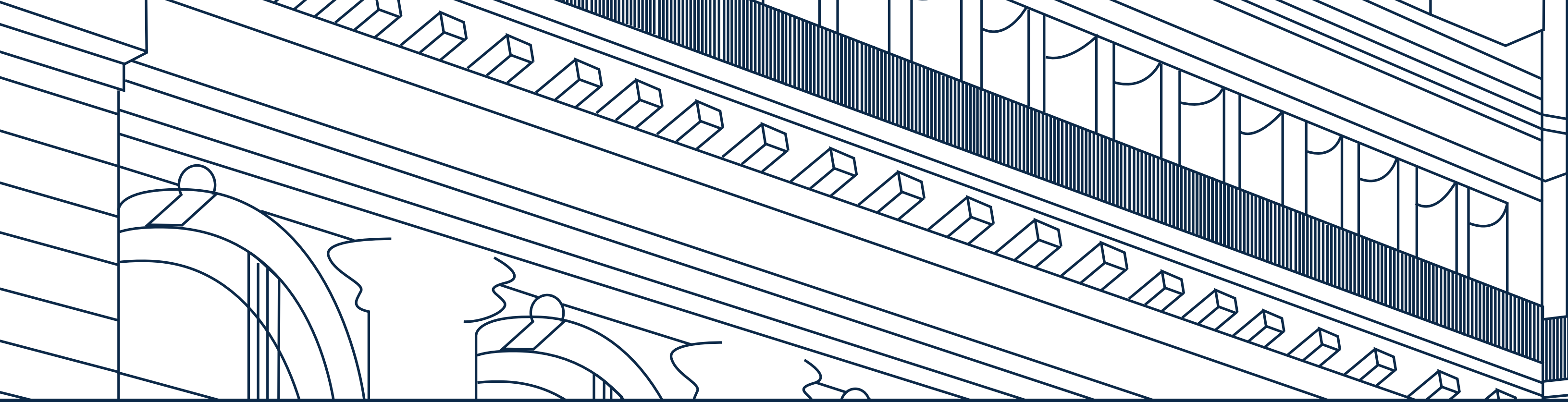
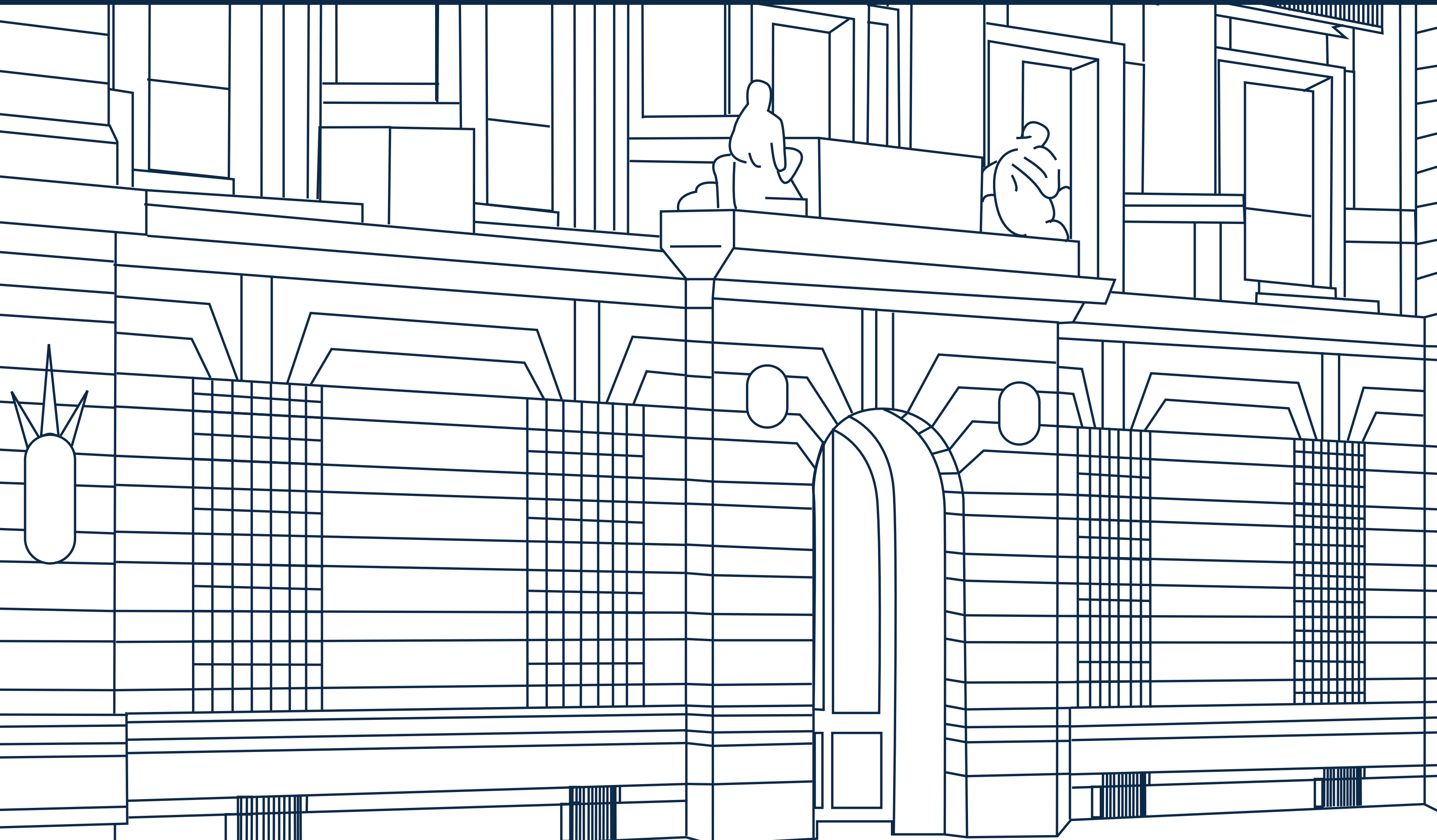


BANCO DE MÉXICO®

Minutes number 100

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on May 18, 2023

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: May 17, 2023.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Rogelio Eduardo Ramírez, Secretary of Finance and Public Credit.
- Gabriel Yorio, Undersecretary of Finance and Public Credit.
- Elías Villanueva, 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

Most members highlighted that during the first quarter of 2023, global economic activity recovered compared to the fourth quarter of 2022. Some members pointed out that this was due to the better functioning of supply chains, to lower pressures on energy prices, and to the reopening of China's economy. **Most members noted that labor markets in several economies continued showing signs of tightening.** However, **some** members expressed that in the United States there are signs of lesser pressures. **One** member stated that in the major economies, there was a moderation in nominal wage growth.

Most members pointed out that world growth prospects for 2023 continue pointing to a deceleration compared to 2022. One member stated that lower growth is expected in advanced economies, while emerging economies are anticipated to face difficulties associated with a moderation in their external demand, a higher debt service, a lower fiscal margin, and high inflation. He/she added that indicators related to world trade volume have already shown certain signs of weakness, while timely indicators of manufacturing and services show a differentiated behavior, with the latter displaying greater dynamism. **Another** member stated that, in some systemically important economies, a recession cannot be ruled out. However, he/she noted that a slight recovery in global economic activity is still expected for 2024. Among global risks, **some** members mentioned tighter monetary and financial conditions. **Some** members added the worsening of geopolitical tensions and challenges to financial stability.

Most members stated that headline inflation continued decreasing in a large number of economies, although they warned that it still remains at high levels. They attributed this decline to lower reference prices for food and energy. One member added that the mitigation of shocks and global monetary tightening have also contributed to the fall in inflation. **However, most members highlighted that the core component continues showing resistance to decline.** In this regard, **one** member considered this behavior a matter of concern. He/she noted that tight labor markets are one of the factors keeping inflation at historically high levels. **Another** member pointed out that in some countries it still does not show an inflection point. **One** member highlighted that in some economies it showed certain moderation. Finally, **some** members indicated that, in several economies, inflation is expected to converge to its target until the end of 2024 or in early 2025.

Most members considered that central banks are in the final phase of their hiking cycles. They highlighted that several monetary authorities have already stopped increasing their reference rates. In this regard, **one** member stated that the main emerging economies that have already paused their hiking cycle accumulated on average 660 basis points of increases. **Some** members underlined that several central banks have communicated that high rates for an extended period will be necessary to achieve the convergence of inflation to its target. **One** member added that the fact that the authorities had used specific tools to deal with the risks to the stability of the financial system which resulted from the events in the banking sector, has allowed central banks to focus on fighting inflation.

All members mentioned that, at its May meeting, the US Federal Reserve raised the target range for the federal funds rate by 25 basis points. Most members stated that for the next meeting, analysts and market participants foresee a pause. Most members considered that the tightening of credit conditions due to problems in the banking sector contributed to this projection. Most members noted that market instruments are pricing in interest rate cuts during the second half of 2023. They highlighted that, in contrast, the chairman of the Federal Reserve stated that, given the current inflation projections, they do not foresee cuts in 2023 and that they will maintain a data-dependent stance. One member added that surveys conducted among analysts indicate that interest rate cuts would occur until next year.

Most members mentioned that, after the financial turbulence generated by the banking sector events in previous months, international financial markets have stabilized. They highlighted that this was due to the timely intervention of authorities in the affected economies. Some members noted that the environment of lower risk aversion was reflected in gains in the main stock market indexes, in a depreciation of the US dollar, and in moderate increases in medium- and long-term interest rates. However, **one** member stated that, in view of the US debt ceiling negotiations, the fixed-income market in that country exhibited volatility. **Most members considered that risks to global financial markets persist. Some** members pointed out that tighter global financial and credit conditions could prevail.

Economic Activity in Mexico

Most members stated that, in the context of a complex external environment, the Mexican economy has remained resilient. They highlighted that, according to the GDP flash estimate for the first quarter, economic activity increased its rate of expansion and growth was higher than expected. One member stated that this means that the national economy would have registered six consecutive quarters of positive growth, something unseen since 2016. However, **another** member reckoned that the balance of risks to growth is biased to the downside. **One** member pointed out that the latest information suggests a slowdown starting in the second quarter of the year.

Most members noted that the performance of the Mexican economy during the first quarter was supported by both the services and industrial sectors. One member highlighted that the expansion of services was generalized during the first two months of 2023, being observed in eight out of its nine subsectors. Regarding the components of the services sector, **another** member highlighted the greater dynamism of those related to retail; transportation and mass media information; finance and real estate; and accommodation and food preparation services. **However, most members noted that industrial activity has lost momentum in recent months. In particular, they highlighted the moderation in manufacturing production. One** member pointed out that this could be reflecting an incipient weakening of external demand. **Some** members also mentioned the slowdown in mining. **One** member stated that construction registered a marginal improvement in March.

Most members highlighted that in the first two months of the year private consumption continued showing dynamism, driven mainly by the consumption of services. One member mentioned that its level is historically high. However, **another** member pointed out that consumption of goods showed a slight reversion in February. **One** member noted that there has been a greater dynamism in the consumption of imported goods compared to that of domestic goods, possibly due to the appreciation of the real exchange rate since the start of the hiking cycle in 2021. **Most members warned that, looking ahead, some timely indicators suggest a moderation of private consumption. Regarding investment, they noted that it continued increasing, supported by the machinery and equipment component**, although **one** member considered that it still shows a significant lag. **Another** member pointed out that, overall, investment in construction is sluggish. **One** member noted that residential construction remained at low levels, while **another** member highlighted the growth of non-residential construction. In the context of lackluster investment, **one** member considered necessary to establish conditions for the country to take advantage of the nearshoring phenomenon. He/she argued that this would help counteract the foreseen cyclical weakness of external demand. He/she added that, from a longer-term perspective, it would allow the country's productive capacity to increase.

Regarding the external sector, **some** members pointed out that manufacturing exports showed moderate growth during the first quarter of the year. **One** member highlighted that imports of intermediate goods have continued contracting, while non-automotive exports have weakened. However, **another** member considered that the latter have been recovering after the decline observed at the end of 2022. He/she added that automotive exports have remained stable and at relatively high levels.

All members agreed that the labor market shows strength. Most members pointed out that the labor participation rate continued increasing, while the unemployment rate reached historic lows. They pointed out that, in line with the above, the working population has grown at a faster rate than the economically active population. Some members highlighted the growth in the number of IMSS-insured workers. **Some** members pointed out the high employment rate among the working-age population. **Meanwhile, most members highlighted the relatively high magnitude of wage revisions. One** member noted that the nominal annual variation of the daily wage of IMSS-insured workers has remained at levels above 11%, while contractual wage revisions have accelerated, with those of private sector companies standing out, at levels of 8.9%. **Another** member warned that minimum wage increases are foreseen to have a greater effect on the average wage, given that, according to the latest figure reported as of March, 35% of the employed population already receives up to one minimum wage.

Most members noted that the output gap continues narrowing. They highlighted that it is not statistically different from zero. One member commented that he/she expected the point estimate, which is slightly below zero, to remain negative this year and the next. **Another** member mentioned that, considering measurement issues, there may be greater demand-related pressures than what would initially seem to be the case.

Inflation in Mexico

All members highlighted that since the last monetary policy meeting, annual headline inflation continued decreasing. Most members argued that various inflationary pressures are easing. However, most members emphasized that it still remains high, registering 6.25% in April. They considered that its decline was mainly due to the evolution of non-core inflation. Some members pointed out that, more recently, the core component has also contributed. **One** member noted that, since February, biweekly inflation data has been below the analysts' consensus. He/she mentioned that in April the monthly variation of headline inflation was negative, something unseen in the previous two years, while the annual variation of practically all of its components and sub-components fell. **Another** member added that, when analyzing the seasonally adjusted and annualized monthly variations of headline inflation and its two components, these have trended downwards. He/she mentioned that the fraction of the consumption basket showing variations greater than 10% has decreased. He/she stated that indicators, such as the trimmed mean, suggest that the performance of most inflation components, except for the services sub-index, has improved. **One** member argued that the downward trajectory of inflation seems to be starting to consolidate, although its decline has been slow and marginal so far.

Most members highlighted that the latest readings of annual core inflation showed a more marked reduction than in previous months, although it still remains at high levels, registering 7.67% in April. One member mentioned that it was below 8% for the first time in eight months. **Another** member added that it has been declining for three consecutive months. **Most members stated that its monthly variation has declined. Some** members noted that in April it was closer to its 10-year average. **One** member added that some indicators related to its monthly variations confirm a deceleration beyond base effects and a less generalized growth. He/she indicated that close to 50% of the consumption basket of goods and services within the core component already registers an annualized monthly inflation below 5%. **However, most members considered that core inflation shows persistence. Some** members stated that, although inflation has declined, it is mainly due to favorable external factors. They warned that, in their opinion, there are domestic inflationary pressures that could hinder the convergence of inflation. **One** member pointed out that the transition to domestic pressures is a pattern observed in most countries. **Another** member stated that this could be attributed to the fact that: i) housing is facing supply-related pressures accumulated over several years; ii) the rest of services may be affected by the normalization of consumption patterns and the pass-through of cost-related pressures; and iii) the labor market shows tighter conditions and relevant wage dynamics in an environment of high inflation.

Most members pointed out that merchandise inflation has been decreasing. One member noted that it is currently below the double-digit levels that were observed for nine months. **Another** member noted that this decline is due to the better functioning of global supply chains and to the moderation of price pressures on various inputs. **Some** members mentioned that both the food and non-food merchandise subindices have decreased. **One** member pointed out that both components accumulated four and five months of declines, respectively, although they remain at high levels. In this regard, **another** member warned that food merchandise inflation remains at double-digit levels.

Most members pointed out that, in its latest reading, services inflation decreased. One member stated that said decrease was mainly due to the behavior of tourism-services inflation, which reflected seasonal factors. **Some** members also mentioned that services inflation continues showing persistence. **Some** members also underlined that it remains high. **Regarding its components, most members noted that the annual price variations of housing and education services still do not show a downward inflection. One** member shared a reflection on the behavior of services inflation. First, he/she stated that its increase partly reflects the recovery of this sector given the reversal of changes in consumption patterns generated by the pandemic. Second, he/she noted that inflation in education services has already stopped increasing and considered that the increase in this component at the beginning of the year was likely a one-off event, although it will continue having an impact on the annual inflation of services due to base effects. Third, he/she pointed out that housing inflation continues being affected by last year's high inflation figures, as this component is highly sensitive to the observed inflation readings and tends to reflect them with a lag. Fourth, he/she pointed out that some of the services components have been affected by the global shocks that have exerted pressure on inflation, as is the case with food services, although these have recently shown a downward trajectory in their seasonally adjusted and annualized monthly variations. However, **another** member warned that the prices of some services, indeed, such as food services, are still increasing at double-digit rates.

Most members mentioned that annual non-core inflation continued decreasing and reached 2.12% in April. They added that this decrease is explained by reductions in the annual variation of both energy and fruit and vegetable prices. One member noted that, since January, inflation of these components accumulated a significant fall of 674 and 644 basis points, respectively. **Another** member indicated that non-core inflation has reflected more immediately the mitigation of external pressures on food and energy prices. **Some** members pointed out that non-core inflation is registering unusually reduced variations that, looking ahead, cannot be deemed permanent. **One** member stated that the April figure was one of the lowest in historical terms and was the lowest reading since December 2020.

Most members pointed out that longer-term inflation expectations remained relatively stable. However, they stated that these are at levels above the target. Some members considered that they still do not show a downward trend. Regarding short-term expectations, **some** members mentioned that inflation expectations for the next 12 months and for 2023 declined. **One** member pointed out that the survey conducted among analysts indicates that the probability that headline inflation ends the year above 5.5% has decreased. **Another** member noted that the median of expectations for the next 12 months accumulates a reduction of 68 basis points from its highest reading during the current inflationary episode. **Most members mentioned that breakeven inflation has declined. One** member said that it remains at levels incompatible with the inflation target. **Another** member pointed out that, in light of the reductions exhibited by this indicator since March, the inflation risk premium has fallen to levels close to its historical average.

Most members mentioned that forecasts for headline inflation were revised marginally downwards for some quarters, while those for core inflation remained practically unchanged. They noted that inflation is still projected to converge to the target in the fourth quarter of 2024. One member noted that the marginal revisions were made because observed inflation has remained slightly below Banco de México's forecasts at the March meeting. However, he/she warned that inflation forecasts drawn from surveys and market instruments are above the central bank's projections for practically all of 2024. **Another** member expressed that the moderation of pressures on international food and energy prices will eventually be transmitted to the prices of goods and services of the core component. He/she mentioned that a more significant decline in inflation continues to be anticipated, due to both the mitigation of global shocks and to the monetary policy actions implemented. **One** member noted that inflation in the United States has shown signs of easing, which favors the disinflation process in Mexico.

All members considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member added that said balance has not deteriorated. He/she stated that, nevertheless, there is still uncertainty associated with the foreseen trajectory of inflation. **Another** member indicated that the projected trajectory should continue to be validated with observed data. He/she considered that the road to inflation convergence remains fragile, lengthy, and difficult. Among upward risks to inflation, **some** members noted the persistence of core inflation at high levels. **One** member added that, although a rapid fall in headline and core inflation is projected as of the third quarter of this year, it may not occur, even after the monetary tightening attained, due to the persistence of inflation that has been observed. In this regard, **another** member pointed out that this could compromise the anchoring of inflation expectations. He/she expressed concern about the persistence of merchandise inflation and the significant increase of services inflation, which may imply that various shocks have still not been fully assimilated. **One** member mentioned that the configuration of inflationary pressures continues to pose challenges for the future, given that the decline in inflation is mainly supported by the non-core component. In this regard, **some** members pointed out the risk of pressures on energy prices and on agricultural products' prices. **One** member added that the non-core component could be affected by climate-related shocks, given the possible arrival of the *El Niño* phenomenon. **Another** member indicated that, following its low readings, non-core inflation could observe a reversion to its mean, hence exerting pressure on headline inflation. In addition, **some** members pointed out the risk of greater cost-related pressures. Specifically, **some** members mentioned the increase in wages in the context of a strong labor market. However, **one** member underlined that recent estimates of the Phillips curve for Mexico suggest that it exhibits a relatively mild slope. He/she argued that the above implies that labor market dynamics are not the main inflation determinant at this time. Instead, he/she considered that those determinants associated with supply and with inflation expectations represent the main channels through which pressures have accumulated, and thus, in his/her opinion, these would also be the means to achieve convergence, and for that reason, inflation expectations must remain anchored. As an additional upward risk, **another** member mentioned possible episodes of foreign exchange depreciation. Among risks to the downside, **one** member highlighted the possibility of a greater-than-anticipated deceleration of the world economy.

Macrofinancial environment

Most members highlighted that, since the previous monetary policy meeting, domestic financial markets, in line with international ones, performed better. They emphasized the timely intervention of the authorities to address the problems that occurred in the US and European banking sectors. In this regard, **one** member indicated that the risk of contagion appears to have subsided. In addition, he/she pointed out that the Mexican banking system has a limited exposure to the institutions that registered problems, has solid levels of capitalization, and exceeds regulatory liquidity requirements. He/she added that a high degree of leverage is not observed in the domestic financial system and, therefore, no fundamental reasons for a shortage of liquidity are foreseen in Mexico.

All members highlighted that the Mexican peso appreciated. Most members pointed out that the national currency is at levels unseen in several years. Meanwhile, **one** member added that the bilateral real exchange rate with the U.S. has appreciated around 10%, while the multilateral one has done so by about 17% since the beginning of the hiking cycle. **Some** members attributed the currency´s recent performance to the ample interest rate spread between Mexico and the United States as well as to Mexico's sound macroeconomic fundamentals. **One** member noted that, after the episodes of financial turmoil in the international banking sector, the increase in volatility that had been observed in the foreign exchange market has reversed. **Another** member highlighted the improvement in trading conditions in said market.

Most members pointed out that, since the last monetary policy decision, short-term interest rates increased and medium- and long-term ones decreased, deepening the inversion of the yield curve. One member noted that domestic financial conditions have reached tighter levels, in line with the domestic and global monetary cycles. **Most members underlined the gains of the Mexican stock market. One** member stated that the behavior of this market has been in line with that observed across other emerging economies. **Some** members pointed out that Mexico's default risk premium decreased.

Some members indicated that commercial banks' performing credit to firms and households has continued to expand, especially credit for consumption. **One** member highlighted that mortgage lending has also increased. **Another** member pointed out that delinquency rates are at low and stable levels. **One** member noted that part of the credit dynamism is attributed to the fact that the economy continues to recover from the impact associated with the pandemic. He/she mentioned that, in real terms, outstanding credit is slightly below the level observed in February 2020. He/she added that, although businesses continue to obtain financing from domestic sources through the issuance of financial instruments, they have faced more adverse conditions issuing debt abroad, in line with the tightening of global credit conditions.

Monetary policy

The Governing Board evaluated the magnitude and diversity of the inflationary shocks and their determinants, along with the evolution of medium- and long-term inflation expectations and the price formation process. It considered that the economy has started to undergo a disinflationary process given that many pressures have eased. Nevertheless, it deemed that these pressures continue having an incidence on inflation, as it remains high, and the inflationary outlook is still very complex. Based on the above, and considering the monetary policy stance already attained in this hiking cycle, with the presence of all its members, the Board decided unanimously to leave the target for the overnight interbank interest rate unchanged at 11.25%. With this decision, the monetary policy stance remains in the trajectory required for inflation to converge to its 3% target within the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. It estimates that the inflationary outlook will be complicated and uncertain throughout the entire forecast horizon, with upward risks. Thus, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, it considers that it will be necessary to maintain the reference rate at its current level for an extended 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 recalled that, since 2021, the inflationary environment has been complex, with inflation levels unseen in recent decades. He/she pointed out that this central bank began the monetary restriction cycle in a timely manner and that, in light of the intensification of inflationary pressures, forceful actions were taken. He/she noted that, after attaining a restrictive policy stance and in view of the signs of easing of various shocks, since the end of last year a reduction in the pace of interest rate increases was started. He/she added that the current outlook, despite remaining complex and uncertain, and despite inflation still being far from target, is less adverse than that registered throughout last year. He/she argued that, given the described inflation outlook and considering the monetary policy stance attained after the accumulated 725-basis point increase in the reference rate, it is appropriate to leave said reference rate unchanged. He/she pointed out that, due to the accumulated increases and considering the clearly restrictive levels of the ex-ante real interest rate, the attained monetary policy is solid and consistent with the disinflationary process. He/she mentioned that a cautious approach should be maintained and the attained restrictive monetary stance should be allowed to continue operating. He/she considered that, with this stance, a signal is sent to the public that Banco de México is still not satisfied with the inflationary environment. He/she highlighted that the monetary restriction contributes to the anchoring of long-term inflation expectations, hence preventing inflation from persisting at high levels even after the shocks dissipate. He/she pointed out that a restrictive policy stance also contributes to an orderly performance of financial markets, including the foreign exchange market, considering the inflationary environment and the global monetary tightening. He/she indicated that the volatility-adjusted spread of domestic and external interest rates, derived from the monetary policy actions, as well as the country's solid macroeconomic fundamentals, have favored the resilient performance of the Mexican peso, which contributes to ease inflationary pressures. He/she also mentioned that a restrictive policy stance leads to an intertemporal reallocation of economic agents' expenditure by incentivizing savings, which further favors the disinflationary process. He/she argued that, during the current cycle, a significant slowdown has been observed in households' demand for liquid assets, while demand for long-term instruments has increased. He/she underlined that, looking forward, the outlook will remain complex, with upward risks and uncertainty over the pace at which the shocks will fade. In this context, he/she considered it difficult to anticipate the time during which the reference rate would remain at its current level. He/she argued that it is too early to begin discussing possible interest rate cuts. He/she sustained that it is crucial to strongly endorse the central bank's commitment to the attainment of its primary mandate and, consequently, the need to continue its efforts to consolidate an environment of price stability.

Another member pointed out that the recent evolution of the main inflation indicators along with the level of monetary restriction attained after 15 consecutive increases in the reference rate allow to consider a pause, for this occasion, in the monetary restriction cycle. He/she emphasized that the tone of the monetary policy statement would be of utmost importance for the formation of market expectations regarding future policy decisions. He/she highlighted that the statement should communicate that, although the main inflation indicators have behaved favorably, they have responded primarily to the evolution of external factors, while domestic inflationary pressures persist which can hinder the convergence of inflation to its target within the planning horizon. He/she underlined the following factors that may prevent inflation from decreasing at the anticipated pace: i) the dynamism of domestic demand, mainly driven by consumption; ii) the strong labor market; iii) increases in labor costs and their pass-through to consumer prices; and iv) medium- and long-term inflation expectations above 3%. Regarding guidance about future monetary policy decisions, he/she indicated that the environment of high uncertainty about the inflationary process calls for a cautious approach and favors a flexible policy stance. He/she added that it cannot be ruled out that a greater or lesser tightening may be required. He/she argued that it should be stated that a pause does not imply that Banco de México's work has concluded, nor that it will necessarily be followed by a monetary easing. He/she added that it should be clearly communicated that Banco de México will respond according to the economic circumstances as they unfold. In particular, he/she mentioned that the upcoming decisions will depend on headline and core inflation consolidating their downward trend. He/she highlighted that, in any case, the central bank must be clear in that the monetary policy stance should remain in restrictive territory within the entire planning horizon. He/she mentioned that the above would contribute to align analysts' inflation expectations, which are currently above forecasts for the entire 2024, with those of Banco de México, which would improve the effectiveness of monetary policy.

One member argued that, considering the interest rate increases accumulated during this hiking cycle, a sufficiently restrictive policy stance was attained to address a still complex inflationary outlook. He/she stated that the ex-ante real interest rate has been in restrictive territory for several months, reaching maximum levels since the overnight interbank rate was adopted as the monetary policy instrument. He/she underlined that, although Mexico's monetary policy stance relative to that of the U.S. has decreased at the margin, the broad interest rate spread and the observed resilience of the Mexican peso provide room for this reduction. He/she added that, in the absence of unexpected shocks, the attained stance is consistent with a downward trajectory of inflation over the forecast horizon. He/she expressed that the terminal rate has been attained, without implying that there will not be a further adjustment or that this is the end of the monetary restriction, since the monetary policy is now shifting from an active policy management, involving nominal rate increases, to a new phase of passive policy management, determined by the decline in inflationary expectations. He/she indicated that the restrictive monetary policy will continue to operate through its transmission mechanisms. He/she considered that a restrictive policy stance should continue for as long as necessary to break the persistence of core inflation. He/she noted that an additional interest rate increase could be required if inflation does not subside. Similarly, he/she pointed out that, if inflation were to decline, an overly restrictive policy stance should be avoided, and, therefore, an interest rate cut would be eventually considered. He/she pointed out that this would not be a monetary easing, but rather an adjustment to maintain the ex-ante real interest rate in a range between 6 and 7%, which, by his/her estimation, is consistent with convergence of inflation to the target. He/she added that future intentions should be made known by means of a forward guidance, specifying these are subject to incoming data and, thus, do not represent a fixed commitment. He/she mentioned that, although it is venturesome to announce that the restrictive stance will be maintained throughout the horizon in which monetary policy operates, it is crucial to communicate that such stance needs to be maintained for an extended period. He/she considered that progress in the communication strategy has been fundamental for the public to get to know the central bank's reaction function and to strengthen the formation of expectations. He/she added that such progress has not responded to circumstantial issues, but instead has been the result of intense discussions and an analysis of the academic literature and of international best practices. He/she highlighted that it is key to continue working so that, through a clear, direct and transparent communication, which is fundamental for the efficient management of inflation expectations, the primary mandate is fulfilled.

Another member pointed out that the attained interest rate level is historically restrictive, both in nominal and real terms, which he/she deemed consistent with the unprecedented inflationary pressures that have been observed. He/she mentioned that, given this stance, the analysis should focus on the evolution of the monetary policy transmission mechanism. He/she stated that: i) starting 9 months ago, a rebalancing in the asset portfolio of the private sector has been observed, with a substitution of liquid assets for longer-term instruments, especially among households, which implies that the interest rate channel is operating and gaining traction; ii) in the current cycle, financing interest rates have increased more than in other episodes, and bank lending conditions have also tightened considerably, which suggests that credit conditions are stringent; iii) in contrast to other monetary cycles in which the real exchange rate depreciated abruptly, this channel is acting in a highly restrictive manner; iv) the asset price channel, which in Mexico tends to be weak, has operated through the increase in the nodes of the yield curve since the beginning of the tightening cycle, affecting the prices of debt instruments, which have decreased significantly; and v) inflation expectations remain anchored and, at the margin, have gradually reversed their negative impacts, a trend which will allow further strengthening of the monetary stance. For this reason, he/she considered that all channels are working in the right direction to bring inflation back to its target over the forecast horizon. He/she underlined that the configuration of inflationary pressures is still fragile, and that the high levels of uncertainty increase the importance of maintaining a flexible and data-dependent approach. He/she indicated that communication must be clear to enable an adequate formation of expectations and an orderly behavior of markets, which continue discounting cuts in the reference rate in the near future, an expectation that he/she considered is not compatible with the convergence of inflation to its target in the planning horizon. He/she forewarned that it should be communicated that the restrictive policy stance will last for a period necessary and sufficient to confirm: i) a clear and downward trend of headline and core inflation towards 3%; ii) a neutral balance of risks around the forecast; and iii) inflation expectations returning to their historical averages. He/she explained that the above is key to ensure the fulfillment of the constitutional mandate.

One member added that the hiking cycle began in a timely manner and Banco de México responded forcefully to the significant deterioration of the inflation outlook. He/she pointed out that, following a significant accumulated increase of 725 basis points in the reference rate, it is reasonable to make a pause in the hiking cycle and evaluate the degree of absorption of this monetary tightening in the economy. The above, considering that, although inflation still remains elevated, signs of easing of price-related pressures can be observed, and such restriction will continue to have an effect during the following quarters. He/she added that the short-term ex-ante real interest rate is at a clearly restrictive level. He/she mentioned that this rate would increase insofar as inflation expectations continue decreasing. He/she reflected on the lag with which monetary policy operates. He/she pointed out that, in this horizon, two stages can be distinguished. In the first stage, which is already taking place, the monetary policy rate affects the channels through which it operates. In the second stage, which will start to become more evident, the impact of the channels is reflected on inflation and its determinants. He/she highlighted that one of the most relevant transmission channels is that of inflation expectations. He/she underlined that shorter-term ones have already stabilized, while longer-term ones, which affect the price formation process to a greater degree, have remained anchored. He/she pointed out that the monetary adjustment has been transmitted along the entire real yield curve and in market interest rates for the different segments. It has also enabled a change in households' asset holdings towards longer-term instruments, which affects consumption decisions. He/she highlighted the functioning of the exchange rate transmission channel. In this regard, he/she emphasized that the Mexican peso has appreciated significantly in real terms since the beginning of the restrictive cycle. He/she observed that the tightness of monetary conditions is at one of the highest levels since the inflation-targeting regime was adopted. He/she underlined that, although, in his/her opinion, there is no conclusive evidence of domestic inflationary pressures, if they were present, they would be already addressed with the restrictive level that has been attained. He/she added that, given the persistence of the core component and the environment of high uncertainty, it is crucial to remain vigilant to take the necessary actions if additional shocks were to occur. He/she stated that, after having paused the hiking cycle, Banco de México can resort to its communication as a tool to continue supporting the strength of the monetary policy stance. He/she added that, to this end, it is reasonable to communicate that a restrictive policy stance will be maintained for as long as necessary to guarantee the convergence of inflation to the target.

3. MONETARY POLICY DECISION

The Governing Board evaluated the magnitude and diversity of the inflationary shocks and their determinants, along with the evolution of medium- and long-term inflation expectations and the price formation process. It considered that the economy has started to undergo a disinflationary process given that many pressures have eased. Nevertheless, it deemed that these pressures continue having an incidence on inflation, as it remains high and the inflationary outlook is still very complex. Based on the above, and considering the monetary policy stance already attained in this hiking cycle, with the presence of all its members, the Board decided unanimously to leave the target for the overnight interbank interest rate unchanged at 11.25%. With this decision, the monetary policy stance remains in the trajectory required for inflation to converge to its 3% target within the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. It estimates that the inflationary outlook will be complicated and uncertain throughout the entire forecast horizon, with upward risks. Thus, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, it considers that it will be necessary to maintain the reference rate at its current level for an extended 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

Victoria Rodríguez, Galia Borja, Irene Espinosa, Jonathan Heath and Omar Mejía voted in favor of leaving the target for the overnight interbank interest rate unchanged at 11.25%.

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

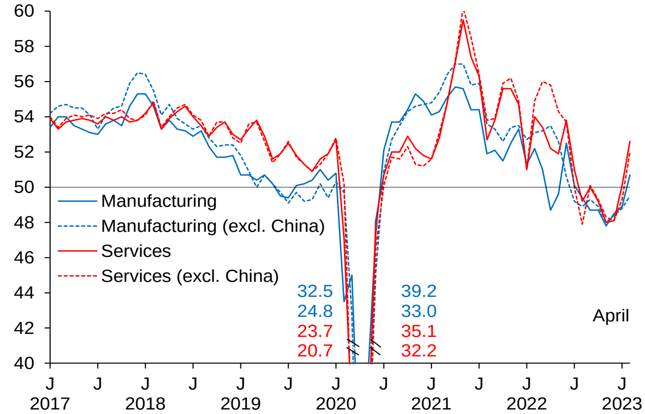
A.1.1. World economic activity

During the first quarter of 2023, global economic activity exhibited a faster pace of growth with respect to the previous quarter, boosted by the gradual fading of disruptions in supply chains, the lifting of mobility restrictions in China, and lower pressures on energy prices, despite tight financial and monetary conditions. Purchasing Managers' Indices point to a global recovery in services and to a certain lack of dynamism in the manufacturing sector (Chart 1). Among global risks, the following stand out: the persistence of inflationary pressures, the intensification of geopolitical tensions, tighter financial conditions, and challenges to financial stability. The risk of a tightening of credit conditions in some advanced economies associated with the recent problems in their banking sectors, or with the possible emergence of new tensions in this sector prevails.

In the United States, Gross Domestic Product (GDP) grew at a seasonally adjusted quarterly rate of 0.3% during the first quarter of 2023, below the 0.6% registered in the fourth quarter of 2022 (Chart 2).[1] The quarterly increase of GDP was supported by private consumption and government spending. Net exports and nonresidential investment also contributed to GDP growth, although the latter component has been losing dynamism, partly as a result of higher interest rates. The performance of GDP was tempered by the significant negative contribution of the change in inventories.

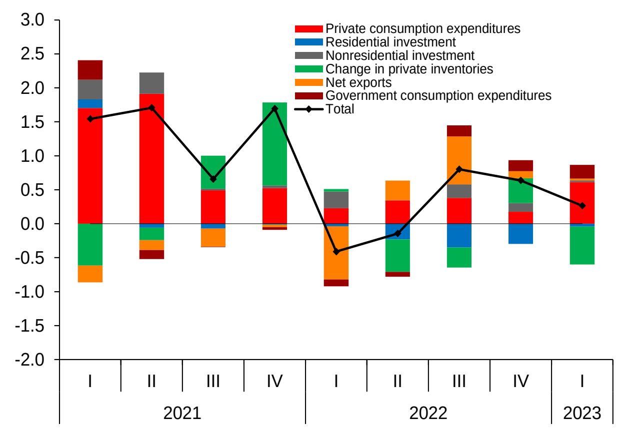
[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 1.1% in the first quarter of 2023 and 2.6% in the fourth quarter of 2022.

Chart 1
Global: Purchasing Managers' Index: Production Component
Diffusion index, s. a.1/



s.a./ Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points is considered an overall increase compared to the previous month and below 50 points an overall decrease.
Note: The figures in the chart correspond to the minimum level of the indicator.
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.
Source: BEA.

US industrial production grew at a monthly rate of 0.5% in April, after having stagnated in February and March. The improvement in industrial activity in April reflected a rebound in mining and, particularly, in manufacturing production. The expansion in the manufacturing sector was largely due to an increase in the production of vehicles and auto parts. This was partially mitigated by a decline in electricity and gas generation as the warmer-than-usual temperatures decreased the demand for heating. Purchasing Managers' Indices suggest a moderate expansion of the manufacturing sector during the second quarter.

The US labor market continued showing signs of strength, although some indicators exhibited a lesser tightening. These include job vacancies and some indicators of wage growth, although the latter remained at high levels. The non-farm payroll increased by 253,000 new jobs in April 2023.The main increases were in professional, health care, social assistance, leisure and accommodation services. Unemployment decreased from 3.5% in March to 3.4% in April. Initial claims for unemployment insurance remained relatively stable during most of the period.

In the euro area, during the first quarter of 2023, GDP registered a variation of 0.1% at a seasonally adjusted quarterly rate, after having slightly contracted during the fourth quarter of 2022.[2] Economic activity continued being affected by the uncertainty surrounding the military conflict in Ukraine and tight financial conditions. However, some factors that were affecting this economy have improved. These factors include the functioning of supply chains, consumer and business confidence, as well as the effect of lower energy prices on the purchasing power of households. The unemployment rate decreased to 6.5% in March, its lowest level on record. Purchasing Managers' Indices point to a contraction of the manufacturing sector and suggest that services continued to expand.

Economic activity in major emerging economies is foreseen to have registered a heterogeneous behavior during the first quarter of 2023. In Emerging Asia, the recovery of most economies has reflected the decline in disruptions in the region's supply chains. In the case of China, economic activity rebounded during the first quarter as a result of the lifting of mobility restrictions in that country. In Emerging Europe, several of the major economies registered a contraction during the first quarter of the year. In Latin America, a mixed behavior is anticipated across countries, with some of them recovering and others contracting.

Since Mexico's previous monetary policy decision, international commodity prices, in general, trended downwards. During the first half of April, oil prices tended to increase due largely to production cuts by the Organization of the Petroleum Exporting Countries and allied countries (OPEC+), as well as by some other economies. This trend subsequently reversed due to persistent concerns about the possibility of a world economic slowdown and weak manufacturing activity data from China. Natural gas reference prices in Europe trended downwards in response to high inventory levels due to the revision of forecasts towards warmer temperatures, increased production, and uncertainty about a possible weakening of demand. In the United States, natural gas prices registered narrow movements. Grain prices in general decreased due to talks regarding the two-month extension of the Black Sea security corridor agreement, which was finally reached in mid-May for a period of two months. The decline in these prices was also due to improved expectations of summer harvests in the United States and a higher-than-expected supply from countries such as Brazil. The prices of most industrial metals registered volatility during the period, with upward tendencies due to supply shortages and a recovery in demand from China in mid-April. Subsequently, prices decreased due to new data pointing to a lag in China's industrial activity and to persisting concerns about a global economic recession.

A.1.2. Monetary policy and international financial markets

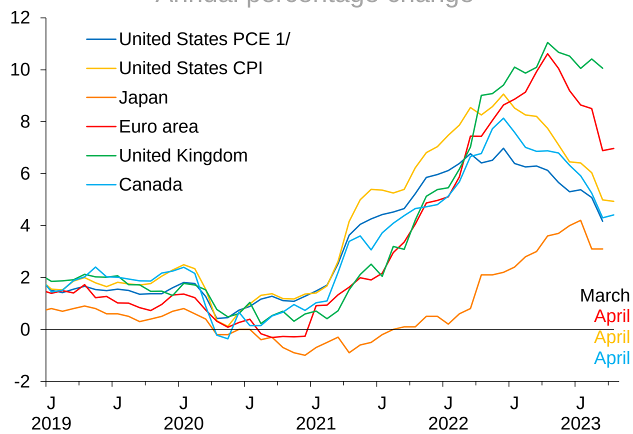
In most advanced and emerging economies, headline inflation declined, although it remains at high levels. The reduction in inflation was largely associated with lower pressures on energy and food prices. Core inflation, on the other hand, has shown a resistance to decline.

In most advanced economies, headline inflation decreased except for the Euro area and Canada, where the most recent data show a marginal increase (Chart 3). However, it remained at high levels and above their respective central banks' targets. Core inflation showed a heterogeneous behavior. In the United States, annual headline inflation as measured by the consumer price index decreased from 5.0% in March to 4.9% in April, as a result of a fall in food prices and a marginal decrease in core inflation. The annual variation of the latter went from 5.6 to 5.5% during the same period. This decrease was mainly due to a lower inflation in services prices, which was partially offset by a rise in

[2] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 0.3% in the first quarter of 2023 and -0.2% in the fourth quarter of 2022.

merchandise inflation. Annual headline inflation as measured by the personal consumption expenditures index (PCE) decreased from 5.1% in February to 4.2% in March.

Chart 3
Selected Advanced Economies: Headline Inflation
Annual percentage change



1/ The personal consumption expenditure deflator is used.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, The UK Office for National Statistics and Statistics Canada.

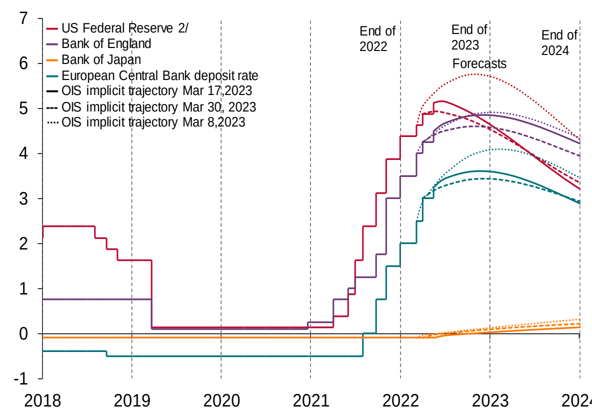
Analysts' short-term inflation forecasts for most of the main advanced economies suggest a moderation in headline inflation in 2023 relative to the levels registered in 2022. However, it would remain above their central banks' inflation targets. Longer-term inflation expectations drawn from financial instruments for these economies remained relatively stable at levels above their inflation targets in most cases.

According to most recent readings, in a large number of major emerging economies, annual headline inflation also decreased. However, it remained above most central banks' targets, except for a few countries, such as China, Russia, Thailand, India and Brazil, where inflation recently lay within its variability range or below its point target. In several emerging economies, core inflation stabilized or slightly decreased.

In this environment, since Mexico's previous monetary policy decision, the central banks of most of the main advanced economies continued tightening their monetary policy stances. Some moderated their pace of interest rate increases while others, such as those of Canada and South Korea, paused their hikes in recent decisions. The former stated that it is prepared to raise the interest rate if necessary and the latter indicated that it will have to judge whether the rate should be increased further. The Bank of Japan left its interest rates unchanged. However, it eliminated the statement regarding its expectation that short- and long-term policy rates will remain at their current or lower levels.[3] Regarding their asset purchase programs, most central banks in this group of economies continued to gradually reduce their securities' holdings.

Monetary policy expectations drawn from financial instruments exhibited volatility during the period for most advanced economies. This was largely associated with the evolution of concerns regarding the banking sector in some of these countries. Based on the latest available information, interest rates implicit in the interest rate swap curves (OIS) of some advanced economies, such as the United States, suggest a first reduction of 25 basis points (bps) in the third quarter of 2023 (Chart 4).

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 US, the average interest rate of the target range of the federal funds rate (5.00% - 5.25%) is used.
Source: Banco de México with data from Bloomberg.

Among the recent monetary policy decisions of major advanced economies, the following stand out:

i) The US Federal Reserve maintained its pace of increase for the reference rate by raising it in 25 basis points (bps) at its May meeting. Thus, it set the target range for the federal funds rate between 5.00 and 5.25%. The Federal Open Market Committee (FOMC) also adjusted its

[3] It also announced that it will conduct a review of its monetary policy over a period of around 12 to 18 months.

forward guidance. It eliminated the statement anticipating an additional tightening to bring inflation back to 2%. Instead, it specified that, in order to determine to what extent additional policy tightening might be appropriate, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments. In addition, it continued reducing the size of its balance sheet. Regarding the financial environment, it reiterated that tighter credit conditions for households and businesses are likely to affect economic activity, the labor market, and inflation, although the extent of these effects remains uncertain. During a press conference, the chairman of that institution assured that the Federal Reserve will maintain a stance dependent on incoming data, that the determination of the appropriate level of monetary tightening will be based on an ongoing assessment, and that in June's meeting they will evaluate whether the current interest rate level is sufficiently restrictive. He pointed out that, considering the current Committee's inflation forecasts, it would not be appropriate to cut interest rates this year. He mentioned that as long as there is a tightening of financial conditions stemming from the problems at some US banks, the Federal Reserve may not have to raise the federal funds rate as much as it would have done in the absence of such tightening. However, he explained that this is difficult to forecast given the uncertainty as to how persistent the effects of the turbulence in the banking system will be, how large they will be, and how long they will take to be transmitted. He added that they are prepared to tighten the stance further if necessary. Based on the latest available information drawn from financial instruments, the highest interest rate level during 2023 is anticipated to be around 5.2% in the second quarter of 2023, to subsequently decrease to around 4.64% by the end of 2023 and to 3.21% by the end of 2024.

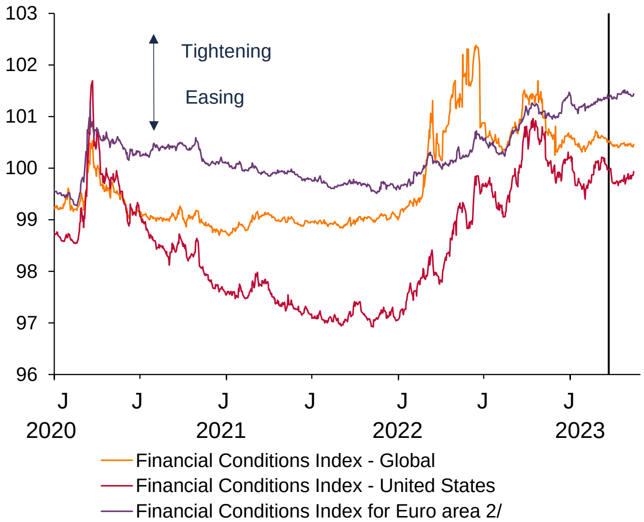
ii) The European Central Bank (ECB) moderated its pace of reference rate increases from 50 to 25 bps at its May meeting. It set its refinancing, key lending and key deposit rates at 3.75, 4.00 and 3.25%, respectively. It stated that the Governing Council's future decisions will ensure that policy rates will be brought to levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target, and will be kept at those levels for as long as necessary. It reiterated that the Governing Council will continue to follow a data-dependent approach in determining the appropriate level and duration of monetary restriction. The president of that institution highlighted that they still have a long way to go in the hiking process. The Governing Council expects to discontinue reinvestments under the Asset Purchase Program (APP) as of July 2023.

Since Mexico's previous monetary policy decision, most of the central banks of the major emerging economies stopped increasing their reference rates. Some suggested that they would maintain them at their current levels for some time at least until inflation starts to decline steadily, that they would not hesitate to raise rates if necessary, or that future adjustments would depend on how the outlook on prices evolves. Other central banks continued raising their reference rates, although some reduced the pace of their increases.

In the context described above, after the turbulence generated by the banking crisis in the United States and Europe in previous months, international financial markets stabilized, while global financial conditions remained tight (Chart 5). Stock markets in most of the major advanced and emerging economies registered gains in an environment of greater stability of the banking sector in the United States and Europe relative to that observed in March (Chart 6). However, risks and uncertainty persist regarding the performance of some regional banks in the United States. In foreign exchange markets, the US dollar exhibited limited movements during the period, in a context of concerns about possibly lower growth in that country, of expectations that the Federal Reserve is nearing a pause in its tightening cycle, and of uncertainty regarding negotiations to increase the debt ceiling in that country. Most emerging market currencies appreciated against the US dollar, although some weakened recently (Chart 7). Interest rates on short- and long-term government bonds of the main advanced economies exhibited volatility. In several cases, interest rates were above the level observed at the time of Mexico's previous monetary policy decision. In addition, the cost of insuring against default by the US government (CDS) increased significantly at different maturities, particularly at one year. This was due to the uncertainty surrounding the agreements to raise the country's debt ceiling. In emerging economies, most long-term interest rates also exhibited volatility, although in most countries they are currently below the level registered at the time of Mexico's previous monetary policy decision.

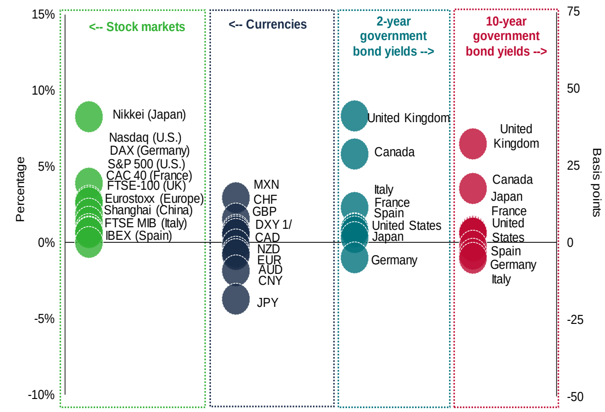
In this context, since Mexico's previous monetary policy decision, cumulative net inflows to emerging economies were registered. For most of the period, flows behaved differently across asset classes, with cumulative net inflows to equity assets and moderate outflows from fixed-income assets.

Chart 5
Financial Conditions Indices[1/]
Units



Source: Prepared by Banco de México with data from Bloomberg and Goldman Sachs.
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 calendarized monetary policy meeting of Banco de México.

Chart 6
Change in Selected Financial Indicators from March 30, 2023 to May 17, 2023
Percent; basis points



Source: Bloomberg and ICE. 1/ MSCI Emerging Markets Index, which includes 24 countries. 2/ DXY: a weighted average estimated by the Intercontinental Exchange (ICE) of the nominal exchange rate of the main six currencies operated globally with the following weights: EUR 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%

Chart 7
Selected Emerging Economies: Financial Assets Performance as of March 23, 2023
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	6.19%	4.01%	12	-13	-18
	Brazil	7.13%	10.76%	-54	-139	-25
	Chile	2.65%	6.09%	109	32	-26
	Colombia	4.01%	5.67%	-39	-82	-31
	Peru	2.90%	0.68%	-20	-44	-27
Emerging Europe	Russia	-2.09%	7.40%	-34	-31	N.D.
	Poland	3.69%	11.73%	-17	-21	-5
	Turkey	-2.88%	-5.26%	523	363	-35
	Czech Rep.	0.21%	3.50%	26	-18	-4
	Hungary	3.53%	7.31%	-41	-69	2
Asia	China	-1.99%	-0.43%	-14	-17	-10
	Malaysia	-1.41%	0.85%	-7	-25	-9
	India	0.11%	7.08%	-30	-33	-16
	Philippines	-2.71%	0.64%	-3	-10	-13
	Thailand	0.21%	-2.03%	26	17	3
	Indonesia	3.88%	0.24%	-47	-49	-13
Africa	South Africa	-6.87%	3.63%	129	90	28

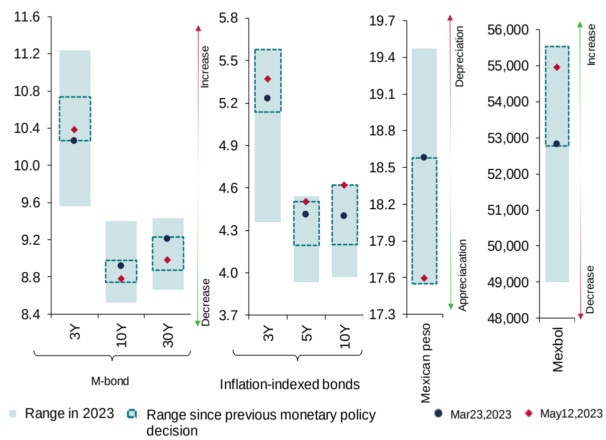
Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year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

A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described above, since Mexico's previous monetary policy decision, the Mexican peso appreciated against the US dollar, while short-term interest rates increased and medium- and long-term ones decreased (Chart 8). The environment surrounding domestic financial markets was affected by lower risk aversion, once the effects of the credit events in the banking system in developed countries partially dissipated. This was accompanied by a decline in volatility across all asset classes.

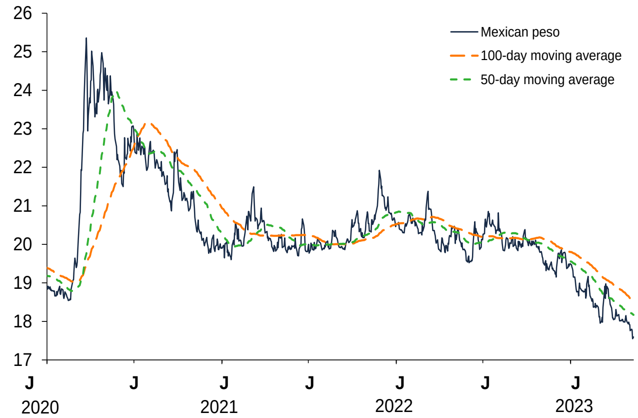
Chart 8
Mexican Markets' Performance
Percent, MXN/USD and index



Source: Prepared by Banco de México.

The Mexican currency traded in a range of 1.37 pesos, between 17.43 and 18.80 pesos per US dollar since the previous monetary policy decision. During the period it appreciated 6.19% and reached its lowest level since March 2016 (Chart 9). The above occurred in a context in which trading conditions, both realized and prospective, improved.

Chart 9
Mexican Peso Exchange Rate
MXN/USD

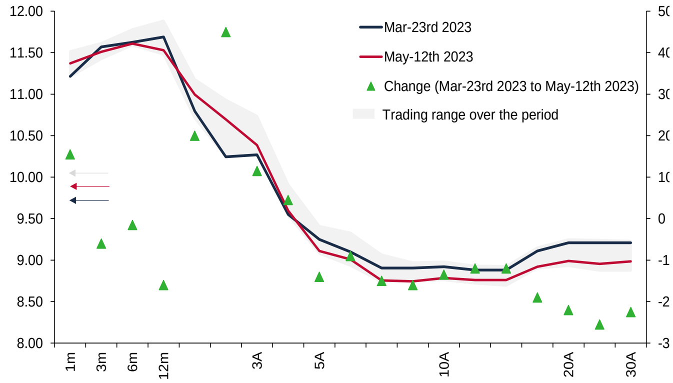


Source: Prepared by Banco de México.

Interest rates on government securities increased up to 45 bps in the short-term nodes, while in the medium- and long-term nodes they decreased up to 26 bps (Chart 10). The yield curve of real rate instruments exhibited generalized increases averaging 22 bps. In this context, breakeven inflation implicit in spreads between nominal and real interest rates of market instruments decreased up to 44 bps (Chart 11). These movements took place in an environment in which trading conditions showed an improvement, although without reaching the levels observed prior to the onset of the pandemic.

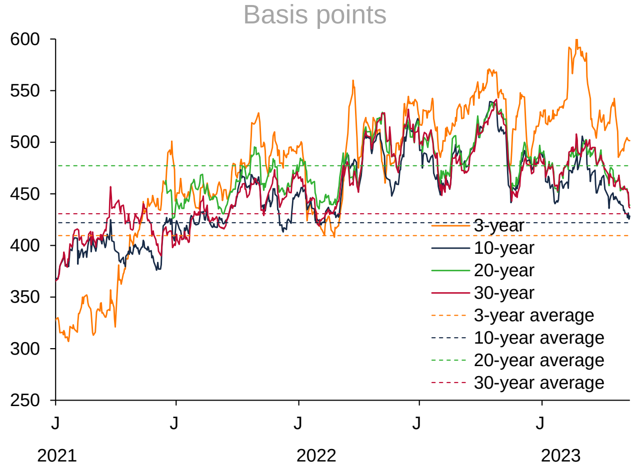
Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swaps curve incorporates that, for the May decision, the reference rate would remain unchanged (Chart 12). Most analysts surveyed by Citibanamex anticipate that the reference rate will remain unchanged in the May decision and that by the end of 2023 it will still be at the current level of 11.25%.

Chart 10
Nominal Yield Curve of Government Securities
Percent, basis points



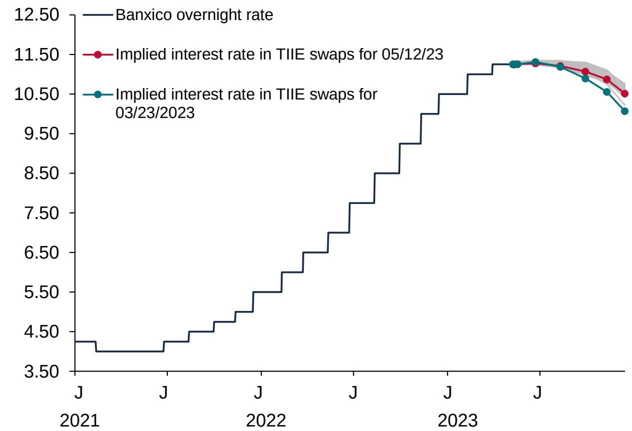
Source: PIP.

Chart 11
Breakeven Inflation and Inflation Risk Implied in Government Securities' Yields
Basis points



Source: PIP.

Chart 12
Interbank Funding Rate Implied in TIIE Swaps
Percent
ontinue



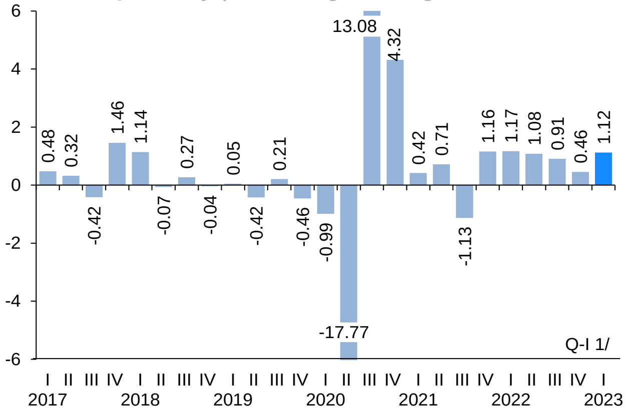
Source: Prepared by Banco de México with Bloomberg data.

A.2.2. Economic activity in Mexico

According to Mexico's GDP flash estimate published by INEGI, the country's economic activity increased its rate of expansion during the first quarter of the year, thus displaying resilience despite the prevailing complex external scenario (Chart 13).

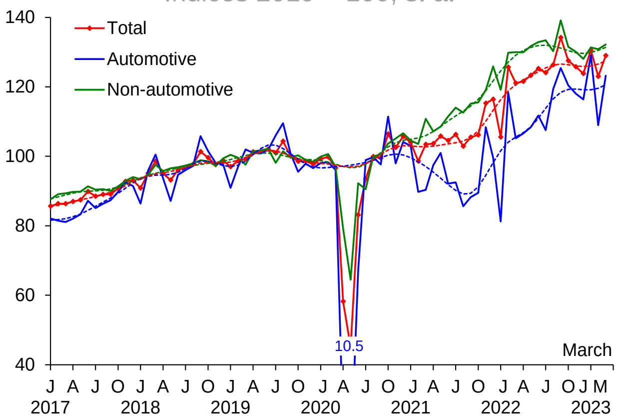
Regarding external demand, during the first quarter of 2023, the value of manufacturing exports registered moderate growth, following the decline observed in the previous quarter. This was the result of growth in both automotive exports and the rest of manufacturing (Chart 14). As for domestic demand, during the first bimester of 2023, private consumption increased significantly as a result of the good performance of both goods and services. Meanwhile, gross fixed investment continued increasing. Regarding the latter's components, investment in machinery and equipment continued showing dynamism, while investment spending on construction slowed its rate of recovery.

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



s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
1/ The figure corresponding to the first quarter of 2023 refers to the timely estimate of quarterly GDP published by INEGI.
Source: Mexico's System on National Accounts (SCNM, for its Spanish acronym), INEGI.

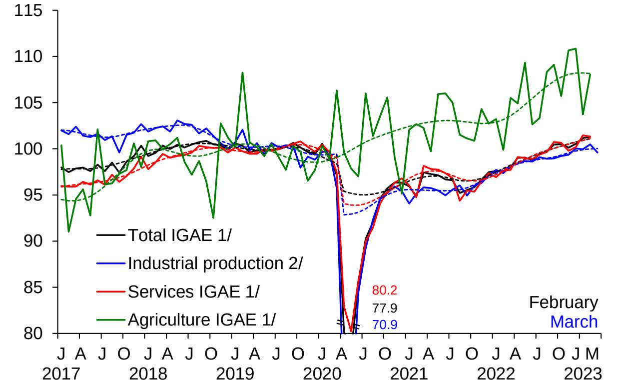
Chart 14
Total Manufacturing Exports
Indices 2019 = 100, s. a.



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. The chart's range was adjusted to facilitate its reading
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, and the National System of Statistical and Geographical Information (SNIEG, for its Spanish acronym), Information of national interest.

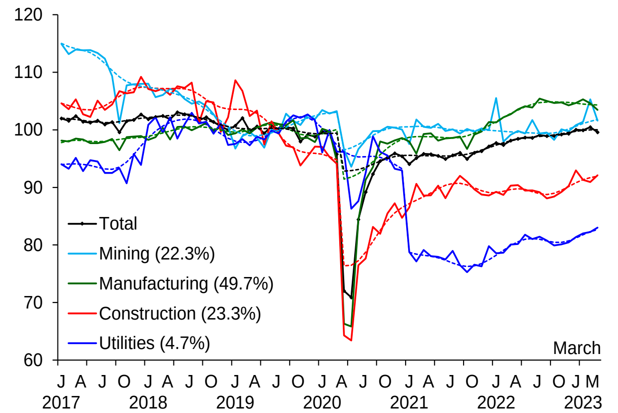
On the production side, during the first bimester of 2023, services increased their dynamism, after having slowed during the previous quarter. This reflected the good performance across most of its components (Chart 15). Industrial activity contracted in March, mainly due to the weakness in manufacturing. Mining reversed much of the expansion of the previous month. In contrast, construction registered an increase (Chart 16).

Chart 15
Global Indicator of Economic Activity
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures as of February 2023.
2/ Figures as of March 2023 from the Monthly Industrial Activity Indicator.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

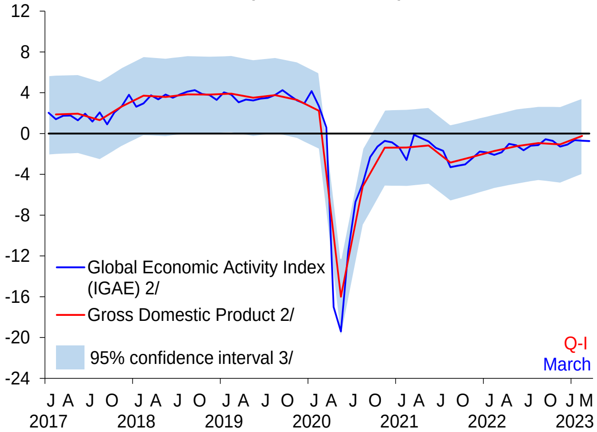
Chart 16
Industrial Activity [1/]
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted 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 2013.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

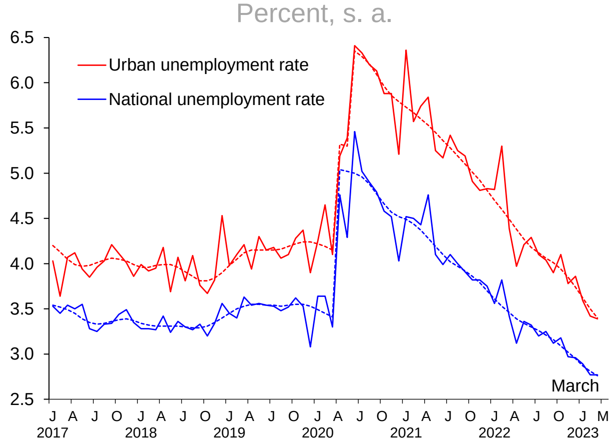
Regarding the cyclical position of the economy, in light of the growth of economic activity during the first quarter of 2023, negative output gap point estimate continued closing (Chart 17). During the first quarter of the year, the national and urban unemployment rates continued decreasing and remained at particularly low levels (Chart 18). Seasonally adjusted figures for April show that the creation of IMSS-insured jobs maintained its dynamism. Finally, in March 2023, unit labor costs in the manufacturing sector continued trending upwards and were above the average level reported in 2022 (Chart 19).

Chart 17
Output Gap Estimates [1/]
Percent of potential output, s. a.



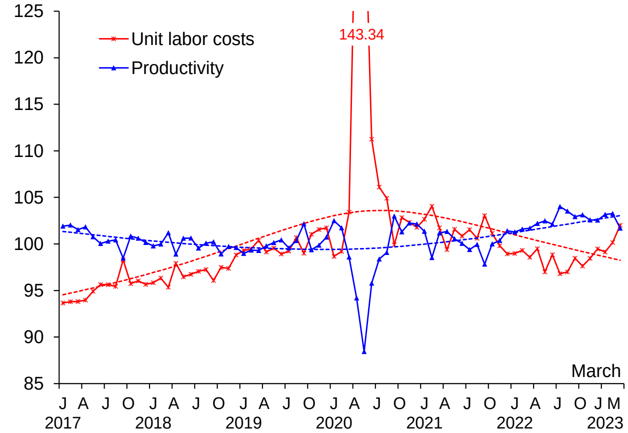
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.74.
2/ GDP figures up to Q1-2023 and IGAE implicit up to March 2023, consistent with said timely figure.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and Urban Unemployment Rates
Percent, s. a.



s. a. / Seasonally adjusted 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 data from ENOE, ETOE (from April to June 2020), and ENOE new edition (ENOE[N]) from July to date.

Chart 19
Productivity and Unit Labor Costs in the Manufacturing Sector [1/]
Indices 2019 = 100, s. a.



a.e. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line. The range of the chart was narrowed to make it easier to read.
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 March 2023, domestic financing to firms registered a positive real annual variation for the ninth consecutive month. Bank credit to firms continued recovering gradually, although it moderated its rate of expansion compared to the fourth quarter of 2022. This slowdown was observed only for large firms. In those issuing regularly in stock markets, part of the contraction in bank credit reflected the fact that this group of firms resorted to debt markets to obtain funds and used a proportion of them to pay off bank debt. In contrast, credit granted to smaller firms maintained a high level of dynamism. This occurred in a context in which the demand of firms for credit continued recovering. Lending standards were more restrictive for large companies and thus remained tight. These conditions, however, have tended to ease for smaller firms since the second half of 2021.

As for credit to households, in March 2023, commercial bank housing portfolio maintained its rate of expansion. Performing credit to consumption continued growing in real annual terms as a result of the dynamism of credit cards and payroll loans. This has taken place in a context in which household demand for credit has continued to increase in general. Mortgage lending and consumer credit conditions remained relatively stable.

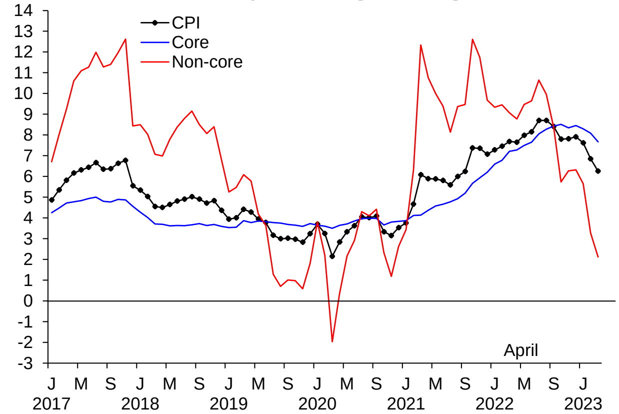
In March 2023, interest rates on bank credit to firms increased consistent with the behavior of the reference rate, reaching levels above those observed at the end of 2019. Corporate credit intermediation margins remained at levels below those of February 2020, although they increased for the second consecutive quarter for smaller firms. Although interest rates on mortgages increased from July 2022 to January of this year, and then remained practically unchanged, their levels remained relatively low. In December 2022, credit card interest rates increased with respect to the level observed in the third quarter. Those for payroll loans registered similar levels.

As for portfolio quality, in March 2023 corporate and housing loan delinquency rates remained stable with respect to those observed in the previous month and at low levels. Finally, consumer portfolio delinquency rates did not show significant changes, following the increases observed in the three previous months, and remain at levels below those registered prior to the onset of the pandemic.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation decreased from 6.85 to 6.25% between March and April 2023 (Chart 20 and Table 1). This decline was due to the reduction in both non-core and core inflation. Headline and core inflation, however, remain at high levels.

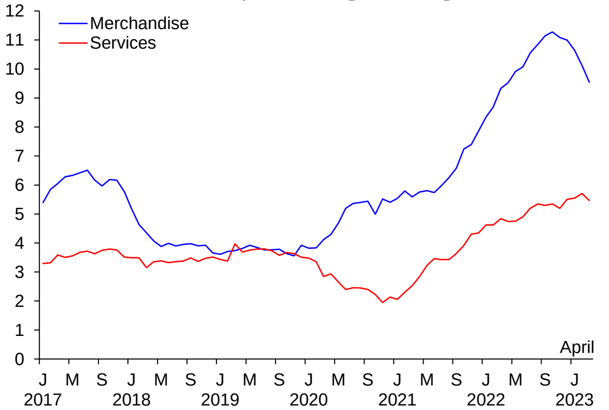
Chart 20
Consumer Price Index
Annual percentage change



Source: INEGI.

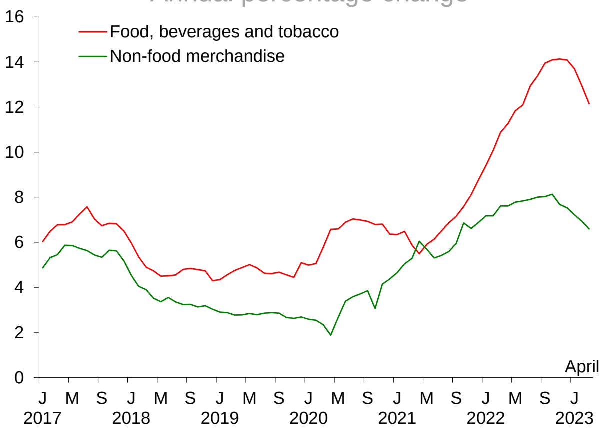
Between March and April 2023, annual core inflation declined from 8.09 to 7.67%. This performance mainly reflected the decrease in annual merchandise inflation from 10.12 to 9.54% (Chart 21). Within its components, the annual variation of food merchandise prices continued decreasing, although still from high levels, from 12.95 to 12.14% in those months. The annual variation of non-food merchandise prices continued decreasing, registering 6.93 and 6.59% between the referred dates (Chart 22). Meanwhile, annual services inflation decreased from 5.71 to 5.46% during the same period. This result reflected a decrease from 7.72 to 7.10% in the annual variation of prices of services other than education and housing. In this regard, the reduction in the annual variation of prices of travel services, which is known for its volatility and seasonal effects, stood out. In contrast, the annual variation of housing prices continued increasing from 3.54 to 3.67%.

Chart 21
Merchandise and Services Core Price Sub-index
Annual percentage change



Source: INEGI.

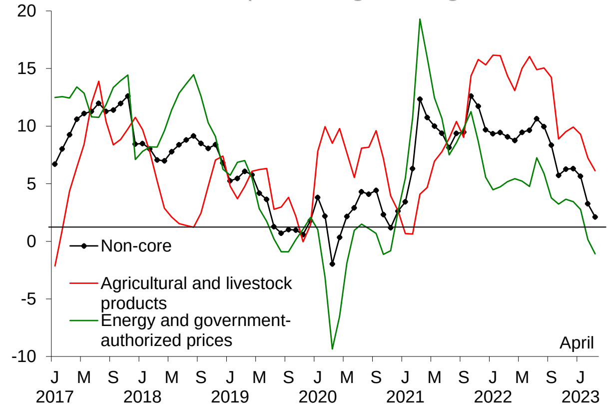
Chart 22
Merchandise Core Price Sub-index
Annual percentage change



Source: INEGI.

Between March and April 2023, annual non-core inflation decreased from 3.27 to 2.12% (Chart 23 and Table 1). This result was mainly influenced by the decline from -2.26 to -4.21% in the annual variation of energy prices, where the decrease from -21.32 to -26.38% in the price of L.P. gas and from 3.19 to 2.43% in the price of gasoline stood out. The annual variation of agricultural and livestock product prices decreased from 7.24 to 6.13% during the same months. This mainly reflected a reduction from 5.82 to 3.73% in the prices of fruits and vegetables.

Chart 23
Non-core Price Sub-index
Annual percentage change



Source: INEGI.

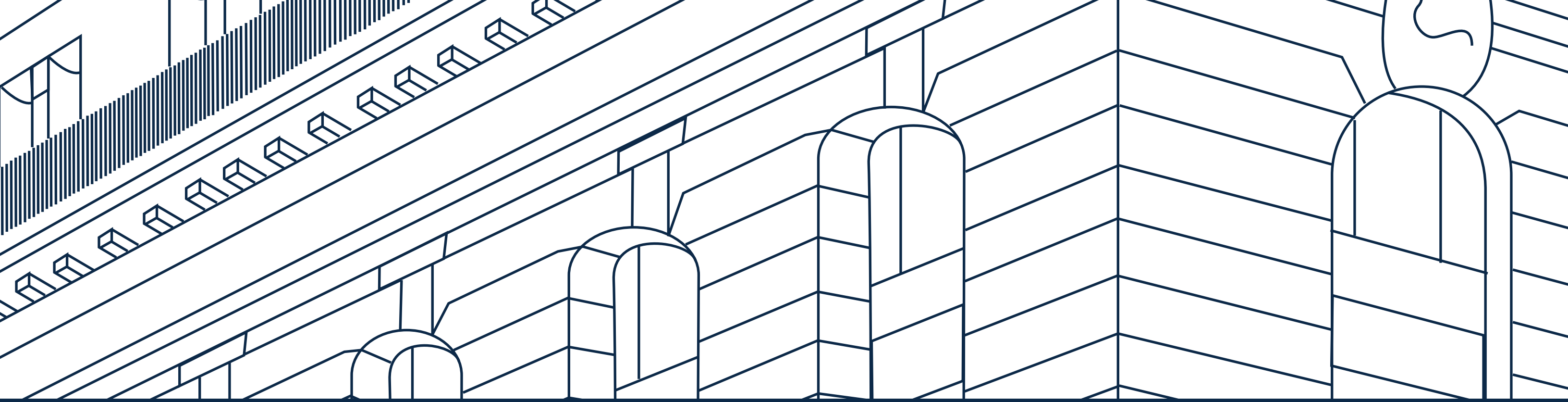
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between February and April 2023, the medians for headline and core inflation for the end of 2023 decreased from 5.28 to 5.05% and from 5.40 to 5.36%, respectively. Meanwhile, the medians for headline and core inflation expectations for the end of 2024 increased slightly from 4.07 to 4.10% and from 4.04 to 4.10%, respectively. The median of headline inflation expectations for the next four years remained at 3.80%, while that for core inflation decreased from 3.85 to 3.80%. The median of headline inflation expectations for longer terms (5 to 8 years) decreased from 3.60 to 3.55%, while that for the core component increased slightly from 3.50 to 3.55%. Finally, compensation for inflation and inflationary risk decreased during the reported period, although it remains at high levels. Within it, inflation expectations implied by market instruments remained stable and continue at high levels, while the inflation risk premium declined.

Inflation is still expected to converge to the 3% target in the fourth quarter of 2024. This projection is subject to risks. On the upside: i) persistence of core inflation at high levels; ii) foreign exchange depreciation due to volatility in international financial markets; iii) greater cost-related pressures, and iv) pressures on energy prices or on agricultural and livestock product prices. On the downside: i) a greater-than-anticipated slowdown of the world economy; ii) a lower pass-through effect from some cost-related pressures; iii) a better functioning of production and distribution chains; and, iv) a larger-than-anticipated effect from the Federal Government's measures to fight elevated prices. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.

Table 1
Consumer Price Index and Components
Annual percentage change

Item	February 2023	March 2023	April 2023
CPI	**7.62**	**6.85**	**6.25**
Core	**8.29**	**8.09**	**7.67**
Merchandise	**10.65**	**10.12**	**9.54**
Food, beverages and tobacco	13.70	12.95	12.14
Non-food merchandise	7.22	6.93	6.59
Services	**5.55**	**5.71**	**5.46**
Housing	3.43	3.54	3.67
Education (tuitions)	4.83	4.88	4.88
Other services	7.51	7.72	7.10
Non-core	**5.65**	**3.27**	**2.12**
Agricultural and livestock products	**9.29**	**7.24**	**6.13**
Fruits and vegetables	8.12	5.82	3.73
Livestock products	10.22	8.37	8.01
Energy and government-authorized prices	**2.77**	**0.16**	**-1.08**
Energy products	1.50	-2.26	-4.21
Government-authorized prices	5.93	6.35	6.78

Source:INEGI.



BANCO DE MÉXICO®

Document published on June 1, 2023