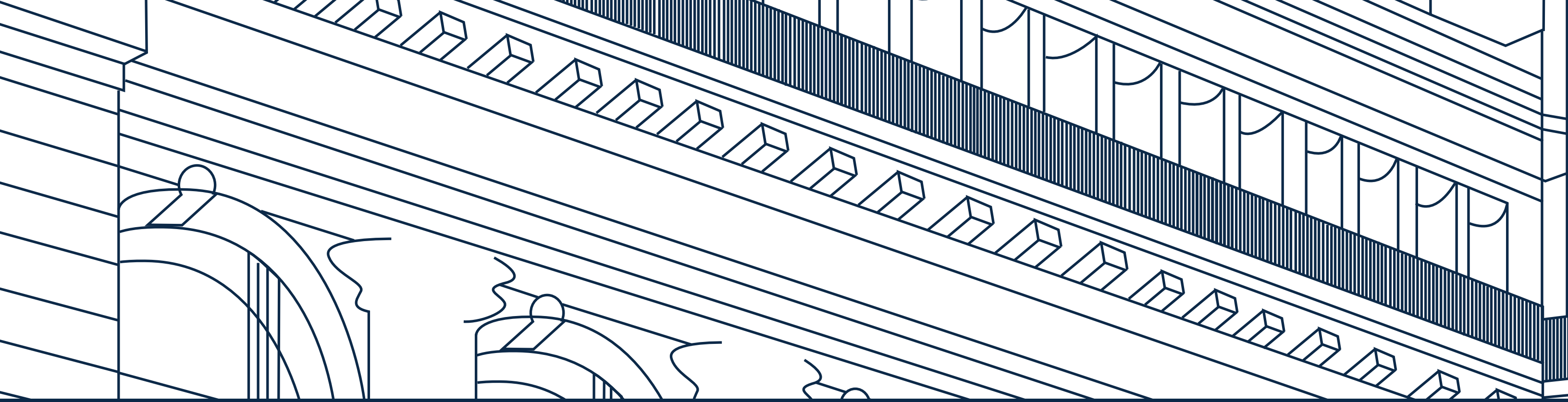

BANCO DE MÉXICO®

Minutes number 104

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on November 9, 2023

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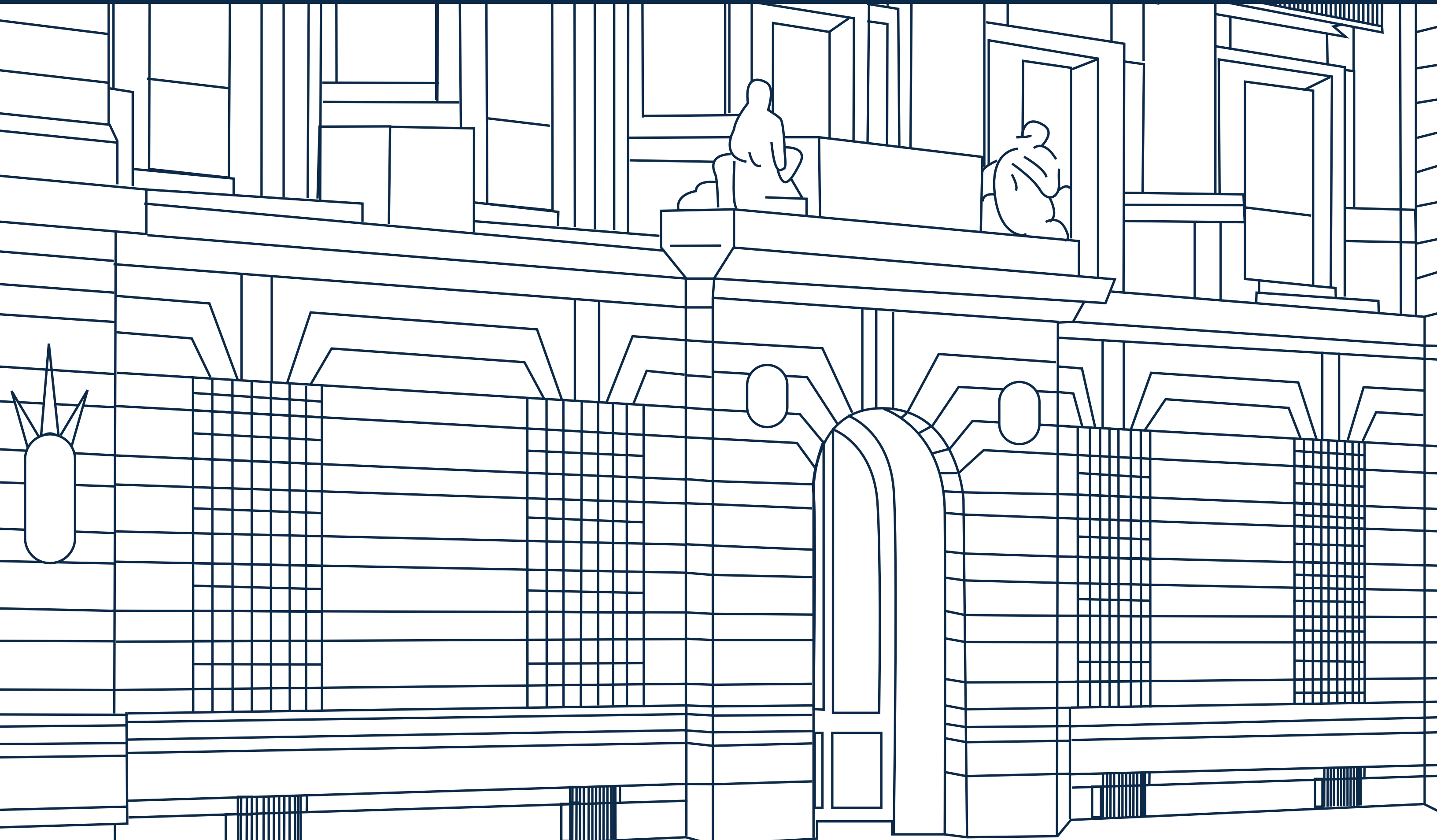

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: November 8, 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.
- Eduardo Magallón, Alternate 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 stated that during the third quarter world economic activity continued expanding. Some members highlighted that the rate of growth was greater than in the second quarter. **Some** members pointed out that it was also higher than anticipated. **Most members added that economic growth has been heterogeneous across countries. In this regard, they noted the resilience of the US economy. Some** members associated said resilience with the support from private consumption. They mentioned that in the euro area economic activity contracted. With respect to China, **some** members stated that, during the same period, economic activity surprised to the upside. However, **one** member noted that, from a longer-term perspective, the Chinese economy has slowed down. **Another** member indicated that investment in said economy remains weak. He/she added that timely indicators continue suggesting a deceleration in the manufacturing sector in advanced economies and a weakening in the emerging ones. He/she pointed out that for both groups of economies the corresponding indicators for the services sector are trending downwards, although they remain in expansion territory. **One** member mentioned that in the United States economic growth has been more resilient than expected. He/she added that global growth forecasts by international organizations remained unchanged since Mexico's last monetary policy decision, although for the United States they were revised upwards for 2023 and 2024.

Some members considered that the balance of risks to global economic activity remains biased to the downside. **One** member emphasized the risk associated with challenges in the real estate sector in China. He/she added that, in the United States, uncertainty prevails as to the impact of the tightening of financial and credit conditions, a reduction in households' excess savings, and the effect of higher interest rates once the refinancing needs of businesses and households arrive.

Some members highlighted that labor markets remain tight in several countries. **One** member mentioned that significant wage-related pressures persist. However, **another** member stated that these markets continue exhibiting signs of a better balance between supply and demand. He/she pointed out that, in the United States, the non-farm payroll has trended downwards in recent months even with some surprises to the downside, and the unemployment rate has increased slightly. In this context, he/she underlined that nominal wage growth in the United States has moderated.

Most members pointed out that headline inflation continued decreasing in most economies. Nevertheless, they indicated that it is still above the central banks' targets in a large number of these economies. Some members underlined that in certain cases headline inflation has rebounded somewhat. **One** member attributed the above to the evolution of energy prices. **Another** member mentioned that various pressures on prices have been easing insofar as the effects of the shocks associated with the pandemic and the military conflict in Ukraine have been dissipating. He/she emphasized that the above, along with tight monetary conditions worldwide, have contributed to the decline of inflation at the global level. **Most members underlined that overall inflation is expected to converge to central banks' targets by the end of 2024 or during 2025. As for core inflation, they pointed out that it has declined more gradually than headline inflation. Some** members stated that, regarding core inflation components, services' prices remained subject to significant pressures. **Most members emphasized that the geopolitical conflict in the Middle East could have repercussions on the global inflationary outlook. However, they noted that, so far, its effects have been limited. One** member stated that geopolitical shocks are often associated with increases in commodity prices, especially those of energy products, and that sometimes they have led to economic contractions and severe inflationary periods. He/she added that the transmission of these shocks typically depends on three factors: their magnitude and duration, the cyclical position of the global economy and the macroeconomic balances that prevail. **Another** member expressed that, up to now, international crude oil reference prices have declined. **Some** members argued that, looking ahead, it will be relevant to continue monitoring the evolution of the military conflict and its potential implications for economic activity, inflation, and global financial markets.

Most members pointed out that the majority of central banks in advanced economies left their reference rates unchanged. Some members added that these authorities are expected to be nearing the end of their hiking cycles. Nevertheless, **one** member considered that they have left open the possibility of additional increases. **Some** members added that the central banks remain cautious and data-dependent. **Most members highlighted that the monetary authorities in the major advanced economies are expected to maintain high reference rates for an extended period. One** member indicated that the European Central Bank stated in its latest monetary policy decision that such policy would contribute substantially to the convergence of inflation to its target. **Another** member cautioned about the risk of a premature easing by monetary authorities, which, in his/her opinion, would hinder the attainment of goals within the foreseen horizon.

Most members mentioned that, in its November meeting, the US Federal Reserve left the target range for the federal funds rate unchanged. One member added that this is the second consecutive pause, and that the chairman of that institution highlighted that tighter financial and credit conditions are likely to affect economic activity, the labor market, and inflation. However, he pointed out that the extent of these effects remains uncertain. **Another** member mentioned that the chairman underlined the dependence on incoming data for subsequent decisions.

All members pointed out that, after Banco de México's previous monetary policy meeting, international financial markets exhibited higher volatility. Most members highlighted that the US dollar registered a generalized appreciation, in a context of greater risk aversion. They added that long-term sovereign interest rates increased significantly worldwide. They pointed out that the expectation that reference rates in the main advanced economies will remain high for a longer period than previously anticipated, contributed to the above. Some members stated that concerns regarding the financing needs of the United States also affected the above. **One** member stated that interest rates in the United States reached levels unseen since 2006. He/she mentioned that yield curves exhibited increases in several countries. **Another** member warned that tighter global financial conditions could significantly impact financing costs, especially for governments with unprecedented high levels of public debt, leaving them with no room for maneuver to face future shocks. He/she underlined that emerging economies continue registering outflows from fixed-income assets and more moderate outflows from equity assets. **However, most members mentioned that these adjustments in financial markets tended to revert in recent days. Some** members indicated that this occurred after the release of figures that showed a moderation in the dynamism of the US labor market and after the Federal Reserve's monetary policy decision. **One** member explained that, so far this year, assets in Asian economies exhibited an unfavorable performance, while assets in Europe and Latin America continued performing positively.

Economic activity in Mexico

Most members underlined that, according to the GDP flash estimate of the third quarter of 2023, the Mexican economy exhibited a higher-than-expected dynamism. Some members indicated that the economy expanded at a rate of 0.9% with respect to the previous quarter, which represented an acceleration relative to the two previous quarters. **Most members stated that the growth rate remains robust**. **They pointed out**

that the economic expansion has been driven by the three sectors of the economy. However, **one** member mentioned that growth of aggregate activity, excluding the construction sector, has moderated.

On the production side, **some** members stated that industrial production continued expanding. They mostly attributed it to the high dynamism of construction. They particularly highlighted the strength of public construction associated with railway works, and, to a lesser extent, of private construction of industrial, commercial, and service buildings associated with the infrastructure projects in the southern part of Mexico. Meanwhile, **some** members underlined that manufacturing shows stagnation. **One** member added that a slight decline in capacity utilization has been observed, except in the automotive industry. **Some** members indicated that services continued trending upwards, although with a differentiated behavior among sectors. **One** member added that some of those sectors show declines.

As for domestic demand, all members highlighted that investment has maintained high growth rates. Some members underlined that gross fixed capital formation is growing at a faster rate than economic activity overall. **Most members noted that the dynamism of investment is mainly attributed to non-residential construction, although they added that investment in machinery and equipment has also contributed to it. One** member mentioned that expectations generated by the nearshoring phenomenon are fueling these two sectors. However, **another** member underlined that investment in machinery and equipment has slowed down.

Most members highlighted the dynamism of consumption. Some members considered that the favorable performance of this indicator is attributed to the dynamics of the imported goods' segment. **One** member noted that domestic goods and services show weakness, which could persist, especially in the case of services. **Another** member pointed out that consumption has been supported by labor market dynamics, the increase in remittances, certain public policies that have allowed a strengthening of households' consumption, and by the high growth rate of consumption credit. **Some** members agreed that domestic spending has gained more relevance in the dynamism of the Mexican economy. **One** member mentioned that domestic spending is expected to continue contributing to the resilience of Mexico's economic activity.

Regarding the external sector, most members pointed out that manufacturing exports exhibit a heterogeneous behavior across components. Some members distinguished between the significant dynamism of automotive exports and the weakness of non-automotive ones. However, **one** member pointed out that the latter are at relatively high levels. **Another** member mentioned that it cannot be ruled out that a greater-than-expected slowdown in the US economy could moderate external demand. **One** member reflected on the importance of external demand as a driving force for economic activity from a medium-term perspective, especially for the recovery after the shock in the second quarter of 2020. He/she explained that, nevertheless, as the reopening process and the normalization of expenditure patterns advanced, private consumption has gained relevance.

Most members indicated that the point estimate for the output gap is positive. Some members mentioned that it is not statistically different from zero. **One** member pointed out that it has expanded into positive territory. **Another** member agreed that indicators suggest tight conditions. **One** member mentioned that, if the economy remains resilient, its cyclical position will exhibit tighter conditions. However, **another** member underlined that said tight conditions are expected to fade gradually, although it will be important to remain vigilant over the implications for the economy's price formation process. Likewise, **one** member argued that the consumption gap indicator has been turning less positive, while the labor market one has stopped increasing, despite remaining at elevated levels.

Most members pointed out that the labor market remains strong. They underlined that the unemployment rates remain at historic lows. One member highlighted that the unemployment gap is clearly in negative territory. **Another** member mentioned that the labor participation rate is high. **Some** members pointed out that the number of IMSS-insured jobs continued growing. **One** member stated, however, that these have been increasing at a slower rate, which could be reflecting, in part, the lack of dynamism of manufacturing. **Another** member considered that the higher levels of employment observed in the northern border's free zone could be associated with the nearshoring process.

Most members stated that annual wage growth remains high. Some members underlined that wages of IMSS-insured workers continue registering double-digit annual variations. Nevertheless, **some**

members noted that this wage indicator has started to stabilize. **One** member added that its growth rate rebounded slightly in September. **Another** member added that considering the evolution of wages in the National Occupation and Employment Survey (ENOE, for its acronym in Spanish) they seem to respond with some lag to the dynamics of inflation, and thus an adjustment process in wages due to the previously observed high levels of inflation could still be taking place. He/she expressed that, to preserve price stability, it is necessary to remain vigilant to labor dynamics not extending these pressures for longer. **One** member added that the 12-month moving average of contractual wage revisions for private firms increased to 9.3%.

Inflation in Mexico

All members agreed that inflation has decreased significantly in Mexico. Most members underlined that headline inflation continues trending downwards. They pointed out that, in view of the progress in the disinflation process, headline inflation registered a level of 4.26% in October 2023. One member stated that this is the lowest figure since February 2021. **Another** member noted that headline inflation fell 444 basis points from its maximum level of 8.70% registered in August 2022. He/she added that various inflation trend measures are on a downward trajectory, and that the share of the CPI basket items with seasonally adjusted annualized monthly variations higher than 10% has decreased. This figure has dropped from around 40% in 2022 to approximately 10% in the latest data. **One** member agreed that various metrics point to the consolidation of a clear and sustained convergence trajectory towards the target. He/she added that variations in headline inflation have been closer to their historical averages and more in line with what was observed prior to the pandemic. **Some** members asserted that the monetary policy stance has contributed to the progress in the disinflationary process. **One** member also added the dissipation of shocks associated with the pandemic and the military conflict in Ukraine. He/she underlined that the disinflationary process has advanced amid a complex external environment and a resilient economic activity in Mexico. **Some** members considered that the performance of various inflation determinants has improved. **One** member exemplified the above with the stabilization of nominal wages, the deceleration of consumption, and the improvement in inflation expectations for different terms. He/she added that lower inflation levels will lead to less frequent price revisions. However, **another** member noted that, although headline inflation has continued decreasing, its decline has slowed down. **One** member emphasized the significant contribution of the non-core component to the decline in headline inflation over the last year, as well as the equally important role of the base effects.

Most members highlighted that the decline in headline inflation in October was mainly supported by the favorable evolution of the core component. They indicated that the latter continued decreasing and registered 5.50% in said month. One member pointed out that its contribution has gained greater relevance, and that, in recent months, it has accounted for almost the entire decline in headline inflation. **Most members noted the 301 basis-point decline in the core component since its highest level registered in November 2022. One** member specified that, while it has decreased more gradually than headline inflation, the magnitude of its decline is only comparable to the disinflation observed between 2009 and 2015. **Another** member added that, as in the case of headline inflation, various trend measures of core inflation also show an improvement, such as the trimmed mean, which is on a decreasing trajectory, as well as the fraction of the basket with extreme variations, which has declined markedly relative to a year ago. However, **one** member warned that the annualized monthly rate of this component appears to have resumed an upward trend.

Most members highlighted the mixed behavior within the core component. They described that merchandise inflation continues decreasing, while services inflation still does not show a clear downward inflection point. Regarding the former, **one** member stated that in October it registered 5.64%, having maintained a clear downward trend since November 2022, when it attained its maximum level of 11.28%. He/she pointed out that over the 16-month period between July 2021 and November 2022, merchandise inflation increased by approximately 550 basis points, while during the disinflationary phase this increase has reversed in less than a year, reflecting a relatively rapid reduction. **Some** members attributed this good performance to the normalization of supply chains, the lower prices of various commodities, and the foreign exchange rate appreciation. They specified that the appreciation has contributed to ease pressures on imported goods' prices.

Regarding services inflation, most members noted that it has rebounded in its latest readings.

Some members mentioned that the annual variations in the prices of educational, housing, and tourism services have increased. They added that the remaining services exhibit a high resistance to decline from elevated levels. **Most members expressed that services inflation continues being subject to significant pressures. They underlined that cost increases have not been fully passed on to services prices yet. Some** members mentioned that this is due to the slow recovery of demand for them. **One** member added that, in general, the difference in the performance of merchandise and services is attributed to the nature of non-simultaneous shocks and their unsynchronized fading process. He/she added that pressures on services prices also reflect, in part, that their production implies a higher share of labor costs as compared to merchandise. He/she pointed out that said pressures emerged during the second half of 2022 and became more prominent in 2023. **Another** member argued that services prices continue to reflect the impact of the shocks associated with the pandemic and the military conflict in Ukraine, and that for this reason its evolution is not necessarily explained by domestic pressures.

Most members noted that non-core inflation remained at unusually low levels, reaching 0.56% in October. One member recalled that this component shifted from 10.65% in August 2022 to -0.67% in July 2023. However, he/she noted that its rebound has been lower than expected.

Most members noted that longer-term inflation expectations remained relatively stable at levels above target. Some members pointed out that they remained above their historical averages. **One** member underlined that, while their median has exhibited few adjustments, other measures such as the interquartile range and skewness point to an improvement in their distribution. **Some** members added that short-term expectations have decreased gradually. **One** member stated that they remain at levels above 4%. **Another** member pointed out that both their trend and their dispersion have systematically shown a resistance to decline. However, **one** member mentioned that in October the median of expectations for the next 12 months continued declining with respect to its level in March. **Another** member warned that the anticipated increase in annual headline inflation for November and December could affect short-term inflation expectations. As for expectations drawn from market instruments, **one** member indicated that breakeven inflation rose mainly due to the increases in the inflation risk premium for different terms.

Most members mentioned that headline and core inflation are still anticipated to trend downwards. They added that the central bank forecasts still foresee inflation converging to the target in the second quarter of 2025. Some members pointed out that these forecasts remained practically unchanged from the previous meeting. **One** member noted that the expected decline in inflation during 2024 considers the implemented monetary policy actions, as well as prospects that various pressures on inflation will continue to dissipate. **Another** member stated that he/she expects the mitigation of the shocks associated with the pandemic and the military conflict in Ukraine to be reflected in a more noticeable reduction in services inflation. **Most members noted that temporary increases in headline inflation are anticipated in November and December. Some** members explained that non-core inflation is expected to show additional increases in the coming months. **One** member indicated that, although a rebound of inflation is anticipated in some periods, it is expected to continue on a downward trend.

All members stated that, despite the progress in disinflation, the outlook continues to be challenging. In this regard, they agreed that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member considered that this balance has increased its upward bias due to the resilient economic activity, the tight labor market, the persistence of core inflation, inflation expectations that are not reversing, and a procyclical fiscal policy. **Another** member stated that the balance of risks has improved with respect to that observed in March. He/she partly attributed this to the greater relevance of the risk of an external slowdown that moderates external demand. He/she added that the revision of forecasts at the September policy meeting implied the materialization of the risk on core inflation's persistence. **One** member argued that to continue labeling the balance of risks as biased to the upside does not mean that the environment is as adverse as it was last year. He/she pointed out that at that time the upward bias meant the possibility that inflation would increase at an even greater rate than what was being observed, while in the disinflation phase it means that inflation could decrease more gradually than what is foreseen during the forecast horizon.

Among upside risks, most members highlighted core inflation's persistence at high levels. However, **one** member expressed that this risk might have decreased as a result of the current lower levels of inflation. He/she stated that, based on empirical evidence, the higher the levels of inflation, the greater the probability that high levels of inflation become entrenched in the economy. Consequently, he/she argued that the reduction already shown by the core component might have eased this risk. **Most members mentioned as a risk episodes of exchange rate depreciation in case of international financial volatility. One** member warned that this could undermine the positive contribution that the exchange rate has had on input costs. **Some** members highlighted that market structures that have not allowed for greater competition in certain products could contribute to a slower reduction in inflation.

As an additional upside risk to inflation, most members noted the possibility of a greater-than-expected resilience of the economy and that the labor market remains tight. One member added that, given that the cyclical position of the economy suggests tight conditions, it will be necessary to remain alert to their implications for the price formation process. In this regard, **another** member warned that higher-than-expected demand-related pressures are likely to be observed, especially considering that the output gap is in positive territory. **One** member considered that the dynamism of both aggregate demand and the labor market points to greater pressures on prices and suggests that the disinflationary process could slow down. He/she stated that this, along with the dissipation of the base effect and the expected increase in the non-core component, raise the possibility that inflation remains above the variability range longer than expected. **Some** members mentioned the pro-cyclical fiscal policy as a risk. **One** member noted that although a lower deficit than the one approved is expected for 2023, a public balance deficit of 4.9% of GDP is anticipated for 2024. He/she mentioned that, the above, together with changes in the composition of government expenditures, implies substantial challenges for the fiscal consolidation foreseen for 2025. Additionally, he/she argued that the lack of a plan to ensure Pemex's viability in the medium and long terms, beyond the support granted to provide it with liquidity, represents a risk for the sustainability of public finances and for credit ratings.

Most members mentioned the possibility of higher-than-expected cost-related pressures. One member considered that due to the still incomplete pass-through of costs and the fact that the adjustment of relative prices between services and merchandise has not yet concluded, services inflation could continue being subject to pressures in the coming months. He/she stated that costs could increase more than expected, due to the aforementioned tightening of the labor market and to idiosyncratic factors, such as the levels of insecurity, the anticipated minimum wage increases, and the effects of Hurricane Otis. Regarding the latter, he/she emphasized that greater weight should be given to climate-related factors in the balance of risks to inflation. **Some** members highlighted the risk of pressures on energy prices due to the escalation of geopolitical conflicts. As for downside risks, **some** members underlined the possibility of a greater-than-anticipated slowdown of the world economy, as well as a lower pass-through effect from some cost-related pressures.

Macrofinancial environment

All members indicated that, in line with developments in international markets, volatility increased in domestic financial markets. They highlighted that after the last policy meeting, the Mexican peso depreciated. Most members stated that trading conditions in the foreign exchange market deteriorated somewhat. One member added that for some weeks the Mexican peso lost part of its attractiveness despite maintaining a high interest rate differential, given the increase in its volatility, higher than that of other currencies. However, **another** member noted that, considering the events throughout 2023, the Mexican peso continued standing out among its peers due to its resilient performance. **Most members expressed that recently, once risk aversion in international markets decreased, the peso reversed part of the depreciation it had registered.**

The majority noted that, since the previous policy meeting, interest rates on government securities increased for all terms. They pointed out that, in line with developments in international financial markets, these adjustments tended to reverse in the last few days. Some members highlighted that Mexico’s sovereign rates exhibited a high correlation and sensitivity to the evolution of US Treasury bonds. **One** member pointed out that the stock market registered a negative performance, affected by the industrial sector. **Another** member asserted that sovereign risk premia decreased, showing a behavior different from that of other emerging economies. **One** member mentioned that the tightening of financial conditions and its potential effects on domestic financial markets must be monitored. **Some** members argued that the implied expectations for the path of the reference rate in TIIE swaps adjusted upwards and exhibited some volatility, discounting with a greater probability that the first interest rate cut takes place between the March and May decisions and that subsequent decreases will be gradual.

Regarding financing in the economy, **some** members noted that total financing continued increasing. **One** member highlighted that its growth rate in real terms rose to 2.8%. **Some** members pointed out that the expansion is attributed to the domestic component. **One** member stated that external financing decreased. **Some** members highlighted the increase in credit to consumers and to firms. **One** member indicated that, according to information from the third quarter, there has been an increase in the demand for credit, although in certain cases the general conditions or lending approval standards have tightened. He/she stated that the dynamism in credit reflects the favorable performance of the economy and the strength of the labor market. **Another** member indicated that, based on October figures, the financial conditions index in Mexico tightened somewhat and remains in restrictive territory, although at relatively low levels. He/she mentioned that delinquency rates are at low and stable levels, although those corresponding to consumption have recently increased marginally.

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 acknowledged the progress of the disinflationary process in Mexico. Nevertheless, it deemed that the outlook is still challenging. Based on the above, and taking into consideration the monetary policy stance already attained and the persistence of the shocks that the Mexican economy is facing, with the presence of all its members, the Board decided unanimously to maintain the target for the overnight interbank interest rate 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 considers that, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, the reference rate must be maintained at its current level for some time. The latter, taking into account that although the outlook remains complicated, progress on disinflation has been made. 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 argued that while the current inflationary outlook is less adverse than the one faced in 2022, it remains complicated and with upside risks, and thus monetary policy should continue to be conducted with a cautious approach. He/she considered that the reference rate should remain at its current level, taking into account the revised forecasts from the September policy decision, the pressures on prices, mainly of services, and the levels of headline and core inflation that still prevail. However, he/she asserted that such levels reflect not only the road that remains to be covered, but also the significant progress in disinflation. In this regard, he/she highlighted the decrease in headline and core inflation since the third and fourth quarters of 2022, respectively, and that, looking forward, disinflation is expected to remain underway. In this context, he/she argued that the possibility of adjusting the reference rate downwards could begin to be evaluated in the policy meetings of the first quarter of 2024. He/she noted that such option would be on the table and that the decisions to be taken would be subject to available information. He/she added that acting cautiously will be required given the challenges that still prevail, so that when macroeconomic conditions allow for downward adjustments, these would be gradual. He/she noted that, depending on the evolution of the inflationary outlook, a cycle of continuous decreases would not necessarily take place. In this regard, he/she pointed out that decisions should be such that the monetary policy stance remains solid. In particular, he/she specified that the restrictive stance should continue to contribute to the reduction of inflation in order to achieve the convergence of inflation to the target. He/she reiterated that monetary policy's priority must continue to be to reduce inflation and consolidate an environment of low and stable inflation. He/she stated that such a policy is consistent with the primary mandate of price stability and that it is for the benefit of Mexico's population.

Another member mentioned that, although significant progress has been made in the disinflationary process, an environment of high uncertainty and risks still prevails. He/she stated that it is not yet possible to declare victory in the battle against inflation and that Banco de México must not drop its guard. In this context, he/she considered that the reference rate should remain at its current level. He/she pointed out that, looking ahead, several factors may hinder the expected path of inflation and complicate the conduction of monetary policy. Among these factors, he/she highlighted a higher-than-expected growth; a pro-cyclical fiscal policy; and the possibility of fiscal pressures derived from the need to support the population affected by Hurricane Otis; all of this with a positive point estimate for the output gap and with an outlook for it narrowing further. Regarding the external front, he/she underlined the lengthening of the Federal Reserve's strategy of maintaining higher interest rates for a longer period, which could trigger new episodes of depreciation. He/she also mentioned the possibility of a prolongation or escalation of geopolitical conflicts that could affect commodity prices and the stability of financial markets. He/she reiterated that given the increase in the upward bias of the balance of risks for inflation, it is necessary to maintain the level of monetary restriction attained. He/she pointed out that the statement of this decision should maintain a cautious tone, underline the high level of uncertainty, and highlight that the upwards bias in the balance of risks for inflation has increased. He/she indicated that, although there is the possibility of adjusting the monetary policy stance in the first quarter of next year, it is subject to assumptions related to the inflationary outlook, which can change rapidly under the present adverse environment, given the risks mentioned above. He/she expressed that, for this reason, it is neither prudent nor necessary to bring forward a signal that could change soon, especially when the market has already internalized the possibility of a first cut to the reference rate between March and May of next year. He/she mentioned that a flexible and data-dependent approach should be maintained, and that such communication should be evaluated once again in the next policy decision.

One member considered that, while the reference rate should remain at its current level, in the policy decisions of the first quarter of 2024 a discussion regarding the possibility of a fine-tuning of the reference rate could begin. He/she argued that such discussion could take place depending on available information suggesting that the risks that have been pointed out have not materialized, and that inflation remains on the foreseen trajectory. He/she highlighted that progress in disinflation must be acknowledged. He/she noted that, due to the reduction in 12-month inflation expectations, the ex-ante real interest rate has increased by almost 80 basis points since March. He/she argued that in the next months said rate should be maintained between 7 and 7.5% in order to guarantee the convergence of inflation to the target; for this reason, the fine-tuning, in his/her opinion, would take place in order to prevent the ex-ante real rate from moving out of that interval. He/she stated that Banco de México should use more and better forward guidance, in line with the recommendations of international organizations. He/she stated that the period during which the reference rate will remain fixed should no longer be categorized as “extended”, and it should rather be indicated explicitly that it will remain unchanged at least until the end of the year. He/she expressed that it should be made clear that next year's policy decisions will be subject to the evolution of incoming data, in order for expectations about the first cut to the reference rate not to be anticipated or postponed in an unjustified manner. He/she noted that analysts estimate a first adjustment to the rate in March 2024, while, according to market instruments, this would occur between March and May. He/she pointed out that expectations should be monitored so that they do not diverge significantly as a reflection of the greater uncertainty about the next reference rate adjustment. He/she recommended communicating that, although monetary policy normalization seems distant, occasional and gradual adjustments during the first quarters of next year are not ruled out. He/she pointed out that, given the domestic pressures, when conducting monetary policy, the main objective should be the absolute policy stance. Regarding the relative stance, he/she stated that the interest rate differential between Mexico and the United States is sufficient to counter financial volatility, although he/she warned that this has started to affect the exchange rate, which could reduce the positive contribution it has had on input costs. He/she added that the lack of coordination between fiscal and monetary policies could delay the transmission of monetary policy and hinder its normalization. He/she argued that, in his/her opinion, monetary policy transmission in Mexico is less effective than in other countries, due to the low levels of financial depth and inclusion, low credit penetration, the high levels of informality, and the lack of competition in the financial system. He/she pointed out that, this same lack of competition in other sectors has allowed those firms with market power to continue increasing their prices, despite the fact that the supply shocks which drove those increases have dissipated. He/she stated that the above has slowed down the decline in inflation.

Another member stated that the reference rate should still remain at its current level for some time, and that the restrictive monetary policy stance should probably be maintained throughout the forecast horizon in order to mitigate risks, consolidate the downward trend in inflation, and continue lowering its expectations. In this regard, he/she highlighted that the disinflationary process has advanced, particularly in the last twelve months, at a speed unseen since the 3% target was set, supported, in part, by the restrictive monetary policy stance. He/she added that price dynamics have started to come close to their historical pattern and that the decrease in inflation cannot be attributed to short-run factors alone, and thus, in general, the observed determinants of inflation have been more consistent with what Banco de México has foreseen. However, he/she stated that inflation expectations have decreased gradually, which could be because in Mexico the formation of inflation expectations seems to be more of a retrospective process rather than a prospective one. He/she mentioned that this is more noticeable in the behavior of business sector expectations. He/she pointed out that in economies where the formation of expectations is of a more retrospective nature, monetary tightening has a lesser effect on inflation than in economies where there are more prospective conditions. He/she considered that the monetary policy transmission channels continue operating in the right direction, although with a heterogeneous impact on economic activity and inflation, and thus they require some time to continue contributing to the disinflationary process. He/she also recalled that the balance of risks for inflation is still biased to the upside. He/she mentioned that, taking all of the above into consideration, an equilibrium must be achieved between the progress in disinflation and the existing risks within the forecast horizon. He/she argued that, given the increase in the ex-ante real interest rate and the tighter monetary conditions, which are reflected in the real exchange rate and in market instruments, it would be possible to evaluate, later on, whether the observed and anticipated disinflationary process are compatible with lower nominal interest rate levels. He/she argued that, given the environment of uncertainty surrounding decision-making, monetary policy's approach should remain prudent, cautious and gradual, in line with the challenges that continue to be faced, in order for inflation to converge to the target, and consistent with seeking an orderly behavior of markets, the financial system, and the economy as a whole.

One member mentioned that the monetary policy stance is sufficiently solid and that, along with the mitigation of inflationary shocks, it has improved the inflationary outlook. Highlighting the progress made, he/she pointed out that the ex-ante real rate is at a clearly restrictive level of around 373 basis points above the neutral range. He/she also underlined that, since March, when the rate reached its current level, headline and core inflation have, both, accumulated 259 basis point declines. He/she stated that the improvement in the inflationary outlook has been observed in its determinants; thus, the lower inflation level will signify less frequent price revisions, wages have stabilized and consumption has decelerated, while inflation expectations continue showing improvements. Furthermore, he/she stated that its balance of risks, without ignoring that it remains biased to the upside, has improved relative to March given the latest forecast revision and certain downside risks that have gained relevance, such as a possible deceleration of the global economy. However, he/she argued that challenges remain, such as the core component's persistence, due, in part, to the behavior of services, which continue to be affected by the shocks of the pandemic and the conflict in Ukraine. He/she stated that monetary policy has been consistent with an environment characterized by a resilient economic activity and an inflation partly stemming from shocks over which monetary policy has no effect. He/she pointed out that, in this complex environment, monetary policy has prevented expectations from becoming unanchored and a contamination of the price formation process. He/she argued that, considering the improvements in the inflationary outlook and that the transmission channels are operating and will continue to have an incidence on inflation in the following quarters, there is room to discuss cuts to the reference rate. He/she mentioned that the challenge is to adjust the monetary policy stance in order to be consistent with the fact that inflation, while still above target, is already trending downwards. He/she stated that, considering the expected progress on the inflationary outlook, the first reference rate cut could occur at the beginning of the first quarter of 2024. He/she mentioned that, in a context in which the disinflationary process may not be linear, the solid monetary policy stance would continue operating even if rate adjustments are implemented. He/she added that, given the prevailing environment of uncertainty, adjustments would be gradual and not necessarily continuous. He/she deemed it adequate to communicate that the reference rate will remain at its current level for some time and that looking ahead a restrictive policy stance that ensures the convergence of inflation to the target should continue.

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 acknowledged the progress of the disinflationary process in Mexico. Nevertheless, it deemed that the outlook is still challenging. Based on the above, and taking into consideration the monetary policy stance already attained and the persistence of the shocks that the Mexican economy is facing, with the presence of all its members, the Board decided unanimously to maintain the target for the overnight interbank interest rate 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 considers that, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, the reference rate must be maintained at its current level for some time. The latter, taking into account that although the outlook remains complicated, progress on disinflation has been made. 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 maintaining the target for the overnight interbank interest rate at 11.25%.

5. DISSENTING OPINIONS/ VOTES

Dissenting opinion on the monetary policy statement. Irene Espinosa.

Although inflation has been decreasing, its convergence to the target in the second quarter of 2025 has become more challenging. During the current half of the year, the disinflationary process has slowed down. Core inflation has fallen mainly due to the decline in merchandise inflation as services inflation has shown a resistance to decline and recently it has increased. In my opinion, the upward bias in the risks to inflation has increased, with a more resilient economic activity, a cyclical position of the economy in positive territory, a tight labor market, core inflation persistence, non-core inflation trending upwards, inflation expectations above our target and not reverting, and a procyclical fiscal policy for 2024. Looking ahead, the commitment to attain fiscal consolidation starting in 2025 represents an additional enormous challenge. Under such conditions, I believe we should remain prudent and cautious in our communication and avoid modifying our forward guidance in advance, given the high level of uncertainty regarding inflation’s downward trajectory.

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.

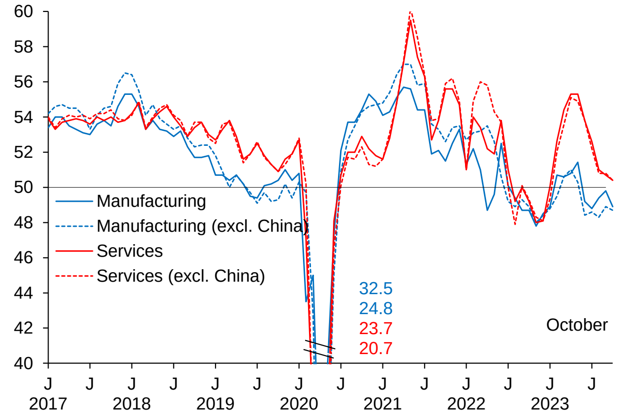
A.1. External conditions

A.1.1. World economic activity

During the third quarter of 2023, global economic activity is expected to have expanded at a greater rate than in the previous quarter, with economic performance remaining quite heterogeneous across countries. The United States and China exhibited greater dynamism as compared to the second quarter. In contrast, economic activity in the euro area remained weak. Purchasing Managers' Indices point to a deceleration in the services sector, mainly in advanced economies, and to a continuous weakness in global manufacturing activity (Chart 1). Among global risks, the following stand out: persistence of inflationary pressures, intensification of geopolitical tensions, tighter financial conditions, and, to a lesser extent, challenges to financial stability.

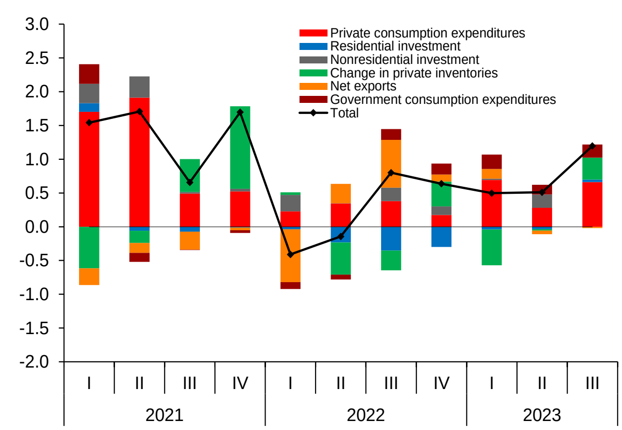
During the third quarter of 2023, economic activity in the United States expanded more than expected at the beginning of the period. Gross Domestic Product (GDP) increased at a seasonally adjusted quarterly rate of 1.2%, after having grown 0.5% in the second quarter (Chart 2).[1] This growth was mainly driven by private consumption, inventory accumulation, and government spending. The strike in the automotive industry is estimated to not have generated significant effects during this quarter.

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: Figures in the chart correspond to respective minimum levels of each 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: Bureau of Economic Activity (BEA).

In September, US industrial production maintained a lackluster performance as it expanded at a seasonally adjusted monthly rate of 0.3%, after having remained stagnant in August. This growth was driven by progress in the manufacturing and mining sectors, which was partially offset by a decline in electricity and gas generation.

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 4.9% in the third quarter of 2023.

Manufacturing activity increased 0.4% as a result of growth in durable goods' production. Looking ahead, Purchasing Managers' Indices suggest that activity in the services sector will be moderate and manufacturing production will remain somewhat sluggish.

In the United States, the non-farm payroll continued expanding, albeit at a more moderate pace. New job creation figures decreased from a monthly average of 233 thousand during the third quarter to 150 thousand in October. The number of new vacancies remained at high levels. Wages registered lower growth, adjusting from a monthly average of 5.9% during the second quarter to 5.4% in the third one. Initial claims for unemployment insurance remained at low levels. The unemployment rate increased marginally from 3.8% in September to 3.9% in October.

In the euro area, economic activity contracted at a seasonally adjusted quarterly rate of 0.1% in the third quarter of 2023, after having remained weak during the previous two quarters.[2] This was the result of a lower external demand and tight domestic financial conditions that would have eased residential and business investment. Additionally, the manufacturing sector remained weak and the services sector lost dynamism. In September, relative to the previous month, the unemployment rate increased slightly to 6.5%.

Economic activity in the major emerging economies is expected to have expanded during the third quarter of 2023. However, the rate of economic growth in Europe and Emerging Asia, as well as Latin America, is estimated to have differed across countries. In the case of China, higher growth was registered in the third quarter with respect to the second one, as a result of a rebound in retail sales and despite the stagnation in industrial production and lower fixed investment. During this period, a stimulus package designed to boost the growth of China's economy was implemented.

International commodity prices exhibited a mixed behavior since Mexico's previous monetary policy decision. Crude oil reference prices decreased between late September and the second half of October, due to the increase in Russian exports and higher crude oil production in Nigeria and Iran. Subsequently, certain upward pressures were observed in mid-October due to the political tensions caused by the conflict in the Middle East, which could involve major oil producers in that region. Said pressures decreased at the end of October due to the mitigation of the conflict's impact on these goods' prices and the increase in production by some members of the Organization of the Petroleum Exporting Countries (OPEC) and the United States. Meanwhile, natural gas reference prices increased during the first half of October due to the lower production, a higher demand amid lower temperatures in the United States, damages to a gas pipeline in the Baltic Sea, strikes by gas sector workers in Australia, and tensions in the Middle East. Grain prices increased slightly in October due to droughts in South America, as well as the blockade and attacks on Ukrainian ports by Russia. Finally, industrial metal prices overall trended downwards in October due to weak investment in China's real estate sector and expectations that the United States will maintain high interest rates for a longer period. However, in early November, metal prices rebounded in the context of news about the fiscal stimulus in China.

A.1.2. Monetary policy and international financial markets

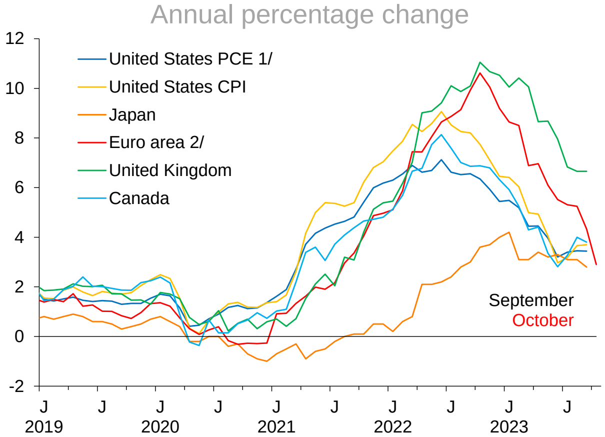
In a large number of major advanced and emerging economies, annual headline inflation continued decreasing, although in some cases it increased in its more recent readings. In most countries it remains at elevated levels and above their central banks' targets. Core inflation continued to decline.

In some advanced economies, pressures on energy prices resulted in increases in headline inflation (Chart 3). In some of these countries, these pressures have started to ease. In most advanced economies, core inflation decreased in its last reading. Nevertheless, this component has declined gradually, largely reflecting some persistence of pressures on services' prices. In the United States, annual headline inflation measured by the consumer

[2] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 0.2% in the first quarter, 0.6% in the second quarter of 2023 and -0.4% in the third quarter of 2023.

expenditure deflator remained virtually unchanged, declining marginally from 3.45% in August to 3.44% in September. Hence, it still remains at levels above the 2% target. A lower annual deflation in energy prices and a decrease in both food inflation and the core component were observed. The annual variation of the latter shifted from 3.8 to 3.7% during the same period. US headline inflation measured by the personal consumption expenditures price index increased marginally in annual terms from 3.67% in August to 3.70% in September. Annual core inflation decreased from 4.3 to 4.1% during the same period.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



1/ The personal consumption expenditures price index is used.
2/ Preliminary figures as of October.
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 major advanced economies remained relatively stable. Although these forecasts continued anticipating a moderation of headline inflation throughout 2024 relative to the levels foreseen for 2023, it would remain above the central banks' targets. Longer-term inflation expectations drawn from financial instruments exhibited relative stability with respect to the levels registered in late September.

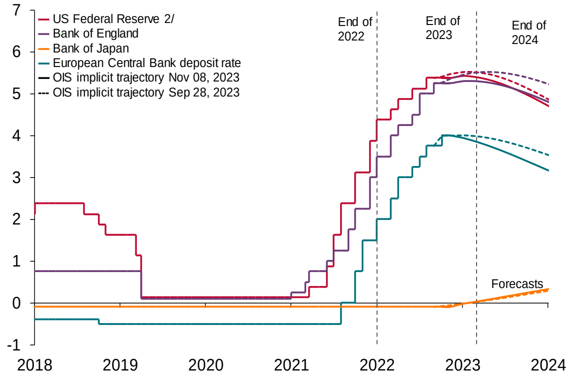
In a large number of emerging economies, annual headline inflation decreased as a result of lower pressures on energy and food prices and on the core component. In most of the major emerging economies, it remains above their respective central banks' targets. Nevertheless, in other countries, such as South Africa, India and Indonesia, it was within each central bank's variability interval. In the particular cases of China and Thailand, annual headline Inflation remained close to 0%. In most of the major emerging economies, core inflation declined.

In this environment, since Mexico's last monetary policy decision, the central banks of the main advanced and emerging economies have made heterogeneous adjustments to their monetary policy reference rates, depending on the evolution of economic indicators which, at the same time, have exhibited differences across countries. Regarding future adjustments, several central banks highlighted that these will depend on the evolution of relevant data and on the inflationary outlook. However, some central banks anticipate that their reference rates will remain at restrictive levels for a longer period, in order for inflation to return to its target level.

Since the previous monetary policy decision, the central banks of major advanced economies left their reference rates unchanged during the analyzed period. However, in October, the Bank of Japan decided to further increase flexibility in controlling the country's yield curve, compared to what it had stipulated in its July meeting.[3] As for asset-purchase programs, most central banks in this group of economies continued to gradually reduce their securities' holdings. Regarding expectations for the monetary policy rate of the main advanced economies, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) are expected to remain at their current levels for the remainder of 2023 and to decline starting in the second quarter of 2024 (Chart 4).

[3] The Bank of Japan indicated that, despite maintaining the target level for yields on 10-year Japanese government bonds (JGB) at around 0%, it will conduct yield curve control by allowing these yields to fluctuate with an upper limit of 1.0 percentage point from the target level. Additionally, it will carry out large-scale purchases of JGBs.

Chart 4
Reference rates and trajectories implied in OIS curves1/
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.

Regarding recent monetary policy decisions in the United States and the euro area, the following stood out:

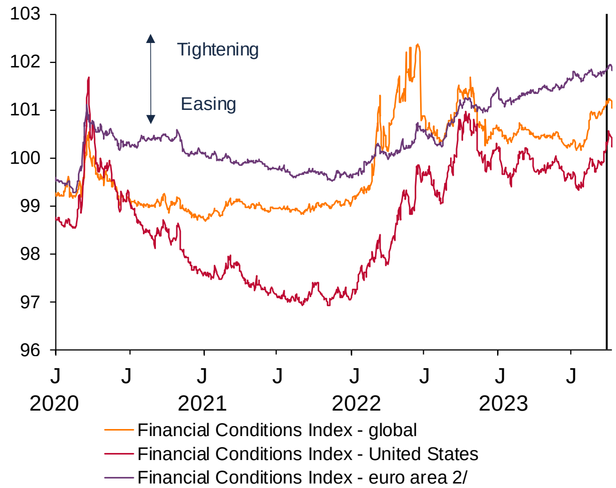
i) At its November meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the second consecutive decision. The target range thus remained between 5.25 and 5.50%. The Fed also continued to reduce the size of its balance sheet. It reiterated that it will continue evaluating incoming information and that, in order to determine the degree of additional tightening that might be appropriate, it will take into account the cumulative tightening of monetary policy, the lags with which it affects economic activity, and inflation, as well as economic and financial developments. During the press conference, the chairman of that institution stated that the Committee will continue assessing in their future decisions whether additional tightening is required to return inflation to its target. He added that the Committee is not considering policy rate cuts at this time. Based on the latest available information, expectations drawn from financial instruments anticipate an interest rate level of 5.4% in the first quarter of 2024, which would subsequently decline to levels near 4.7% towards the end of that year.

ii) After increasing its reference rate by 25 basis points in September, the European Central Bank (ECB) left it unchanged in October. Thus, its refinancing, key lending and key deposit rates thus stood at 4.50, 4.75 and 4.00%, respectively. In this regard, its Governing Council considers that interest rates are at levels that, if maintained for a sufficiently long period, will contribute substantially to the timely return of inflation to its target. It also reiterated that it will continue using a data-dependent approach to determine the appropriate level and duration of monetary tightening. The president of that institution indicated that it is premature to consider a discussion about a rate cut.

Since Mexico's last monetary policy decision, in the main emerging economies, most central banks left their interest rates unchanged. Such was the case, for instance, of the central bank of China. However, considering the specific economic circumstances in each country, some of them announced cuts, such as the central banks of Brazil, Chile, Peru, Poland, and Hungary. In contrast, the central banks of Indonesia and the Philippines raised their reference rates for the first time since the beginning of this year, while the central banks of Russia and Turkey continued raising their monetary policy rates.

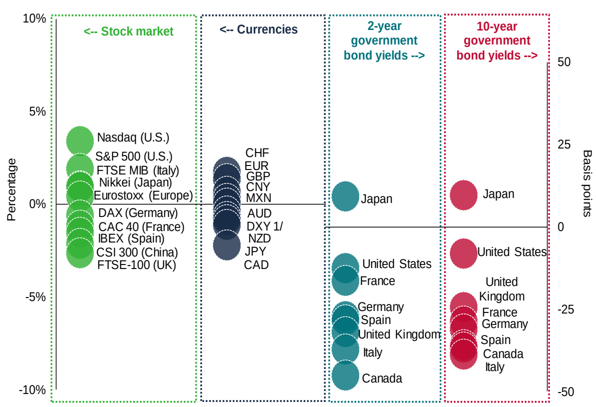
International financial markets registered high volatility and tighter financial conditions since the last monetary policy decision, which slightly moderated at the margin (Chart 5). The tightening of financial conditions responded to concerns regarding the fiscal position in the United States and expectations of a tight monetary policy stance for a longer period than previously anticipated, among other factors. Thus, in most advanced economies, sovereign debt interest rates rose in October. However, in early November, this trend was interrupted by the expectation of a less tight monetary policy stance by the US Federal Reserve. Figures suggesting a certain rebalancing in slack conditions in the US labor market partly contributed to the above. Stock markets in both advanced and emerging economies registered some losses overall (Chart 6). In foreign exchange markets, the US dollar remained stable. Since Mexico's last monetary policy decision, the currencies of most emerging economies exhibited a mixed behavior against the US dollar (Chart 7
. Lastly, during the reporting period, emerging economies registered moderate capital outflows, which were observed in both equity assets and 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 September 28 to November 8, 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 September 22, 2023
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-1.58%	-0.79%	-5	-4	-19
	Brazil	0.75%	1.85%	38	2	-21
	Chile	1.77%	-3.73%	74	28	-3
	Colombia	0.04%	0.75%	6	-35	-29
	Peru	0.01%	-5.24%	26	30	2
Emerging Europe	Russia	3.46%	5.69%	260	-64	N.D.
	Poland	3.78%	9.46%	9	-27	-3
	Turkey	-4.68%	-2.22%	663	244	-15
	Czech Rep.	0.65%	2.52%	-38	-19	-1
	Hungary	3.28%	3.59%	-4	12	3
Asia	China	0.39%	-2.36%	12	-4	-10
	Malaysia	0.99%	1.00%	2	-9	4
	India	-0.33%	-1.59%	12	12	-13
	Philippines	1.55%	-1.05%	46	38	-7
	Thailand	1.42%	-6.92%	-1	0	8
	Indonesia	-1.06%	-1.97%	50	10	-6
Africa	South Africa	2.58%	-0.31%	-22	-32	-12

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 1, 2022.
Source: Bloomberg.

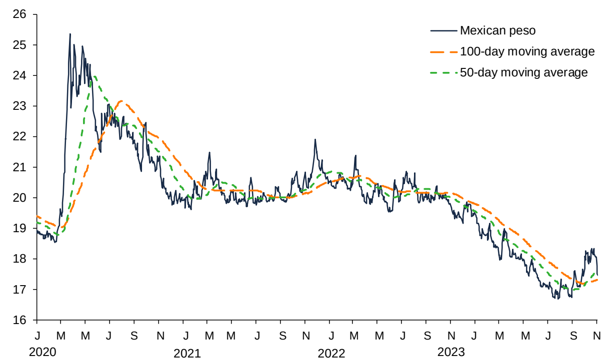
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described, the Mexican peso depreciated and interest rates on government securities increased for all terms. However, in line with the behavior of international financial markets, these adjustments tended to reverse.

In particular, the Mexican peso maintained a depreciating trend since Mexico's last monetary policy decision. However, in the latest trading sessions, the currency registered an appreciation similar to that of other emerging countries. The Mexican peso traded in a range of 1 peso and 13 cents, between 17.20 and 18.33 pesos per US dollar. Hence, during the period it registered a depreciation of 1.58% (Chart 8).

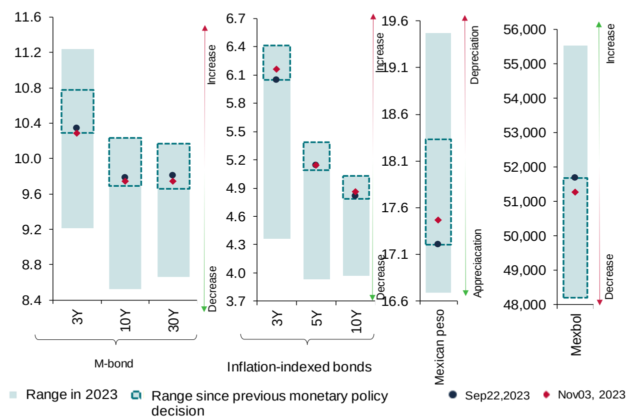
Chart 8
Mexican peso exchange rate
MXN/USD



Source: Prepared by Banco de México.

Interest rates registered negative dynamics during most of the period, with increases along the entire curve. This trend recently exhibited a significant correction. As a result, at the end of the period, marginal changes were observed for most terms with respect to the levels prevailing at the moment of the previous monetary policy decision in Mexico (Chart 9).

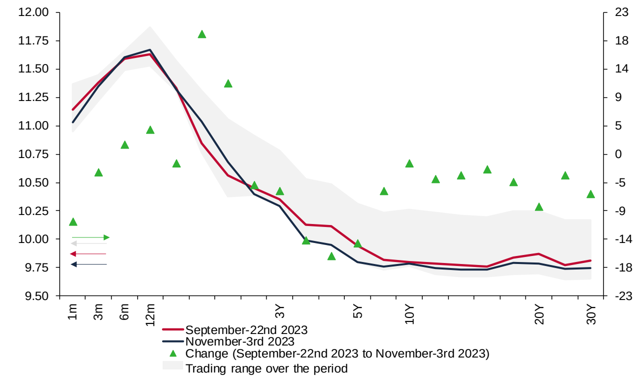
Chart 9
Mexican markets' performance
Percent, MXN/USD and index



Source: Prepared by Banco de México.

Interest rates on government securities registered mixed dynamics, with increases of up to 20 basis points in the short term and decreases of up to 9 basis points in the long-term nodes (Chart 10). The yield curve of real rate instruments fluctuated within a narrow range without a defined trend. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments exhibited volatility throughout the period, closing with decreases in all terms (Chart 11). These movements occurred in an environment in which trading conditions slightly deteriorated.

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



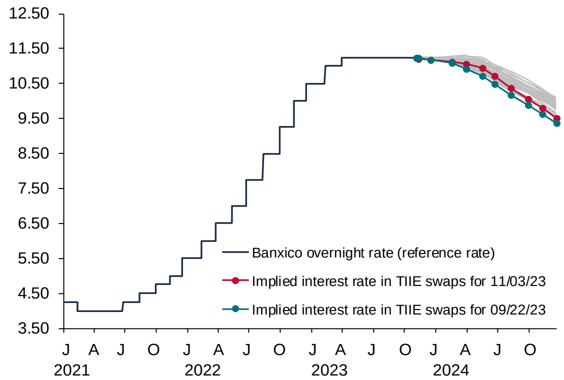
Source: PIP.

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

Source: PIP.

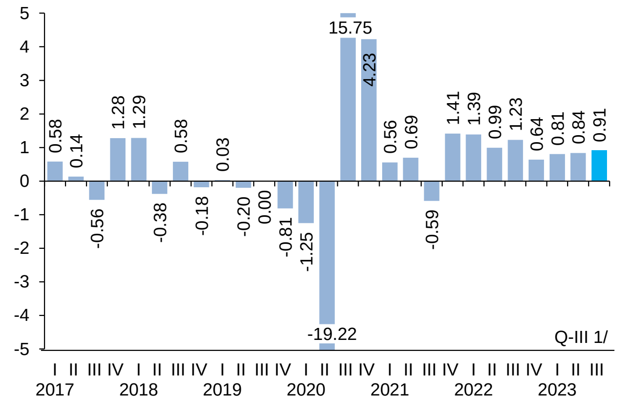
Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve does not foresee any adjustment for the November decision and incorporates the first cut of 25 basis points between March and May 2024 (Chart 12). Most analysts surveyed by Citibanamex anticipate that the interest rate will remain unchanged for the rest of 2023.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent



Note: Shaded areas represent the range since the last monetary policy decision.
Source: Prepared by Banco de México with Bloomberg data.

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



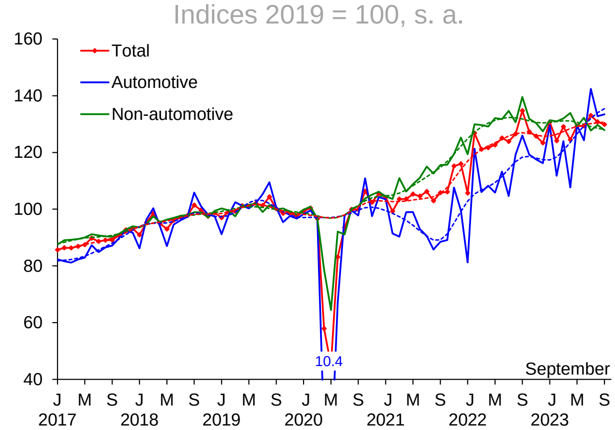
s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
1/ The figure corresponding to the third quarter of 2023 refers to the quarterly GDP flash estimate published by INEGI.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

A.2.2. Economic activity in Mexico

According to Mexico's GDP flash estimate published by INEGI, in the third quarter of 2023, economic activity was resilient and continued experiencing robust growth, by expanding at a seasonally adjusted quarterly rate of 0.9% (Chart 13).

During the bimester July-August 2023, private consumption continued growing as a reflection of a certain acceleration in the consumption of goods, given that the consumption of services has trended downwards since the end of the second quarter. During the same period, gross fixed investment maintained a significant dynamism. This was mainly due to the strength of non-residential construction investment. Spending on investment in machinery and equipment moderated its rate of growth. As for external demand, during the period of July-September, the value of manufacturing exports increased with respect to the second quarter. This was due to a rebound in automotive shipments (Chart 14). The rest of manufacturing exports contracted.

Chart 14
Manufacturing exports
Indices 2019 = 100, s. a.

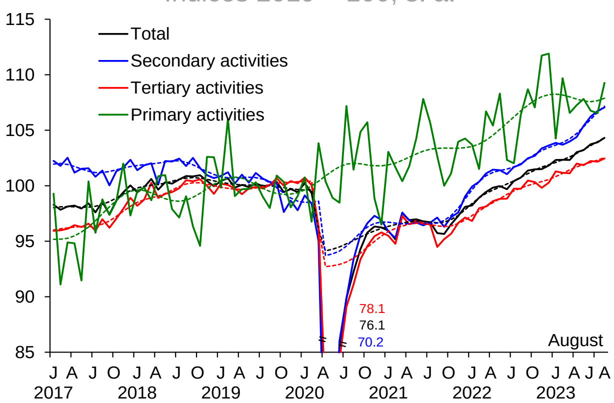


s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Prepared by Banco de México with data from the Tax Administration Service (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 bimester July-August, industrial activity continued showing a positive performance (Chart 15). This is attributed to the high dynamism of construction (Chart 16), particularly the extraordinary pace of expansion of civil engineering works. Manufacturing remained stagnant, as a result of the fall in transportation equipment in August and the weakness in the rest of manufacturing. The equipment sector is expected to reverse its August decline, given the performance of light vehicle manufacturing reported in September. Services as a whole remained resilient and continued trending upwards. However, a differentiated behavior was observed among its subsectors.

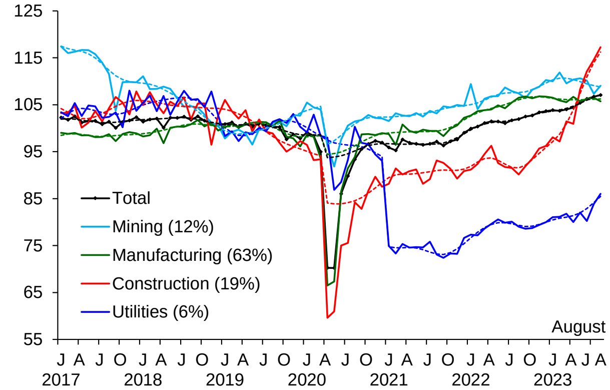
Regarding the cyclical position of the economy, the point estimate of the output gap, which was already in positive territory, widened, without being statistically different from zero (Chart 17). The labor market continued showing strength. In September, both national and urban unemployment rates remained at low levels (Chart 18). With seasonally adjusted figures, between July and October, the number of newly created IMSS-insured jobs continued increasing, although with a lower dynamism than that registered in the first half of the year. Finally, in August, unit labor costs in the manufacturing sector registered particularly high levels, from a historical perspective (Chart 19).

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



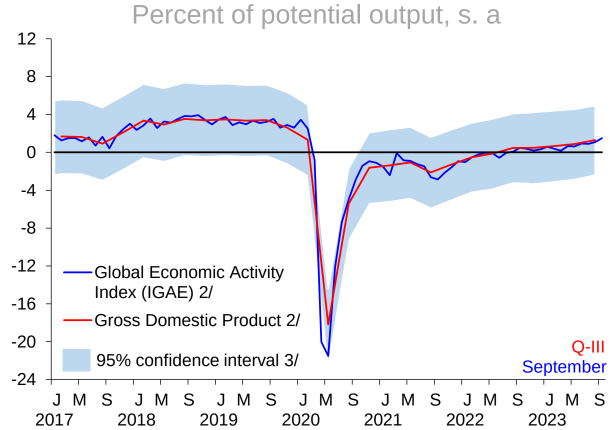
s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line. The range of the chart was narrowed to facilitate reading.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

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



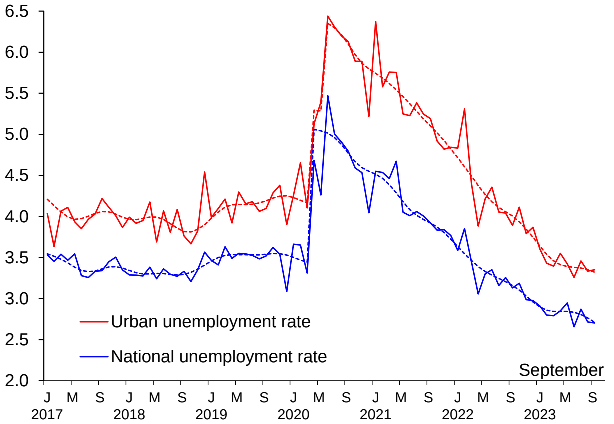
s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

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



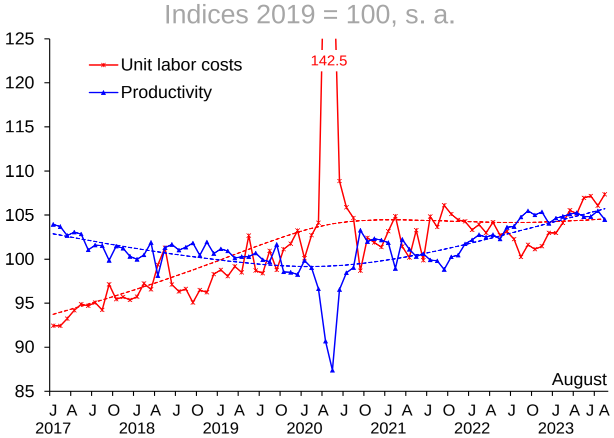
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.74
2/ GDP flash estimate up to Q3-2023 and IGAE implicit up to September 2023, consistent with said timely 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.

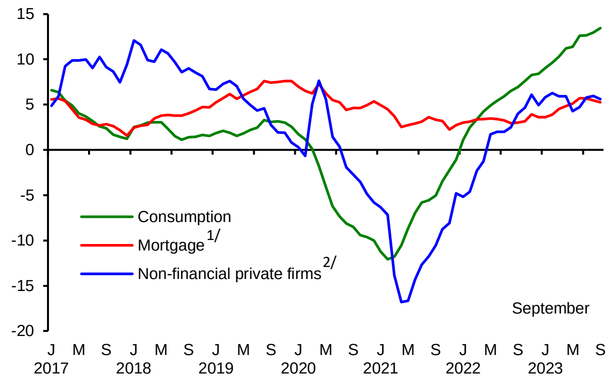
Chart 19
Productivity and unit labor costs in the manufacturing sector [1/]
Indices 2019 = 100, s. a.



s. a. / 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 September 2023, domestic financing to the private sector continued showing dynamism. Within it, bank lending to firms continued expanding, and thus its real annual variation reached levels similar to those observed at the beginning of the year (Chart 20). As for lending to households, the bank housing portfolio continued increasing. Meanwhile, commercial bank consumer credit registered the highest rates of change since the first half of 2013. The dynamism of commercial bank credit to the private sector continued to be driven mainly by an increased demand for financing from firms and households, in line with the continued expansion of economic activity and the strength of the labor market.

Chart 20
Performing credit from commercial banks to the non-financial private sector
Real 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.

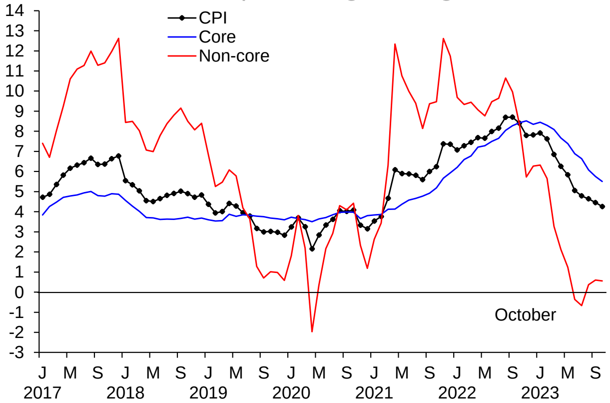
As for the cost of financing, interest rates on bank lending to firms remained stable and at high levels in September 2023. Corporate credit intermediation margins continued to be generally lower than those observed prior to the pandemic. Interest rates on mortgages did not register significant changes with respect to previous months, and continued being at levels similar to pre-pandemic ones. Within consumer credit, credit card interest rates have been adjusting with a lag to changes in the reference rate, after having remained relatively stable until June 2022. Lastly, interest rates on payroll loans have remained relatively stable since August 2021.

As for portfolio quality, in September 2023 corporate and mortgage delinquency rates remained at low levels similar to those of August. Consumer portfolio delinquency rates continued being at levels lower than those registered prior to the onset of the pandemic, although they increased for the fourth consecutive month.

A.2.3. Development of inflation and inflation outlook

Progress on disinflation continued in Mexico. Annual headline inflation decreased from 4.45% in September 2023 to 4.26% in October. This downward adjustment was mainly due to the reduction in core inflation, as the decline in non-core inflation was marginal (Chart 21).

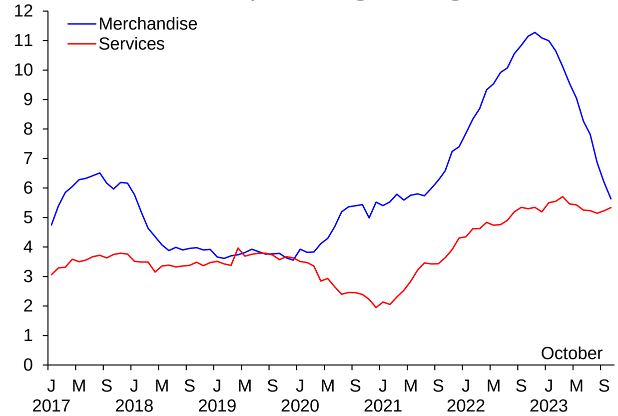
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

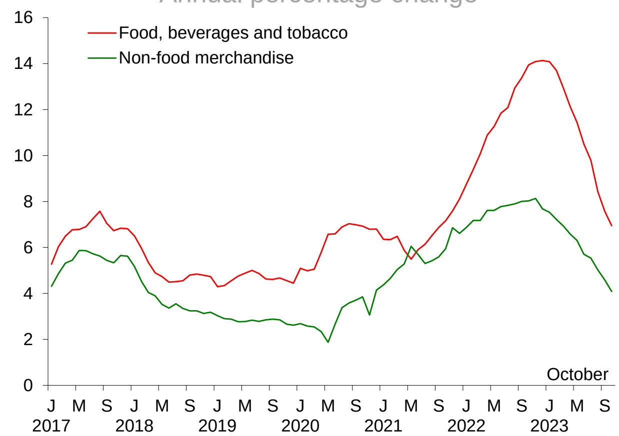
Annual core inflation decreased from 5.76 to 5.50% between September and October 2023. As the effects of the various shocks that have affected it have continued to be absorbed, annual merchandise inflation kept decreasing from 6.20 to 5.64% (Chart 22). During this period, the annual inflation of food merchandise fell from 7.57 to 6.95% and that of non-food merchandise from 4.59 to 4.09% (Chart 23). In contrast, annual services inflation increased from 5.23 to 5.34%. Prices of this component continued being subject to pressures from the resilience of economic activity, the strength of the labor market, the increased demand for services after confinement, and the pass-through of cumulative cost-related pressures to consumers. On the aforementioned dates, annual inflation of services other than education and housing rose from 6.32 to 6.48%, driven primarily by the higher annual variations of prices of travel services. Annual inflation of education services remained high at 6.59 and 6.60% during the same period, while housing inflation registered levels of 3.58 and 3.67%, respectively.

Chart 22
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

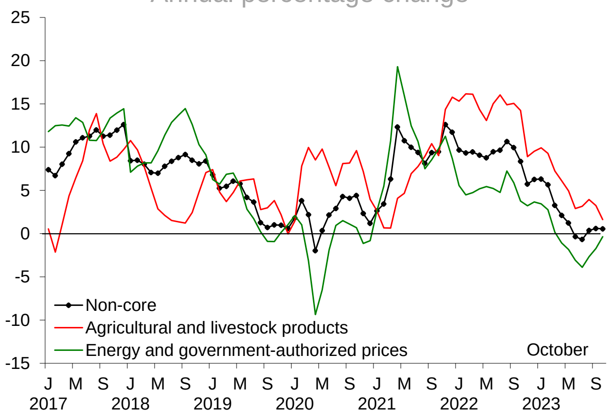
Chart 23
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Annual non-core inflation went from 0.60 to 0.56% between September and October 2023 (Chart 24). This result reflected, on the one hand, the reduction from 3.25 to 1.62% in the annual inflation of agricultural and livestock products. On the other hand, this was offset by the increase in the annual inflation of energy products, which went from -4.61 to -2.59%, influenced by the higher annual variation in the prices of L.P. gas and electricity.

Chart 24
Non-core price sub-index
Annual percentage change



Source: INEGI.

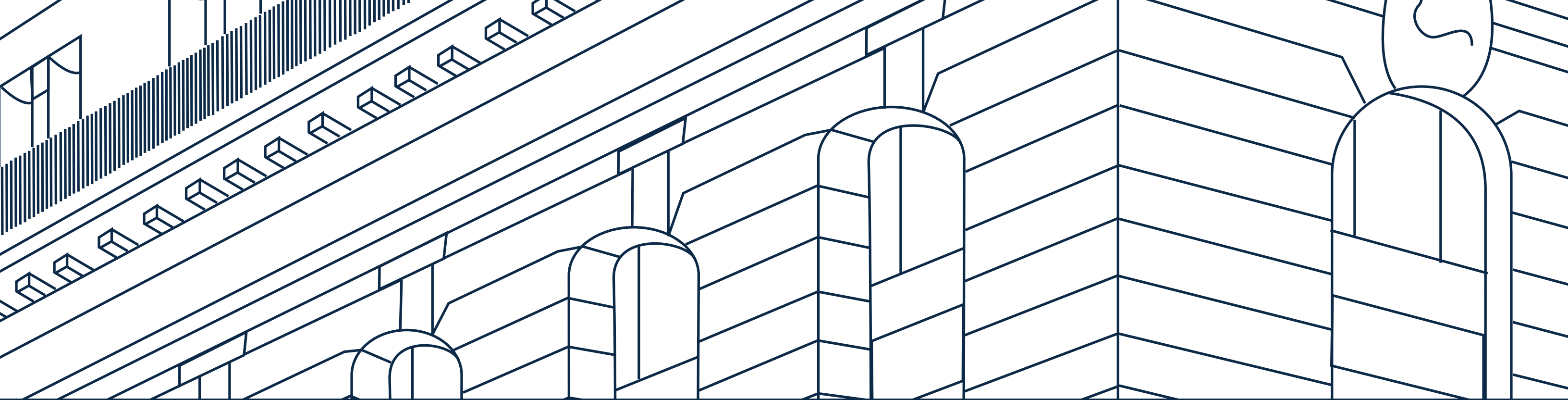
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between August and October 2023, the median for headline and core inflation at the end of 2023 decreased from 4.66 to 4.60% and from 5.21 to 5.11%, respectively. The median of headline inflation expectations for the end of 2024 remained unchanged at 4.00%, while that of the core component adjusted marginally from 4.12 to 4.11%. The median of headline inflation expectations for the next four years remained at 3.80%, while that of core inflation adjusted from 3.79 to 3.78%. The median of headline inflation expectations for the long term (5 to 8 years) went from 3.53 to 3.60%, while that of core inflation registered 3.59%, figure similar to that of August of 3.60%. Finally, compensation for inflation and inflationary risk has remained relatively stable since the previous monetary policy decision. Regarding its components, expectations implied by market instruments increased moderately, while the inflation risk premium declined slightly.

Inflation is still projected to converge to the 3% target in the second quarter of 2025. This forecast is subject to risks. On the upside: i) persistence of core inflation at high levels; ii) exchange rate depreciation; iii) greater cost-related pressures; iv) that the economy shows greater resilience than expected; and v) pressures on energy prices or 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, and iii) that the lower levels of the exchange rate compared to the beginning of the year contribute more than anticipated to mitigate some pressures on inflation. 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	August 2023	September 2023	October 2023
CPI	**4.64**	**4.45**	**4.26**
Core	**6.08**	**5.76**	**5.50**
Merchandise	**6.86**	**6.20**	**5.64**
Food, beverages and tobacco	8.44	7.57	6.95
Non-food merchandise	5.03	4.59	4.09
Services	**5.15**	**5.23**	**5.34**
Housing	3.59	3.58	3.67
Education (tuitions)	5.49	6.59	6.60
Other services	6.38	6.32	6.48
Non-core	**0.37**	**0.60**	**0.56**
Agricultural and livestock products	**3.94**	**3.25**	**1.62**
Fruits and vegetables	8.15	6.75	4.77
Livestock products	0.47	0.33	-0.97
Energy and government-authorized prices	**-2.68**	**-1.71**	**-0.35**
Energy products	-5.99	-4.61	-2.59
Government-authorized prices	5.24	5.14	5.03

Source: INEGI.



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