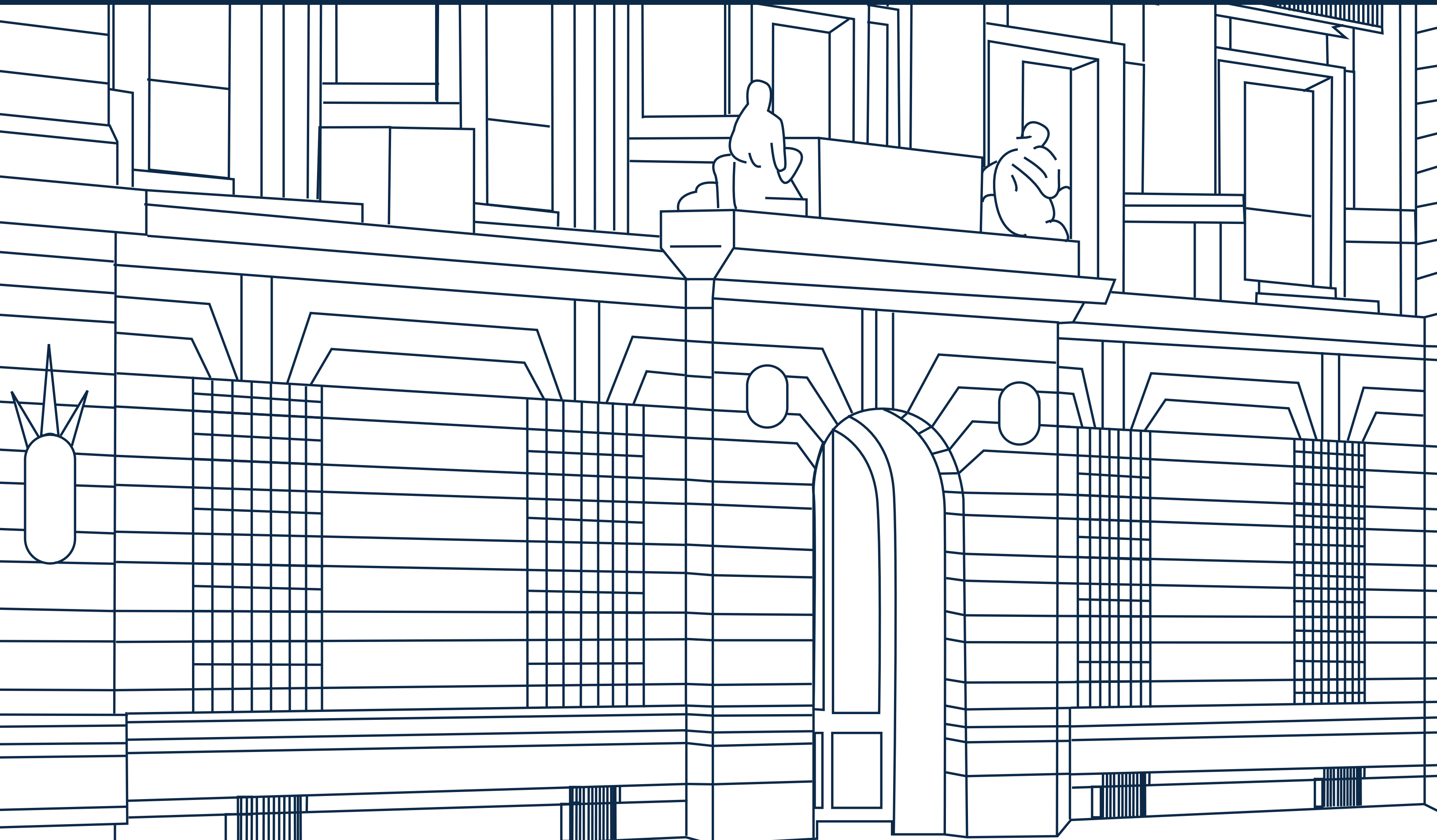


BANCO DE MÉXICO®

Minutes number 111

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on September 26, 2024

This document is provided for the reader's convenience only. The translation from the official Spanish version was made by Banco de México's staff. Discrepancies may possibly arise between the original document in Spanish and its English translation. For this reason, the original Minutes in Spanish are the only official document.



> **FOREWARNING**
> This document is provided for the reader's convenience only. The translation from the official Spanish version was made by Banco de México's staff. Discrepancies may arise between the original document in Spanish and its English translation. For this reason, the original Spanish version is the only official document.

1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: September 25, 2024.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Rogelio Ramírez de la O, Secretary of Finance and Public Credit.
- Gabriel Yorio, 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 of the Board mentioned that available indicators suggest that during the third quarter of 2024 world economic activity grew at a rate similar to that of the previous quarter. **One** member considered that it has continued expanding at a moderate pace. **Most members highlighted that performance was heterogeneous across countries. One** member noted that, relative to the first half of the year, the lower rate of expansion in advanced economies has been offset by a stronger-than-anticipated recovery in emerging economies. **Most members noted that growth continues being driven mainly by the services sector. Some** members highlighted the sluggishness in manufacturing. **One** member underlined that, looking ahead, the expectation of a mild slowdown in global growth in 2024 and 2025 prevails, and thus a "soft landing" is still anticipated. However, he/she cautioned that such scenario is subject to high uncertainty. He/she warned that among the most relevant risks for global economic performance are those associated with the electoral process in the United States, the loss of dynamism in the Chinese economy, the escalation of geopolitical conflicts, and the high level of fiscal deficits in several economies. In the case of the United States, **another** member considered that the fading of factors that once supported the resilience of its economy, such as the financial position of households, which is already weakening, suggests that some downward risks have gained relevance. **One** member added that, according to analysts, the probability of a recession in that country in the next 12 months is still low. However, he/she recalled that about 80% of them consider that the full impact of interest rates on that economy has not yet materialized.

Most members noted that labor markets in the major advanced economies have shown signs of lower dynamism. Some members pointed out that unemployment gaps have been narrowing in several of these economies, except for the euro area, as noted by **one** member. **In the case of the United States, most members highlighted the better balance between supply and demand in the labor market. Some** members pointed out that wage growth in that country has been declining. They indicated that the unemployment rate has been increasing and is above 4%.

Most members agreed that the disinflation process continues at the global level. Some members noted the differentiated behavior of inflation across countries. **Some** members highlighted that headline inflation in advanced economies is currently closer to central banks' targets, as compared to the beginning of the year. **One** member added that in these economies, the trimmed mean indicator of headline inflation shows a downward trend. **Most members mentioned that the recent moderation of headline inflation in these economies was mainly due to reductions in the non-core component. One** member detailed that the latter is associated with lower food inflation. He/she added that, in contrast, in some cases, core inflation rebounded at the margin. **Some** members highlighted that this component, especially the services segment, continues showing persistence. However, **one** member argued that, although core inflation is declining moderately, it lies below the levels of the beginning of 2024. In the particular case of the United States, **some** members highlighted the favorable behavior of headline inflation, which decreased from 2.9% in July to 2.5% in August. Regarding emerging economies, **one** member mentioned that inflation's behavior has been more favorable in Asia and emerging Europe than in Latin America. He/she pointed out that in a large number of emerging economies, headline inflation lay within the central banks' variability range. **Another** member commented that it registered decreases in these economies due to a moderation in food and energy inflation. However, he/she acknowledged that the core component remains elevated.

Regarding international commodity prices, **some** members mentioned that energy prices trended downwards due to the expectation of increased production by OPEC. **One** member argued that the expectation of lower global economic growth was also a contributing factor. **Another** member added that there was a rebound in wheat, corn and sugar prices due to climate-related factors affecting various regions. He/she stated that metal prices also increased due to supply issues in Russia.

All members highlighted that the US Federal Reserve cut the target range for the federal funds rate by 50 basis points. Most members noted that the magnitude of the adjustment had not been fully incorporated by the markets ahead of the decision. One member commented that rate cuts of such magnitude have only occurred in episodes of marked deceleration, such as in 2001, 2008 and 2020. However, he/she pointed out that in the press conference, the chairman of that institution argued that the labor market and the economy continue showing a solid performance, and thus he foresees that the magnitude of the rate cut could help maintain the strength of the labor market and the economy. **Some** members highlighted that in its statement the Federal Open Market Committee indicated that has gained greater confidence that inflation is moving sustainably toward its target. **One** member added that commitment to the maximum employment mandate was also highlighted. **Another** member underlined the reference that risks to achieving its employment and inflation goals are in balance. **Some** members indicated that the Federal Open Market Committee projections point to an additional cumulative loosening of 50 basis points for the remainder of 2024. **One** member added that additional cuts of 100 basis points are expected in 2025. However, **another** member pointed out that the chairman of said institution mentioned that there is no predefined trajectory for the reference rate.

The majority noted that the central banks of other advanced economies also lowered their reference rates. They detailed that the European Central Bank and the Bank of Canada cut their reference rates again by 25 basis points. One member highlighted that these institutions did not commit to a predetermined path for the reference rate and that they maintained a data-dependent approach. As for the European Central Bank's decision, **some** members indicated that said institution noted the resistance to decline of the services component. **One** member added that said central bank also emphasized the tightness of the euro area's labor market. **Another** member stated that the rate cut was implemented while that institution still anticipates a slight rebound in inflation towards the end of the year. Regarding the Bank of Canada, he/she highlighted that, in its monetary policy statement, it noted that downside risks to inflation continue gaining relevance. **Some** members pointed out that the Bank of England left its reference rate unchanged. **One** member indicated that this was in line with the cautious tone of its previous policy decision. **Some** members commented that the Bank of Japan also left its target rate unchanged, although a second-rate hike is expected for the rest of the year. **Some** members mentioned that markets anticipate that, looking ahead, the moderation of monetary restriction will continue in most advanced economies. **One** member estimated that the monetary policy normalization cycle will be a discontinuous process, in terms of both sequence and magnitude. Regarding emerging economies, **another** member highlighted the heterogeneity of their monetary cycles. However, he/she detailed that most of them are expected to continue reducing their monetary restriction until they converge to their neutral positions in 2025. **One** member noted that the Bank of Brazil increased its reference rate by 25 basis points and stated that the inflationary outlook will require a more restrictive monetary policy stance.

The majority commented that volatility in international financial markets eased in the last few weeks. They noted that given the prospects of reference rate cuts by several central banks, government interest rates decreased, mainly short-term ones. They mentioned that gains in the main stock market indexes and a generalized depreciation of the US dollar were registered. One member added that in recent weeks the performance of financial markets showed greater heterogeneity by region and asset class.

Economic activity in Mexico

All members agreed that Mexico's economic activity is undergoing a period of weakness. The majority indicated that it has registered a visible loss of dynamism since the last quarter of 2023. One member underlined that the national accounts data published at the end of August showed downward revisions for the most recent quarterly variations, indicating that the economy has been practically stagnant. **Another** member stated that data for the second quarter showed that the slowdown has taken place in both supply and demand. **One** member attributed the economic weakness to the uncertain environment associated with idiosyncratic factors, as well as to the expectation of a lower US economic activity and to the ongoing electoral process in that country. **Another** member estimated that the lack of economic dynamism is a consequence of the stagnation of US manufacturing production, which affects the export sector, and of a slowdown in investment, which typically occurs around federal government transitions. He/she considered that despite the signs of a slowdown, an economic contraction is not anticipated. **Most members added that information available at the beginning of the third quarter shows a certain rebound. One** member stated that the IGAE of July increased at a seasonally adjusted monthly rate of 0.6%. **Some** members pointed out that this expansion partly reflected the growth in primary activities. **One** member noted that this sector rose 11.6% at the margin. **Another** member highlighted that although July figures suggest a slight progress, the economy is expected to maintain its relatively low dynamism throughout the planning horizon.

Regarding the sectoral performance of economic activity, **some** members emphasized the slowdown in secondary and tertiary activities. **One** member pointed out that sluggish industrial production has affected wholesale trade, which together with a weaker evolution of other services has made the tertiary sector lose dynamism. **Some** members warned that there is a generalized weakening in manufacturing components. **One** member pointed out that two thirds of the subsectors that comprise it register negative annual variations. **Some** members noted that in recent months economic activity improved slightly, associated with a certain rebound in construction. **One** member mentioned that, although building construction has shown dynamism, civil engineering works have slowed down due to the completion of different government projects.

Regarding domestic demand, the majority indicated that consumption slowed down. Some members considered that it has even stagnated. Most members highlighted that this component contracted in the second quarter. One member stated that it registered a negative quarterly variation of 2.20% in seasonally adjusted annualized figures. He/she member indicated that this setback is the first one since mid-2020. **Most members noted a contraction in consumption of imported goods. One** member pointed out that social transfer payments were brought forward to the first quarter, and thus their absence in the second quarter would have partly explained the observed trend in consumption. He/she argued that these payments resume in the third quarter, consumption is expected to rebound to some extent. He/she added that, looking ahead, other factors would also support consumption dynamics, such as the increase in income from remittances denominated in pesos, boosted by the recent exchange rate depreciation, as well as wage revisions. However, **another** member mentioned that several indicators related to consumption as well as timely data indicate that its moderation will continue.

Most members pointed out that investment has continued registering a lack of dynamism since mid-2023. They noted that this was observed in all its categories. As for external demand, **one** member indicated that it has remained sluggish. **However, most members pointed out that the value of both automotive and non-automotive manufacturing exports showed some reactivation in July. One** member noted that this was mainly due to an improvement in shipments to the United States.

Regarding the cyclical position of the economy, **some** members indicated that the point estimate of the output gap calculated with GDP data continued narrowing from positive levels. **Some** members pointed out that it is expected to remain close to zero in the remainder of 2024 and to be persistently negative in 2025. **One** member stated that a significant negative gap is unlikely, since a recession is not expected. **Another** member indicated that some slack indicators, such as the labor market, remain in positive territory. **One** member noted that the indicator based on principal components has become less positive, in light of a slightly negative consumption gap. He/she recalled that, in general, measuring economic slack involves a high degree of uncertainty. However, he/she pointed out that hard data confirm the economic slowdown. He/she considered that the cyclical conditions of the economy could continue to be a relevant factor in the price formation process.

Some members stated that Mexico's economic activity is expected to expand at a moderate pace in 2024 and 2025. **Some** members considered that the balance of risks to growth of economic activity remains biased to the downside. **One** member argued that a downward risk factor that has gained relevance is the possibility of a lower-than-expected growth of the US economy, to the detriment of Mexico's external demand. He/she added that another risk is the environment of high uncertainty that prevails due to both domestic and external factors.

All members indicated that the labor market remains solid. Most members highlighted that the unemployment rate remains close to its historic lows. One member underlined that labor force participation rates are at levels similar to those observed prior to the pandemic. **Another** member stated that both the participation rate and the employment-to-working-age population ratio remain high. **However, all members acknowledged that job creation has slowed down. One** member indicated that recent readings suggest that after having shown high dynamism, growth of employed population has aligned more closely with its pre-pandemic trend. **Another** member underlined that the slowdown in job creation is visible both in the employed population reported by the ENOE and in IMSS-insured jobs. He/she detailed that lower job creation is more noticeable in construction, manufacturing and trade, and therefore it seems to be closely associated with the weakness of the industrial sector. **One** member added that the slowdown in the pace of employment growth could intensify due to the weakness of the prevailing economic activity. **Some** members mentioned that, nevertheless, wage increases remain high. **One** member detailed that average IMSS-insured wages increased by 4.5% in real terms. **Another** member highlighted that the annual variation of nominal wages of IMSS-insured workers stood at 9.7% in August. He/she added that the negotiation of contractual wages in private firms resulted in an increase of 9.3% in the same month. However, **one** member argued that wage growth shows some moderation. **Another** member added that the distribution of wage revisions in recent years has been affected by past inflation figures and by increases in the minimum wage. He/she pointed out that these benchmarks are expected to be lower in 2025, which would influence wage dynamics.

Inflation in Mexico

Most members agreed that Mexico's inflation outlook has been improving, after the significant global shocks of previous years. However, they forewarned that it still faces challenges. One member stated that the current level of core inflation is evidence of this improvement. **Some** members considered that the gradual reversal of the shocks associated with the pandemic and geopolitical conflicts as well as a timely and consistent restrictive monetary policy by the central bank have contributed to the significant disinflation progress. **One** member pointed out that this process has been heterogeneous across inflation components and non-linear.

Most members underlined that headline inflation decreased from 5.57% in July to 4.66% in the first fortnight of September. One member highlighted that headline inflation started to decrease after having increased for five consecutive months. **Another** member warned that, although headline inflation is beginning to resume a downward trend, it is still above the levels observed in October 2023. **The majority pointed out that this decline was mainly due to the partial reversal of the effects of the supply shocks that have affected non-core inflation. They commented that this reversal was already anticipated. One** member noted that non-core inflation's contribution was greater than that of core inflation. **Another** member detailed that headline inflation was affected by the prices of various fruits and vegetables, along with increases in some energy prices mainly due to higher international references. **Some** members emphasized that given the nature of the shocks and the fact that their effects concentrated in few CPI items, these did not lead to a generalized increase in prices. **One** member added that various trend indicators, such as inflation's trimmed mean, showed low sensitivity to these shocks. He/she noted that, instead, what took place was an adjustment of relative prices. **Another** member pointed out that there are no signs of a pass-through of the aforementioned shocks, which are temporary, to the core component.

All members noted that core inflation continued trending downwards, registering 3.95% in the first fortnight of September. Some members emphasized that this component has clearly trended downwards for almost two years. **One** member underlined that it is currently at levels unseen since the first quarter of 2021. **Some** members highlighted that since November 2022, when it peaked during the current inflationary episode, this indicator has decreased 456 basis points. **Some** members noted that the rate of decline of this component has slowed down recently. Nevertheless, **one** member pointed out that the average of the last 6 months of the seasonally adjusted annualized monthly variation, which stands at 3.4%, better reflects its most recent favorable behavior.

Some members noted that annual merchandise inflation stood at 2.94% in the first fortnight of September. **One** member emphasized that such level had not been reached since early 2016. **Most members mentioned that in its last reading food merchandise inflation was 3.95%, while that of non-food merchandise was 1.69%, in both cases clearly below their respective historical averages. One** member stated that these values have not yet reached their respective historical minimum values. He/she specified that the 3-month averages of the seasonally adjusted annualized monthly variations of these subcomponents are at 2.72 and 1.14%, respectively. **Another** member detailed that the last time food merchandise inflation was below 4.0% was eight years ago. **One** member recalled that, in this episode, both components reached their highest levels since the inflation targeting regime was adopted in Mexico. **Some** members considered that merchandise inflation will hardly continue declining.

All members stated that services inflation continues showing persistence. Some members mentioned that between July and the first fortnight of September it went from 5.22 to 5.15%. **One** member noted that it remained at levels close to those registered over the past 14 months. **Another** member highlighted that it has been above 5% since the second fortnight of July 2022, exhibiting a lateral behavior since then. **One** member stated that the components of services inflation have exhibited a differentiated behavior among them. He/she pointed out that the improvement in the category of other services has been the most notable compared to the levels reached at the beginning of 2023. He/she argued that its recent increase partly responds to the rise in tourism services prices, which are volatile. He/she highlighted that in the first fortnight of September, the variation at the margin of services excluding education, housing and tourism was -0.07%, laying below its historical average and being the lowest variation for an equivalent fortnight since 2020. He/she added that while services inflation remains high, it is necessary to acknowledge the signs of improvement. **Another** member stated that the dynamics of services prices have been highly correlated with the evolution of wages. He/she noted that this has resulted in relevant costs in several key subcomponents, such as housing and other services. He/she indicated that these cost-related pressures have passed on to final prices, given the resilience that the economy had exhibited. However, he/she argued that this behavior is unlikely to continue indefinitely, given that, in view of the decline in inflation and minimum wage increases lower than those observed in previous years, wage revisions are expected to moderate.

With respect to non-core inflation, most members indicated that it declined significantly from 10.36% in July to 6.73% in the first fortnight of September. One member highlighted that this component interrupted the upward trend it had been displaying since last February. **Another** member added that said reversal was greater than expected. **The majority stated that this was due to the decline in inflation both of agricultural and livestock products and of energy. Some** members pointed out that annual inflation of agricultural and livestock products decreased from 13.72 to 6.50%, while inflation of energy products shifted from 9.17 to 7.92% in the same period. **Some** members recalled that the non-core component is highly volatile. **One** member added that at times it exhibits a significant downward trend, improving headline inflation's performance, but at other times it exerts an upward influence.

Some members considered that inflation expectations drawn from surveys remained relatively stable. **Some** members mentioned that these remain above Banco de México's forecasts. **One** member stated that, overall, they continue without showing a downward trend. He/she indicated that the median of headline inflation expectations for year-end 2024 increased, while those for the end of 2025 and the next 12 months declined. **Another** member pointed out that short-term expectations have evolved in line with their historical averages and noted that their dynamics are unlike those observed during 2021 and 2022. **One** member underlined that, according to surveys, core inflation is projected to lie at levels similar to the current ones by the end of 2025. **Some** members commented that medium- and long-term expectations remain at levels above target. **One** member noted that expectations for the next 4 years increased, while those for the next 5 to 8 years remained unchanged. **Another** member attributed the resistance to decline of headline inflation expectations to the anticipated behavior of the non-core component, since medium- and long-term expectations of core inflation have registered downward adjustments. Regarding inflation expectations drawn from market instruments, **some** members reported that these declined marginally. **One** member added that they have exhibited inertia. **Another** member stated that they also remain above Banco de México's forecasts. **One** member noted that there was a decrease in the risk premium and in the breakeven inflation rate derived from market instruments.

Most members mentioned that forecasts for headline and core inflation were revised slightly downwards for some quarters in the short term. Some members commented that, in the case of headline inflation, it was due to a faster-than-anticipated reversal in supply shocks. **Most members stated that headline inflation is expected to resume its downward trend, and core inflation, to continue trending downwards. Some** members pointed out that headline inflation is still expected to converge to the target in the fourth quarter of 2025. **One** member added that core inflation is also foreseen to register 3% in that same quarter.

The majority considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member argued that such bias persists even when accounting for the observed and expected weakness of economic activity. **Another** member highlighted that, after the global shocks, the inflation environment continues improving. **One** member specified that, based on risk distribution estimates derived from economic conditions for core inflation, the latter has improved throughout the year.

Most members mentioned the persistence of core inflation as an upward risk. Some members specifically highlighted the services component. **One** member added the risk that merchandise inflation may rebound, reverting to its historical average, and that services inflation fails to decrease due to domestic pressures. **Some** member underlined the risk of a greater exchange rate depreciation. **One** member mentioned the possibility of climate-related impacts on the prices of agricultural and livestock products. **Some** members pointed to the risk of greater cost-related pressures. **One** member noted the possibility of additional increases to the minimum wage in early 2025. However, **another** member commented that as the economic slowdown deepens, the pass-through of costs is expected to face limits.

Regarding risks to the downside, **some** members highlighted the possibility of a lower-than-anticipated economic activity in Mexico or in the United States. **One** member warned that, in his/her opinion, said risk has become more relevant. **Another** member added that the impact of the exchange rate depreciation on inflation could be of lesser magnitude than anticipated, as well as the risk of a lower pass-through of certain cost-related pressures.

Macrofinancial environment

Most members stated that since the last monetary policy decision financial markets in Mexico continued registering volatility. Some members mentioned that, nevertheless, said volatility has moderated recently. **One** member added that trading conditions improved, which was most clearly observed in the fixed-income market. **Most members underlined that the Mexican peso has traded within a broad range. They indicated that the peso has experienced depreciation episodes, and that such depreciation partially reversed. Some** members pointed out that the exchange rate volatility derived from idiosyncratic factors, as well as from the unwinding of carry trade positions against the yen and the evolution of the electoral process in the United States. **One** member considered that the effects of these factors were partially attenuated by the Federal Reserve's monetary policy decision. **Some** members argued that, in an uncertain environment, further bouts of financial volatility cannot be ruled out. **One** member emphasized that said volatility could be observed in the coming months, particularly in November, given the electoral process in the United States. **Another** member underlined that the bias towards depreciation in medium-term expectations prevails and could materialize due to both idiosyncratic and global factors. However, **one** member added that Mexico has robust fundamentals and that the risk-adjusted interest rate spread remains among the most attractive. **Another** member considered that the central bank should remain vigilant of the orderly behavior of financial markets.

Most members noted that the government bond yield curve decreased, especially at the short end. One member commented that a similar behavior was observed in the interest rate derivatives market. He/she indicated that the implied trajectory for the monetary policy rate in TIIE swaps anticipates a level of 10.46% for the monetary policy decision of September, 10.14% for the policy decision of November, and 9.81% for the end of the year. He/she underlined that a 50-basis point decrease is not ruled out in the November or December decisions. He/she added that the consensus of surveyed analysts anticipates an adjustment of 25 basis points at this monetary policy meeting and a 10.00% policy rate by the end of 2024. He/she noted that risk premia have decreased in both default protection insurance and the spread between yield rates on bonds issued by the Mexican government and those issued by the US Treasury. He/she highlighted that the stock market was not immune to the uncertainty and exhibited high levels of variability. **Another** member stated that said market performed slightly unfavorably, due to the expectation of lower local growth and increased uncertainty. He/she stated that financial conditions tightened further reaching their highest level since October 2022, as a result of the behavior of variables related to the foreign exchange market and country risk. He/she noted that the economic policy uncertainty index increased significantly in August and September, due to both domestic and external factors. **One** member mentioned that, regarding capital flows, there were inflows to fixed-income markets for all maturities.

With respect to financing in the economy, **another** member stated that in July financing to the non-financial private sector continued increasing, albeit at a slower pace than in recent months. He/she specified that domestic financing to this sector grew at an annual rate of 3.3%, exhibiting a lower dynamism compared to 2023. He/she added that, in the same month, commercial bank credit to businesses, consumption and housing also grew at more moderate rates. Regarding credit risk, he/she noted that delinquency levels remain low and stable.

Monetary policy

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It considered the nature of the shocks that have affected the non-core component and the projection that their effects on headline inflation will continue dissipating over the next quarters. It took into account core inflation's trajectory and the fact that it is anticipated to continue decreasing. It estimated that, although the outlook for inflation still calls for a restrictive monetary policy stance, its evolution implies that it is adequate to reduce the level of monetary restriction. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate to 10.50%.

Looking ahead, the Board expects that the inflationary environment will allow further reference rate adjustments. It will consider that global shocks will continue fading and the effects of the weakness in economic activity. It will take into account the incidence of the restrictive monetary policy stance that has been maintained and that 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 considered that macroeconomic conditions and the prospective assessment of the inflationary environment suggest that the reference rate can be adjusted downwards once again by 25 basis points to a level of 10.50%. He/she argued that the level of monetary restriction would thus moderate in line with the inflation outlook. He/she highlighted that key factors in this decision are that, first, the supply shocks that exerted upward pressure on non-core inflation are dissipating and are expected to continue to do so. In this regard, he/she reiterated that headline inflation has resumed a downward trajectory, which is expected to persist over the following quarters. Second, he/she noted the substantial progress in reducing core inflation, which better reflects the medium-term trend of inflation, as well as the expectation that this component will continue declining. Third, he/she stressed that the economic environment is conducive to a sustained moderation in inflationary pressures. He/she emphasized that the decline in inflation abroad, especially in the United States, along with the weakening of economic activity in Mexico will continue to support this trend. He/she considered that it should be communicated that, going forward, the inflationary environment is expected to allow for further reductions in the reference rate. He/she emphasized that, given the levels that core inflation has already attained, the magnitude of adjustments could be evaluated. He/she indicated that, in this process, the incidence of both the restrictive policy stance that has been maintained and that prevailing on inflation throughout the horizon in which monetary policy operates will be considered. He/she also argued that it must be acknowledged that inflationary pressures persist, as the effects of the shocks associated with the pandemic and the military conflict in Ukraine have not fully dissipated. In that regard, he/she highlighted that a restrictive monetary policy stance continues being necessary, like the one that would prevail even after the adjustment to the reference rate proposed in this monetary policy meeting and any potential adjustments in future meetings has been made. He/she added that it is essential to reinforce the message that Banco de México will remain committed to attaining its primary mandate of ensuring the stability of the peso's purchasing power, as this is the most effective way to contribute to the country's development.

Another member explained that, since the last monetary policy meeting, headline inflation and its components have performed slightly better than anticipated, opening the possibility of easing monetary restriction. He/she expressed that the press release should emphasize that the proposed 25-basis point reduction to the reference rate indicates progress in the right direction; however, this does not imply that the fight against inflation is over, given that significant risks prevail. He/she noted the importance of conveying that future decisions will be based on incoming information. He/she warned that the coming months will likely bring significant uncertainty due to both external and domestic factors. Therefore, he/she stated that the monetary policy stance must remain sufficiently restrictive to ensure the continuation of the disinflation process. He/she highlighted the role played in this process by the exchange rate as a monetary policy transmission mechanism. He/she recalled that, under the floating exchange rate regime, the pass-through effect can be limited if market confidence in the central bank's commitment to its primary mandate remains strong. He/she mentioned that, although weak economic activity is expected to contribute to the disinflationary process, this possibility has not yet materialized. He/she added that services inflation, which better reflects domestic pressures, keeps showing a resistance to decline and remains at high levels. He/she estimated that said persistence could continue given the resilience of private consumption. He/she noted that non-core inflation is still above the level needed for headline inflation to converge to the target. He/she added that further shocks that could divert it from its expected downward trajectory cannot be ruled out. He/she considered that unless a clear downward trend in this component consolidates, easing the monetary restriction should be approached with great vigilance. In short, he/she argued that significant risks and a high level of uncertainty persist, which could jeopardize disinflation, and therefore future decisions should be made with caution. He/she estimated that adopting a risk management approach will enhance the credibility of this central bank in its commitment with its primary mandate and will increase the likelihood of achieving the convergence of inflation to the target.

One member noted that the inflationary outlook is consistent with ongoing adjustments to the reference rate. He/she also mentioned that a decrease in the tightness conditions of the economy can be observed, while the distributions of medium- and long-term inflation expectations remain stable and anchored. He/she stated that monetary restriction is well-positioned to manage different risks. Also, he/she emphasized that, despite volatility in financial markets in recent months, several metrics indicate an improvement in trading conditions in both debt and foreign exchange markets. He/she argued that, consequently, no deterioration in the functioning of the monetary policy transmission mechanisms is perceived, including the multilateral real exchange rate, which he/she noted is at levels comparable to those observed in 2015. As a result, he/she considered that medium-term determinants of inflation suggest that the process of convergence will continue. Nevertheless, he/she commented that, when adjusting the reference rate, the following factors must be taken into account: i) that the monetary policy stance is sufficiently restrictive to ensure the convergence of inflation to its target within the forecast horizon; ii) that it is as efficient as possible to facilitate orderly adjustments in price dynamics, financial markets, and the economy overall; and iii) that it allows the continued management of risks to inflation on both sides of the balance of risks. He/she considered that throughout the monetary restriction cycle, the response of the reference rate was more than proportional to the increase in inflation in terms of both magnitude and duration. He/she added that the downward recalibration, which began in March this year, has been both prudent and gradual, aiming to maintain a monetary policy stance that mitigates upward risks to inflation. He/she pointed out that this has led to a slower monetary cycle compared to previous episodes. He/she warned that, despite the improved inflationary outlook, new bouts of volatility cannot be ruled out, which will continue to require caution from the central bank. He/she stated that, if the distribution of risks to inflation continues improving, it may be advisable to adopt a path of continuous data-dependent adjustments, in such a way that the policy stance is consistent with the constitutional mandate at all times.

Another member considered that, although headline inflation has resumed a downward trend, more certainty is still needed that progress in the inflation outlook is significant before lowering the reference rate. He/she warned that long-term inflation expectations have been anchored for some time at levels above target because in the past the central bank did not maintain a restrictive policy stance for the necessary duration to consolidate inflation at 3%. He/she argued that, in contrast, the previous reference rate cuts were initiated prematurely, and expansionary and accommodative policy stances were maintained when inflation was above target. In this regard, he/she noted that between 2009 and 2016 the ex-ante real interest rate averaged at levels close to zero. He/she deemed that the above contributed to generating the perception that the central bank was content with inflation being slightly below 4%. He/she added that, in the current juncture, core inflation, which reflects the medium-term trend of inflation, is slightly below 4%. He/she deemed that, as a result, markets currently anticipate that the existing level of inflation will be tolerated until the end of 2025, leading to a continuous reduction in the reference rate. He/she pointed out that this new opportunity must now be leveraged to avoid sending the message of complacency as in the past, by prematurely and automatically confirming a rate-cutting cycle. He/she argued that, in contrast, the degree of certainty about an adjustment of the monetary policy stance should be assessed in each decision. He/she added that emphasis should be placed on core inflation, which is sensitive to monetary policy actions, rather than on non-core inflation, which is highly volatile. He/she warned that it is necessary to break the persistence of services inflation in order to achieve a further decline in core inflation. He/she commented that the larger-than-expected cut to the federal funds rate should be considered within the context of the Federal Reserve’s dual mandate. He/she stated that since Banco de México has a sole inflation mandate, the evolution of economic activity should not be overestimated in policy decisions, while more certainty is required regarding the direction and magnitude of the new phase in the economic cycle in order to assess if the reaction function needs to be recalibrated. He/she also reiterated that lack of growth in Mexico is not attributed to the monetary policy stance, but rather to other domestic and external factors. He/she stressed the importance of attaining the 3% inflation target despite the challenging outlook for the rest of 2024 and for 2025. He/she indicated that having greater confidence that core inflation continues trending downwards and that the inflationary outlook continues improving will allow assessing the level of monetary restriction needed to reach the inflation target, without undermining the credibility of the commitment to the price stability mandate.

One member recalled that in March the Governing Board decided to begin lowering the reference rate, given the significant progress in the inflation outlook. He/she highlighted the decrease in both headline and core inflation from their peaks and a less adverse balance of risks compared to previous years. He/she commented that the disinflationary process has continued albeit with both upward and downward risks, and therefore has considered it congruent to adopt a gradual approach in conducting monetary policy. He/she added that starting in the June decision, risks to the downside began taking on more significance, and thus since then there were arguments supporting the continuation of adjustments to the monetary policy stance. He/she stated that the above arguments still hold and new ones have emerged, further widening the room for adjustment. He/she highlighted: i) that core inflation continues trending downwards and that its trajectory has not been affected by shocks to the non-core component, which have started to reverse faster than anticipated; ii) that the evolution of economic activity continues suggesting an increased slack, as the output gap has closed and is expected to turn negative towards the end of 2024; iii) that in recent weeks volatility in the Mexican peso’s exchange rate has moderated, and although additional episodes of depreciation cannot be ruled out, the risk of a greater pass-through to prices would be offset by other factors, such as the economy's cyclical conditions; and iv) that the magnitude of the Federal Reserve's reference rate cut, previously observed only during periods of marked economic weakness, creates room for adjustment in terms of the relative policy stance, and the signs of a slowdown in the US economic activity and labor market have further implications for demand and for the anticipated slack conditions in Mexico. He/she estimated that the inflationary context allows to anticipate the continuity in adjustments to the level of restriction. He/she added that, in the absence of further shocks, discussions could begin regarding the level of reference rate cuts. He/she emphasized that, given the high degree of restriction achieved, even with additional adjustments, the reference rate will remain restrictive, which will be necessary throughout the forecast horizon. He/she considered that continuing to adjust the level of monetary restriction is not only timely but also necessary to conduct monetary policy efficiently, while addressing the prevailing risks and considering the progress in the inflation outlook, ensuring that a policy stance aligned with convergence is maintained.

3. MONETARY POLICY DECISION

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It considered the nature of the shocks that have affected the non-core component and the projection that their effects on headline inflation will continue dissipating over the next quarters. It took into account core inflation's trajectory and the fact that it is anticipated to continue decreasing. It estimated that, although the outlook for inflation still calls for a restrictive monetary policy stance, its evolution implies that it is adequate to reduce the level of monetary restriction. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate to 10.50%.

Looking ahead, the Board expects that the inflationary environment will allow further reference rate adjustments. It will consider that global shocks will continue fading and the effects of the weakness in economic activity. It will take into account the incidence of the monetary policy stance that has been maintained and that 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, Irene Espinosa, and Omar Mejía. Jonathan Heath voted in favor of maintaining the target for the overnight interbank interest rate at 10.75%.

5. DISSIDENT OPINIONS / VOTES

Vote: Jonathan Heath.

We need to be patient in order for the current monetary policy stance to have the desired effect on the persistence in services inflation. Furthermore, initiating a cycle of monetary easing prematurely could send a signal of complacency and that we are content with the high levels of headline inflation, since adjustments to the monetary policy stance at the margin are a more relevant signal than the level of the monetary restriction per se. For the moment, we need a bit more time to confirm the trend the current positive signals seem to suggest as well as to assess if we need to adjust our reaction function given the global cyclical and monetary conditions we will face in the coming months.

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.

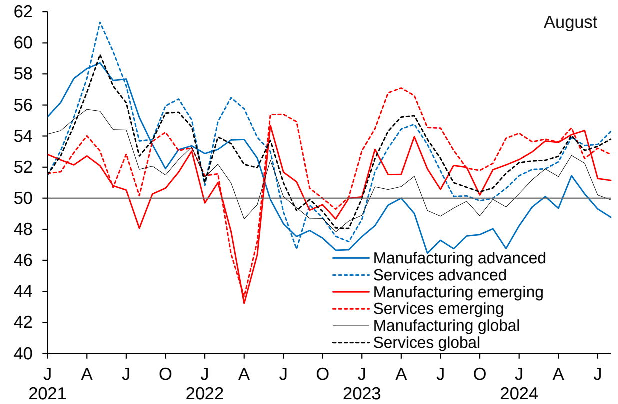
A.1. External conditions

A.1.1. World economic activity

World economic activity would have expanded during the third quarter of 2024 at a pace similar to that observed in the previous one, maintaining heterogeneity in the pace of growth across countries. This would reflect, in general, the lower growth in advanced economies compared to the second quarter of 2024 and the greater dynamism in emerging economies. Purchasing Managers' Indices of August show in increasing divergence between the manufacturing and services sectors. These indicators suggest a slowdown in manufacturing activity in emerging economies, continued weakness in this sector in advanced economies, and progress in the services sector at the global level (Chart 1). World merchandise trade improved during the quarter ending in July relative to the previous three months. Among key global risks, the following stand out: the intensification of geopolitical turmoil, the protraction of inflationary pressures, greater volatility in financial markets, and, to a lesser extent, the challenges to financial stability.

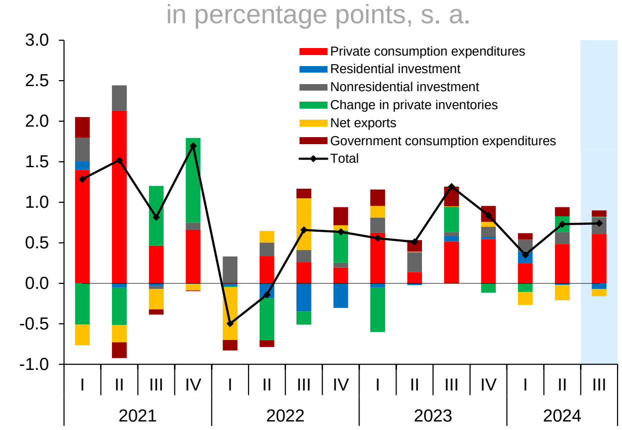
Available indicators in the United States suggest that gross domestic product (GDP) growth in the third quarter of 2024 would be similar to that of the second quarter, which was 0.7% at a seasonally adjusted quarterly rate (Chart 2).[1] This performance would be supported by the strength of domestic demand, mainly private consumption and non-residential investment.

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.

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



s. a. / Seasonally adjusted figures.
Note: The shaded area refers to Atlanta Federal Reserve's GDPNow forecasts as of September 17.
Source: BEA and Reserve Bank of Atlanta.

* 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 quarterly rate, the change in US GDP was 3.0% in the second quarter of 2024.

US industrial production has remained virtually stagnant since the fourth quarter of 2022. In August, it increased at a seasonally adjusted monthly rate of 0.8%, after having contracted 0.9% in July. This rise was due to an increase of 0.9% in manufacturing and of 0.8% in mining. The sector of electricity and gas generation stagnated compared to the previous month. Purchasing Managers' Indices suggest that manufacturing activity remained weak in September.

The US labor market continued showing signs of easing, moving more clearly to a situation of better balance between labor supply and demand. Non-farm payrolls continued moderating their pace of expansion. Between June and August, the three-month moving average decreased from 147 to 116 thousand new positions on a monthly average, considering that June and July figures were revised downwards. The number of job vacancies decreased from 7.9 million in June to 7.7 million in July. This indicator has generally maintained a downward trend since May 2022. After having trended upwards since the end of April, initial claims for unemployment insurance have decreased since the first week of August and stood at 219 thousand new claims in the week ending September 14. The unemployment rate decreased marginally from 4.3% in July to 4.2% in August. Lastly, the annual variation of average hourly wages rose from 3.9% in July to 4.1% in August, although this has moderated throughout the year.[2]

Economic activity in the euro area is expected to have expanded in the third quarter of 2024 at a marginally faster pace than that observed in the second quarter.[3] Available indicators suggest that the dynamism in the services sector will continue supporting the recovery, while manufacturing activity would remain sluggish. The labor market continued showing strength. The unemployment rate decreased from 6.5% in June to 6.4% in July, remaining at historic lows. However, the vacancy rate has declined and is approaching pre-pandemic levels.

Regarding the rest of the major advanced economies, they are expected to expand in the third quarter of 2024, although most would grow at a slower pace compared to the previous quarter. Labor markets in this group of economies have shown, in general, signs of easing, although they have remained solid.

Most major emerging economies are expected to have shown a greater dynamism in the third quarter of 2024 compared to the previous quarter, mainly in emerging Asia. In the particular case of China, economic activity is expected to have expanded at a greater pace during the third quarter of 2024 compared to the second quarter, in which it grew 0.7% at a seasonally adjusted quarterly rate.[4] This acceleration would be explained, primarily, by the increase in exports. In contrast, retail sales, fixed investment, and industrial production continued decelerating in August. In this regard, the Chinese economy continues facing significant challenges, due to the weakness of its real estate sector and of domestic demand, as well as to trade and technological restrictions imposed by some countries. The aforementioned, despite the various stimuli implemented by its authorities to boost growth.

Since Mexico's last monetary policy decision, international commodity prices have exhibited a mixed behavior. Oil prices registered some volatility associated partly with the conflicts in the Middle East and Libya. Starting on September, prices decreased due in part to the expectation of a lower demand from China. The abovementioned despite the decision of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+) to postpone increasing production until December. By the third week of September, prices rose somewhat due to disruptions in oil production in Texas caused by Hurricane Francine.

Natural gas reference prices generally increased, although with some volatility. In Asia and Europe, prices were subject to upward pressures partly due to concerns about gas supply in the context of the various geopolitical conflicts. In the United States, prices increased due to production interruptions caused by adverse weather conditions in that country.

Grain prices behaved differently throughout the period. During the first weeks of August, they decreased due to the expectation of a greater supply of grains. However, starting in mid-August, this trend reversed due to adverse weather conditions in the

[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 0.3% in the first quarter of 2024 and 0.2% in the second quarter. Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 1.3% in the first quarter of 2024 and 0.8% in the second quarter of 2024.

[4] Expressed as an annual rate, China's GDP growth rate was 4.7% in the second quarter of 2024.

Americas and Europe, while there was an expectation of higher demand in several countries.

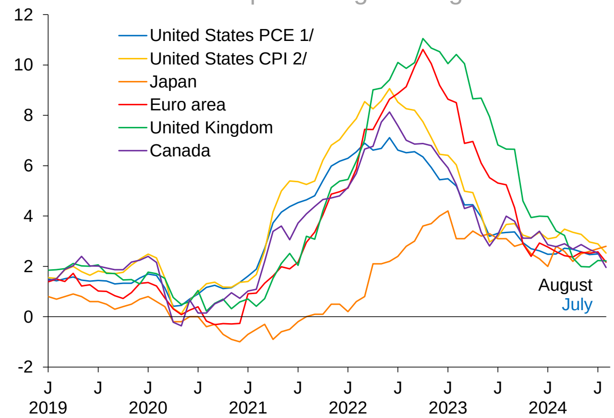
Industrial metal prices have exhibited some volatility since Mexico's last monetary policy decision. At the beginning of the period, prices were driven upwards, partly because of the resilient growth of the US economy, although this trend partially reversed due to the expectation of lower demand from China. Starting in the second week of September, prices were subject to upward pressures associated with prospects of loosening financial conditions. To a large extent, this expectation also drove precious metals prices upwards. Thus, gold prices reached historical highs in the fourth week of September.

A.1.2. Monetary policy and international financial markets

In various major advanced economies, annual headline inflation decreased in its most recent readings (Chart 3). This reflected lower pressures in the non-core component. Meanwhile, services inflation in the core component showed some persistence. In advanced economies, headline inflation was closer to their respective central banks' targets than at the beginning of the year.

In the United States, annual headline inflation measured by the consumer price index declined from 2.9% in July to 2.5% in August, largely as a result of a deflation in energy prices. Although annual core inflation remained relatively stable at 3.2% in July and August, it is still lower than at the beginning of the year. The reduction in core inflation so far this year has been the result of a lower inflation in services and a higher deflation in goods. Annual inflation of the personal consumption expenditure price index has advanced towards the 2% target, standing at 2.5% in June and July, a level below those observed earlier this year. Although annual core inflation has remained relatively stable at around 2.6% since May, it is below the levels registered at the beginning of the year. The decline that this component has shown so far this year has reflected a reduction in the annual inflation of services.

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.
Note: The series include information up to August 2024, except for the United States (PCE), for which the latest available data corresponds to July 2024.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

In the euro area, annual headline inflation decreased from 2.6% in July to 2.2% in August, after having shown some resistance to decline in previous months. The recent fall reflected a deflation in energy prices and a moderate reduction in annual core inflation. The latter stood at 2.8% in August, after having remained practically unchanged at 2.9% in the three previous months.

Analysts' inflation forecasts anticipate headline inflation in several major advanced economies to be at levels similar to current ones by the end of 2024, with a continuing convergence towards their central banks' inflation targets throughout 2025. Meanwhile, longer-term inflation expectations drawn from financial instruments for some of these economies decreased slightly with respect to expectations registered in the first week of August. Both short- and long-term inflation expectations remain at levels above inflation targets in various advanced economies.

In emerging economies, the recent behavior of annual headline inflation was heterogeneous. It rose in several countries, partly due to a rise in energy and food inflation, which in some cases has reversed in recent readings. Despite the above, headline inflation in a large number of these economies was within the variability range considered by each of their central banks.

In this context, since Mexico's last monetary policy decision, the central banks of the major advanced and emerging economies adjusted their reference rates in a differentiated manner, considering the specific circumstances of each country.

In the main advanced economies, various central banks continued adopting a less restrictive monetary policy stance by lowering their reference rates and continuing to gradually reduce their securities' holdings. The US Federal Reserve cut the federal funds rate for the first time since 2020 in its September decision. Similarly, the Reserve Bank of New Zealand announced its first rate cut in more than four years in August, while the Bank of Canada lowered its monetary policy rate for the third consecutive month in September. The European Central Bank also announced a decrease in its key interest rates in September, after having left them unchanged in July. Other central banks kept their reference rates unchanged. One of them was the Bank of England, after having previously lowered them. In addition, the Bank of Japan decided not to adjust its reference rate in its most recent decision, after having raised it in previous months.[5]

Specifically, at its September meeting, the US Federal Reserve reduced the target range for the federal funds rate by 50 basis points (bps), after having left it unchanged for eight consecutive decisions. The target range is currently between 4.75 and 5.0%. The Federal Open Market Committee (FOMC) noted that it has gained greater confidence that inflation is moving steadily toward the 2% target and that risks to achieving its employment and inflation goals are roughly in balance. In addition, it noted that in considering additional adjustments to the target range for the federal funds rate, they will carefully assess incoming data, the evolving outlook and the balance of risks. It also reiterated its commitment to return inflation to its 2% target and added that it will support maximum employment. Additionally, the Federal Reserve continued reducing the size of its balance sheet.

During the press conference, the chairman of the Federal Reserve stated that the recalibration of the monetary policy stance will help to maintain the strength of the economy and the labor market, and will continue to enable further progress on inflation as the process of moving toward a more neutral stance begins. However, he noted that they do not follow any pre-established monetary policy path and that they will make decisions by evaluating conditions meeting by meeting. He stated that if the economy remains solid and inflation persists, they can dial back monetary policy restraint more slowly. In contrast, if the labor market were to weaken unexpectedly or inflation were to fall more rapidly than anticipated, the Committee will be prepared to respond. He noted that the Committee's forecasts for the federal funds rate are a baseline and that their decisions will depend on the way the economy evolves, noting that, if appropriate, they may go faster, slower, or pause in recalibrating their monetary policy. He stated that it should not be assumed that 50 bps will be the new pace of rate cuts going forward.

Regarding the adjustments to the Committee's projections, between June and September, the median headline inflation forecasts measured by the personal consumption expenditure price index was revised downwards from 2.6 to 2.3% for the end of 2024, from 2.3 to 2.1% for the end of 2025, and was left unchanged at 2.0% for the end of 2026. Likewise, the median GDP growth forecast was revised downwards for the end of 2024 from 2.1 to 2.0%. That for unemployment was revised upwards from 4.0 to 4.4% for the end of 2024, from 4.2 to 4.4% for the end of 2025, and from 4.1 to 4.3% for the end of 2026. The Committee adjusted downwards the median of its expectations for the federal funds rate for the end of 2024 from 5.1 to 4.4%, suggesting an additional 50 bps of rate cuts during the current year. Similarly, expectations for the end of 2025 were revised from 4.1 to 3.4%, which implies 100 bps of additional rate cuts in 2025 compared to the end of 2024. For the end of 2026, expectations also decreased, from 3.1 to 2.9%, that is, 50 bps of additional rate cuts for that year. The long-term rate expectation was revised upwards from 2.8 to 2.9%.

At its September meeting, the European Central Bank cut its reference rates. It reduced its key deposit and key lending rates by 25 bps and its refinancing rate by 60 bps to 3.50, 3.90 and 3.65%, respectively. Its Governing Council reiterated that it

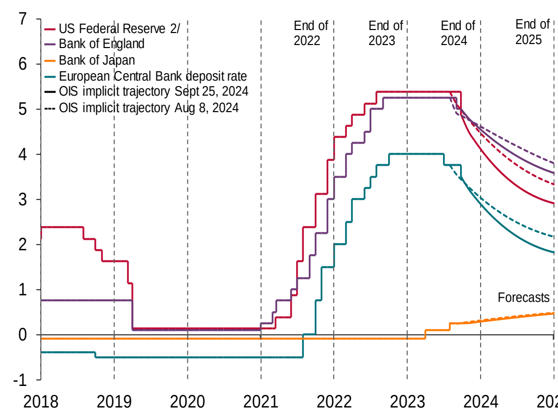
[5] At its September meeting, the Bank of Japan maintained its reference rate at around 0.25%, after having previously raised it in its March and July decisions. Said central bank indicated that high uncertainty persists regarding the country's economic activity and prices, including the evolution of economic activity and prices abroad, the behavior of commodity prices and the way in which the country's companies set wages and prices. It pointed out that it is necessary to monitor the evolution of the financial and foreign exchange markets, as well as their impact on the country's economic activity and prices. The governor of said institution pointed out that if their economic and price projections are achieved, they will increase interest rates and adjust accordingly the degree of monetary support. Additionally, he indicated that the risk of excessive inflation as a result of rising import prices has decreased significantly and that they have some time to decide on their monetary policy.

will keep reference rates at sufficiently restrictive levels for as long as necessary in order to ensure that inflation returns to its target promptly. Once again, it announced that it will maintain an approach dependent on economic and financial data to determine the appropriate duration and degree of such tightening. At the press conference, the president of said institution stated that, although the future path of reference rates is clearly downwards, it is not predetermined, neither in terms of sequence nor in terms of the magnitude of rate cuts. Regarding the Pandemic Emergency Program (PEPP), the Governing Council will continue to reduce the portfolio by an average of EUR 7.5 billion per month, with reinvestments scheduled to be discontinued by the end of 2024.

In the main emerging economies, some central banks, mainly in Latin America, continued lowering their reference rates. The central banks of South Africa, the Philippines and Indonesia lowered their reference rates for the first time in more than three years. In China, after its central bank announced rate cuts in several of its reference interest rates in July, it determined not to make any adjustments in August. However, in September, the governor of said central bank announced a monetary stimulus package, as well as measures to support the real estate sector and the stock market. In particular: i) it reduced its medium-term lending facility (MLF) rate by 30 bps; ii) it announced that it will lower the interest rate on seven-day reverse repurchase agreements by 20 bps; iii) it indicated that it will cut the loan prime rate (LPR) and deposit rate by 20 to 25 bps; and, iv) it will cut the reserve requirement ratio (RRR) by 50 bps. It indicated that the latter could be reduced further, possibly by 25 to 50 bps in the remainder of the year. Meanwhile, some central banks continued leaving their reference rates unchanged. In contrast, the Bank of Brazil raised its reference rate by 25 bps in September, after having lowered it for the last time in May. Russia's central bank also increased recently its reference rate by 100 bps, after having raised it by 200 bps in its July decision.

Regarding future actions, the central banks reiterated, in general, that further adjustments to their reference rates will remain dependent on incoming data and their implications for the inflation outlook. Some of these institutions anticipate that reference rates will remain at restrictive levels for some time and announced that they are prepared to make additional adjustments if necessary to bring inflation back to target. Some of them suggested that adopting a gradual approach to reducing monetary restriction may be appropriate depending on the evolution of economic conditions. As for markets' expectations for monetary policy rates in major advanced economies, reference rates implicit in swap curves (OIS) for the end of 2024 were revised downwards for some economies compared to the level expected in the first week of August (Chart 4). In the case of the United States, the anticipated level of the federal funds rate at the end of 2024 decreased from 4.34 to 4.1%, according to information from the federal funds rate futures market. The expected levels for the reference rates at the end of 2024 for the euro zone and Japan remained around 3.0 and 0.3%, respectively, in the same comparison.

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

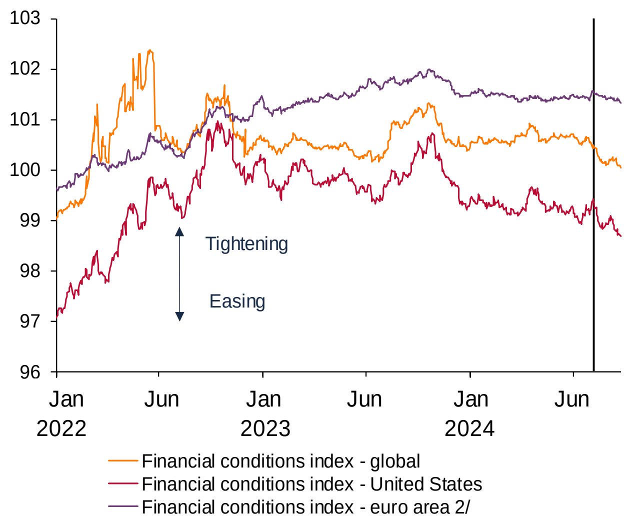


1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the United States, the average interest rate of the target range of the federal funds rate is used.
Source: Bloomberg.

In this context, since Mexico's last monetary policy decision, international financial conditions eased (Chart 5). Likewise, after the sharp increase in volatility observed during July and the first week of August, it gradually decreased. However, in September there was a transitory increase in volatility partly due to the release of US employment data, which led to expectations of a possible moderation in the growth rate of the US economy.

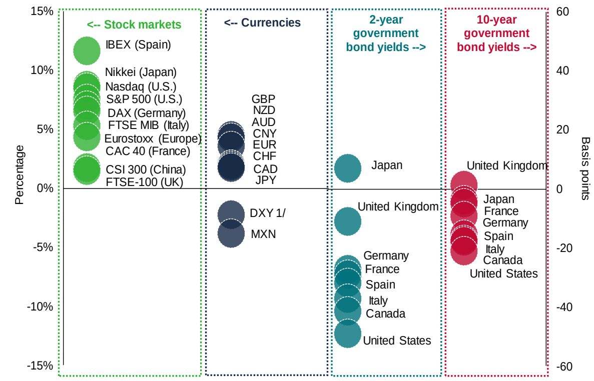
Regarding long- (10-year) and medium- (2-year) term rates, these registered decreases in most of the main advanced and emerging economies (Chart 6). Starting in the second week of September, the slope of the US yield curve (defined as the spread between 10-year and 2-year government bond rates) moved into positive levels, after having been in negative territory since July 2022. Stock markets in most advanced and emerging economies registered gains after the declines at the end of July and the first week of August. In the particular case of China, losses were registered, caused partly by lower investor confidence in economic growth, although these reversed at the end of September due to the stimuli announced by China's central bank and other government agencies. As for foreign exchange markets, the US dollar weakened against most advanced and emerging market currencies (Chart 7). Lastly, since the last monetary policy decision, there have been net capital inflows to emerging economies both in equity and 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 the last scheduled monetary policy meeting of Banco de México.
Source: Bloomberg and Goldman Sachs.

Chart 6
Change in selected financial indicators from August 8 to September 25, 2024



1/ DXY: 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 August 2, 2024
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-1.17%	-0.10%	-64	-47	0
	Brazil	3.03%	3.59%	68	38	-13
	Chile	2.82%	0.41%	18	-61	-8
	Colombia	-0.54%	0.30%	-40	-62	-2
	Peru	-0.56%	2.76%	-50	-69	-3
Emerging Europe	Russia	-8.80%	-4.83%	194	82	N.A.
	Poland	2.40%	0.27%	-7	20	0
	Turkey	-2.81%	-5.33%	98	56	-16
	Czechia	2.95%	0.83%	-20	5	-2
	Hungary	2.76%	1.58%	7	2	1
Asia	China	1.63%	-5.38%	-12	-8	-5
	Malaysia	6.54%	3.37%	-2	0	-7
	India	0.23%	4.87%	-13	-14	4
	Philippines	3.67%	12.29%	-35	-50	-10
	Thailand	6.64%	10.27%	-13	-9	-7
	Indonesia	6.17%	6.40%	-35	-40	-8
Africa	South Africa	5.29%	5.06%	-26	-64	-18

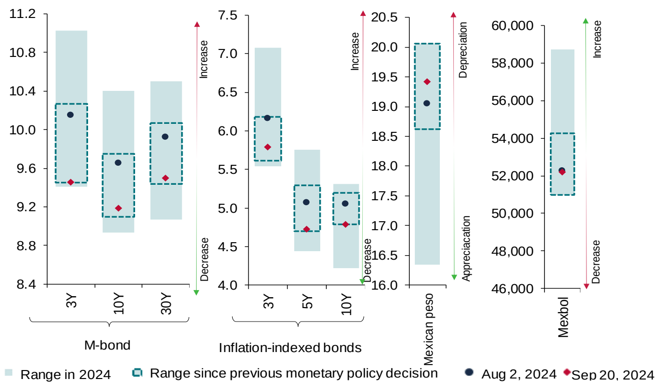
Note: An upward adjustment indicates currency appreciation. Interest rates correspond to government bonds at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year swap rates 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, domestic financial markets exhibited a heterogeneous performance by asset class. The Mexican peso depreciated moderately against the US dollar, although the period was characterized by episodes of high volatility. Interest rates fell overall, particularly in short-term bonds (Chart 8).

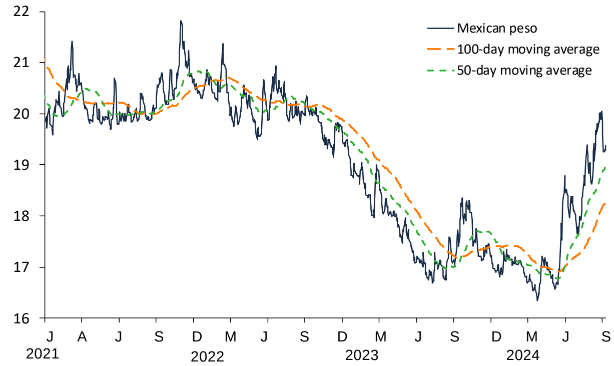
Chart 8
Mexican markets' performance
Percent, MXN/USD and index



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

The Mexican peso depreciated by 1.17% as a result of several factors, such as the unwinding of carry trade positions against the yen, developments in both the electoral outlook and the expectations on monetary policy in the United States, and idiosyncratic factors. During the period, the Mexican peso traded in a range between MXN/USD 18.60 and 20.25 since the last monetary policy decision (Chart 9). This behavior occurred in an environment characterized by a deterioration in actual trading conditions and in those implied in market instruments.

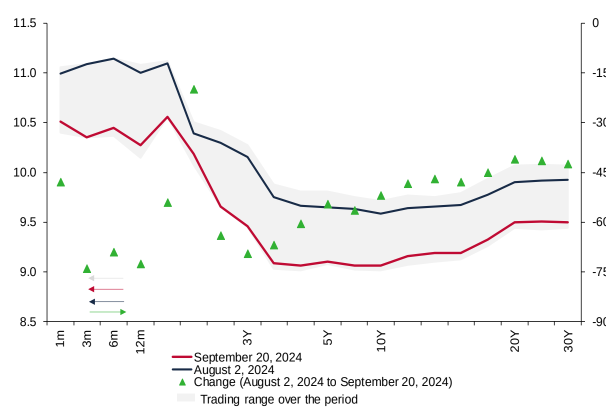
Chart 9
Mexican peso exchange rate
MXN/USD



Source: Banco de México.

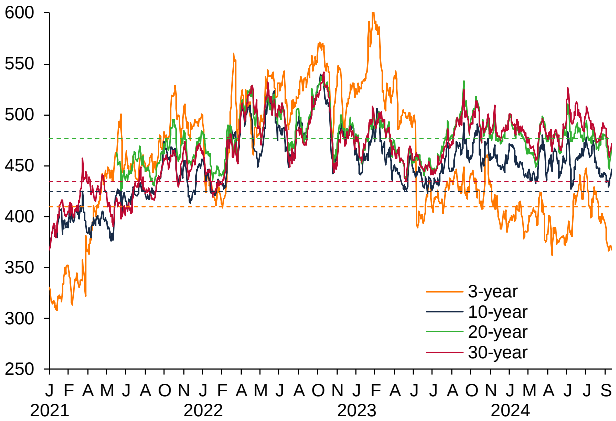
Interest rates on government securities decreased along the entire yield curve, with the adjustment of up to 70 bps in short-term bonds (Chart 10) standing out. Yields on real-rate instruments showed decreases of up to 60 bps in the short and middle part of the curve. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments decreased (Chart 11). Despite the described performance, the fixed-income market exhibited a slight deterioration in trading conditions, due to an increase in volatility during the period.

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



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

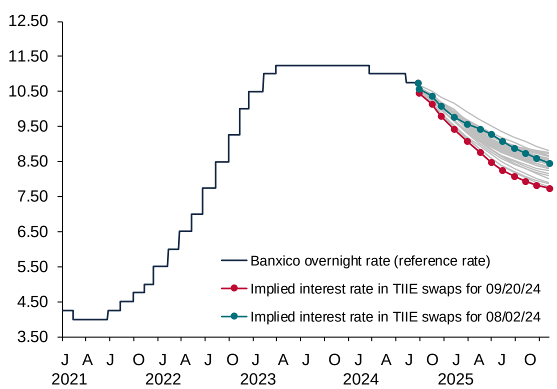
Chart 11
Breakeven inflation and inflation risk implied in government securities' yields
Basis points



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

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swaps curve incorporates a high probability of a decrease in reference rate in the September 2024 decision. It also presents an expectation of 9.81 and of 7.85% for the target rate for the end of both 2024 and 2025, respectively (Chart 12). In line with the information implicit in the interest rate swap curve, the consensus of analysts surveyed by Citibanamex anticipates a 25-bps cut at the September meeting and a reference rate of 10.00% at the end of 2024.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent

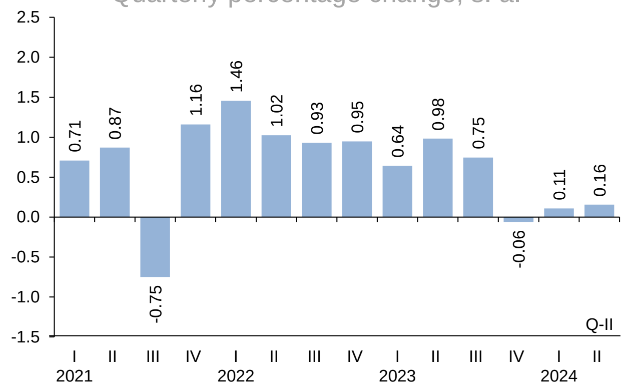


Note: Gray lines represent the daily implicit curves since the last monetary policy decision.
Source: *Proveedor Integral de Precios* (PIP).

A.2.2. Economic activity in Mexico

The weakness that the Mexican economy had exhibited since the end of 2023 continued throughout the second quarter of 2024 (Chart 13). This occurred in a context of high uncertainty associated with external and domestic factors.

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



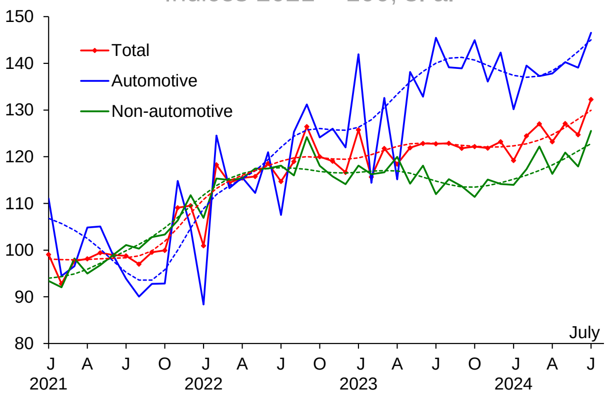
s. a. / Seasonally adjusted figures.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding domestic demand, consumption remained weak during the period of April-June 2024. Although consumption of domestic goods and services recorded two monthly increases, these were insufficient to reverse the contraction registered in April. In turn, consumption of imported goods decreased for three consecutive months, although remaining at high levels. During the same period, gross fixed investment increased, although with less dynamism than in the first three quarters of 2023. In June, investment in construction partially reversed the recovery observed in previous months. Meanwhile, investment in machinery and equipment remained sluggish. As for external demand, in July 2024, the value of manufacturing exports, both automotive and non-automotive, rebounded (Chart 14).

On the production side, after exhibiting weakness in the second quarter of the year, the Mexican economy slightly improved in July (Chart 15). Primary sector activities rebounded significantly, reaching their highest level on record

(Chart 16). At the same time, industrial activity continued improving moderately compared to the weakness observed between the last quarter of 2023 and the first four months of 2024 (Chart 17). Regarding its components, construction registered a positive trend in recent months, while manufacturing remained weak. The services sector expanded, after having been stagnant in June, although its performance remained heterogeneous across its segments.

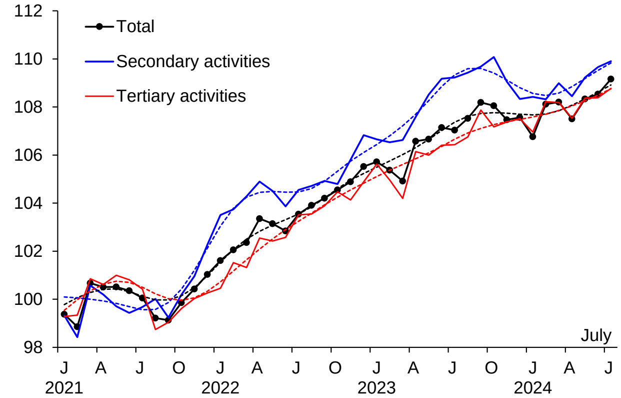
Chart 14
Manufacturing exports
Indices 2021 = 100, s. a.



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.

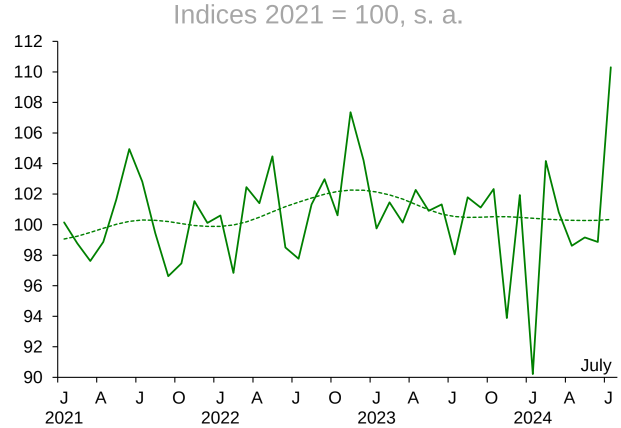
Regarding the cyclical position of the economy, in the second quarter, the estimate of the output gap, which had been becoming progressively less positive given the weak economic activity, closed (Chart 18). In July 2024, national and urban unemployment rates decreased in their monthly comparison, although they remained at historically low levels (Chart 19). In August, the loss of dynamism in the rate of creation of formal employment affiliated to the IMSS accentuated. Lastly, in July 2024, unit labor costs in the manufacturing sector remained at high levels (Chart 20).

Chart 15
Global Indicator of Economic Activity
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.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

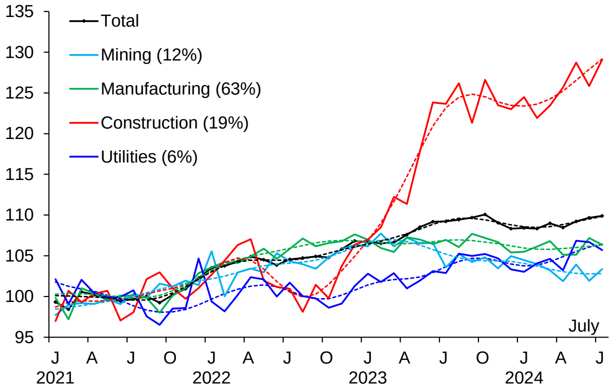
Chart 16
IGAE: Primary sector activities
Indices 2021 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 17
Industrial activity[1/]

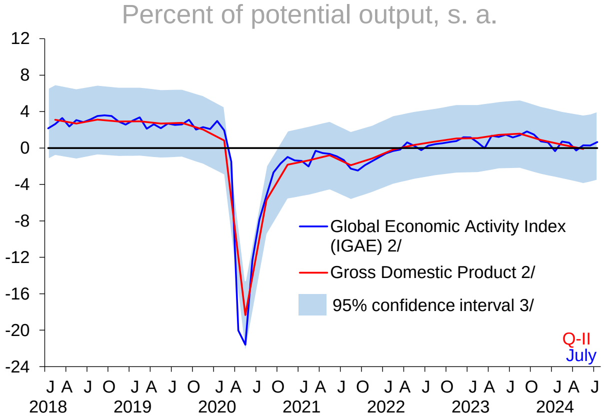
Indices 2021 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ 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 18
Output gap estimates[1/]

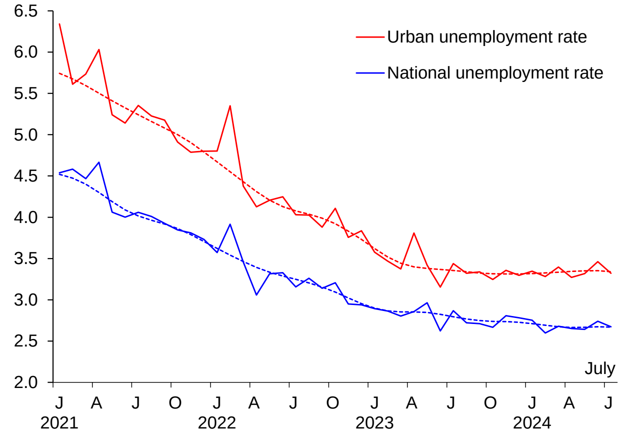
Percent of potential output, s. a.



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/ GDP flash estimate up to Q2-2024 and IGAE up to July 2024.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 19
National and urban unemployment rates

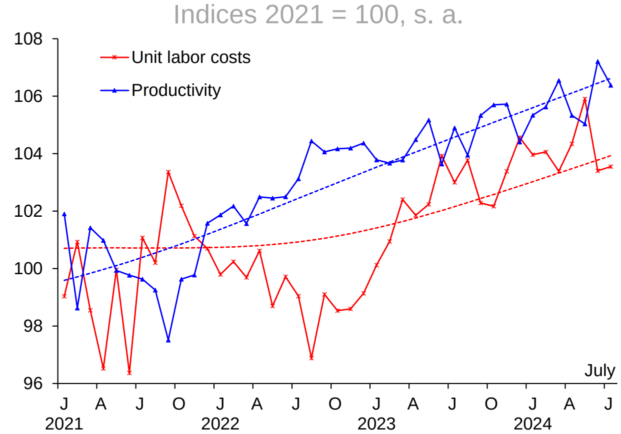
Percent, s. a.



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 20
Productivity and unit labor costs in the manufacturing sector[1/]

Indices 2021 = 100, s. a.



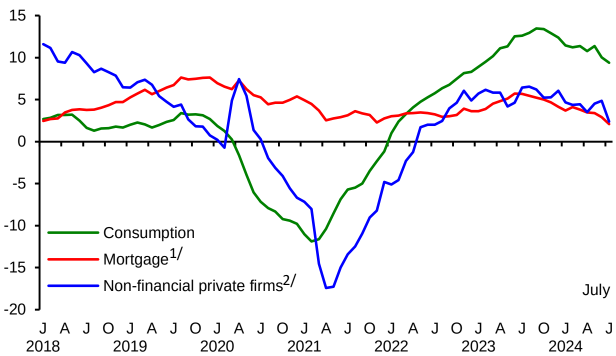
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly Manufacturing Industry Survey and industrial activity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

In July 2024, domestic financing to the private sector continued growing at a moderate pace compared to the dynamism observed throughout 2023. Commercial bank lending to firms registered a reduction in its real annual growth rate with respect to the previous month (Chart 21). In addition, the growth rate of commercial bank lending to households continued decreasing.

As for the cost of financing, interest rates on bank credit to firms remained at high levels in July 2024, despite a certain reduction as compared to the previous month. Credit intermediation margins did not exhibit significant changes during the same month. Interest rates on mortgage lending remained at levels similar to those observed prior to the pandemic. Finally, regarding commercial bank consumer credit, in April 2024, interest rates in the segment remained at relatively high levels, although they declined slightly in some portfolios.

As for portfolio quality, the delinquency rates of bank credit to firms and households did not register significant changes in July and thus remained at low levels. In the segment of consumption, in recent months this indicator has decelerated the upward trend it registered in the second half of 2023.

Chart 21
Performing credit from commercial banks to the private sector
Annual percentage change

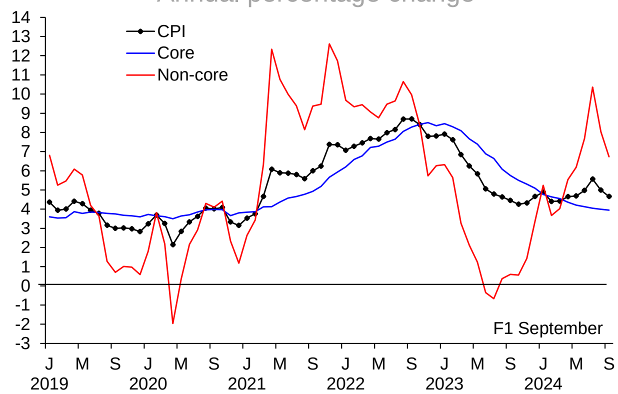


1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation decreased from 5.57% in July to 4.66% in the first fortnight of September 2024. This performance was mainly the result of the decline in non-core inflation due to some reversal of the supply shocks that had affected it. During this period, core inflation continued trending downwards (Chart 22 and Table 1).

Chart 22
Consumer Price Index
Annual percentage change



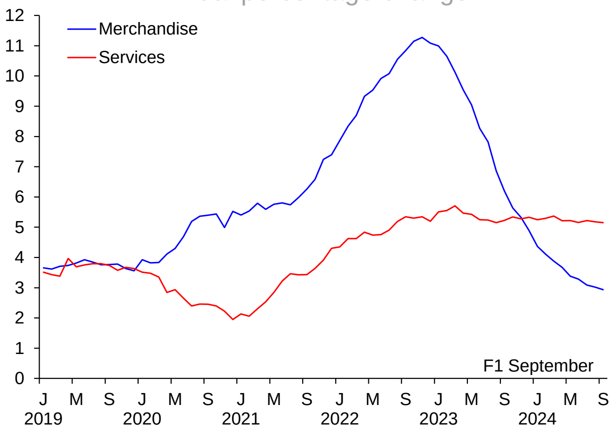
Source: INEGI.

Annual core inflation shifted from 4.05 to 3.95% between July and the first fortnight of September 2024. Regarding its components, annual merchandise inflation decreased from 3.09 to 2.94% during the same period (Chart 23). This performance was influenced by a reduction from 4.03 to 3.95% in annual food inflation and from 1.95 to 1.69% in non-food inflation (Chart 24). In turn, annual services inflation remained at high levels, without showing a clear downward trend. On those dates, it shifted from 5.22 to 5.15%.

Between July and the first fortnight of September 2024, annual non-core inflation fell from 10.36 to 6.73%, as the effects of the shocks that had exerted pressure on agricultural and livestock products' and on energy prices partially faded away (Chart 25 and Table 1). Between these dates, annual inflation of agricultural and livestock products decreased from 13.72 to 6.50%.

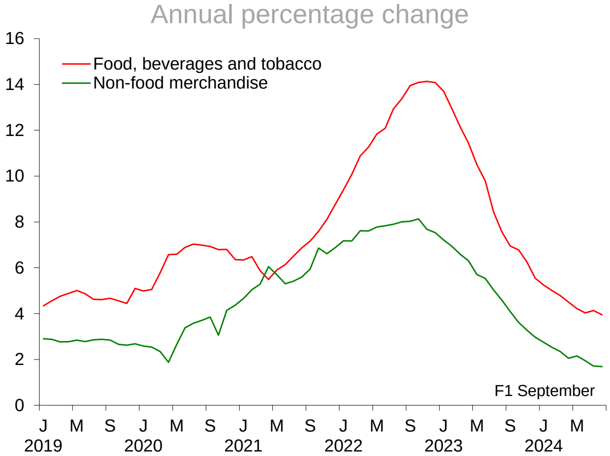
Inflation of fruit and vegetables' prices declined from 23.55 to 7.15%. In turn, annual inflation of livestock products shifted from 5.36 to 5.08% during said period. Annual inflation of energy products decreased from 9.17 to 7.92% for the same comparison, mainly due to a decrease from 25.61 to 19.41% in the annual variation of L.P. gas prices.

Chart 23
Merchandise and services core price subindex
Annual percentage change



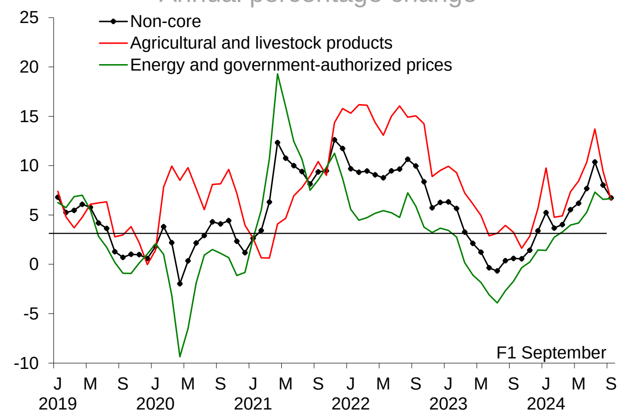
Source: INEGI.

Chart 24
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Chart 25
Non-core price sub-index
Annual percentage change



Source: INEGI.

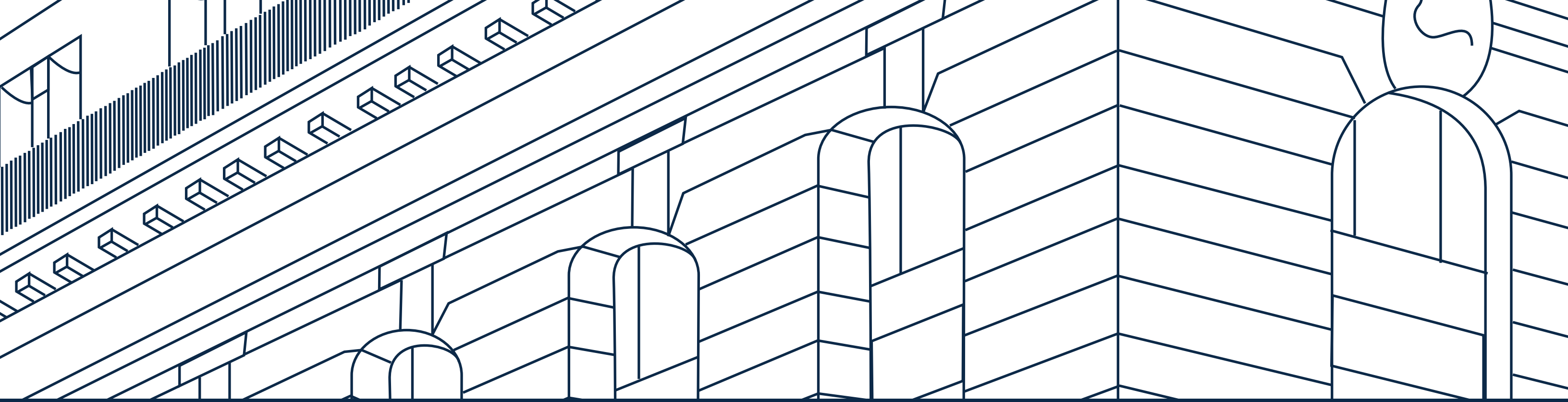
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between July and August 2024 the median of headline inflation for the end of 2024 increased from 4.58 to 4.64%, and that of core inflation decreased from 3.97 to 3.90%. The latter expectation has been adjusting downwards since March 2024, when it stood at 4.15%. Inflation expectations for the end of 2025 exhibited limited adjustments. The median of headline inflation expectations adjusted from 3.83 to 3.80%, while that of core inflation shifted from 3.71 to 3.72%. At the same time, the median of headline inflation expectations for the next four years increased from 3.70 to 3.75%, while that of core inflation expectations decreased from 3.64 to 3.62%. The medians of headline and core inflation expectations for the long term (5 to 8 years) remained stable at around 3.60 and 3.50%, respectively. Lastly, breakeven inflation has decreased since the previous monetary policy decision. Regarding its components, inflation expectations implied in market instruments and inflation risk premium decreased.

Headline inflation is still expected to converge to the target in the fourth quarter of 2025. This forecast is subject to risks. On the upside: i) persistence of core inflation; ii) greater foreign exchange depreciation; iii) greater cost-related pressures; iv) climate-related impacts, and v) the intensification of geopolitical conflicts. On the downside: i) weaker-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. However, the inflationary outlook has been improving, following the major shocks caused by the pandemic and the war in Ukraine. The current levels of core inflation and the prospect of further declines reflect this improvement.

Table 1
Consumer Price Index and components
Annual percentage change

Item	July 2024	August 2024	1st fortnight Sep. 2024
CPI	**5.57**	**4.99**	**4.66**
Core	**4.05**	**4.00**	**3.95**
Merchandise	**3.09**	**3.02**	**2.94**
Food, beverages and tobacco	4.03	4.13	3.95
Non-food merchandise	1.95	1.71	1.69
Services	**5.22**	**5.18**	**5.15**
Housing	3.96	4.00	4.08
Education (tuitions)	6.36	6.09	5.78
Other services	6.01	6.03	6.16
Non-core	**10.36**	**8.03**	**6.73**
Agricultural and livestock products	**13.72**	**9.45**	**6.50**
Fruits and vegetables	23.55	12.61	7.15
Livestock products	5.36	6.12	5.08
Energy and government-authorized prices	**7.31**	**6.58**	**6.67**
Energy products	9.17	7.91	7.92
Government-authorized prices	**3.42**	**3.72**	**3.95**

Source: INEGI.



BANCO DE MÉXICO®

Document published on October 10, 2024