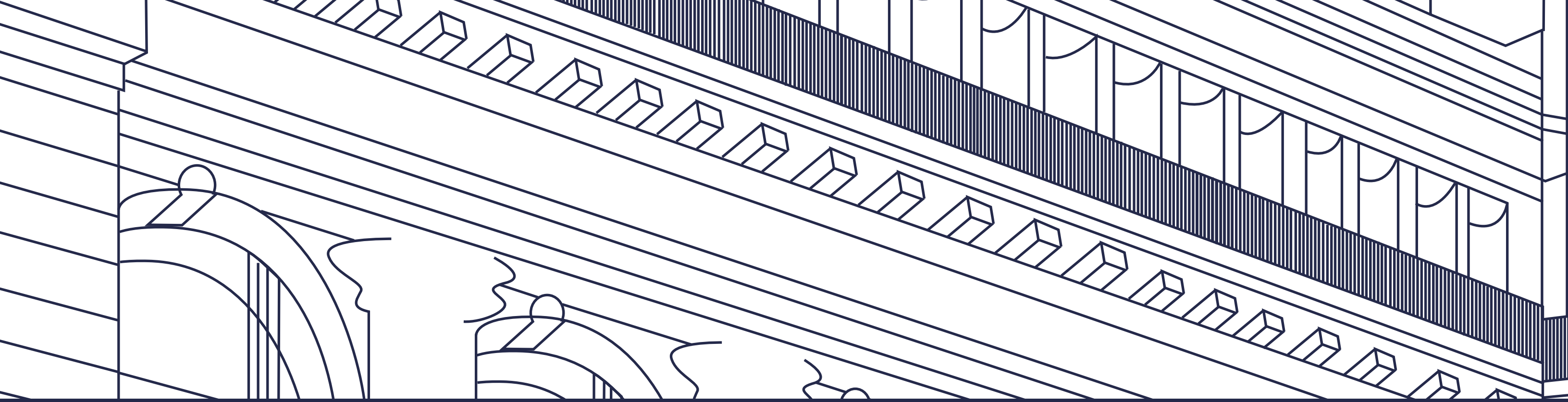

BANCO DE MÉXICO®

Minutes number 73

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on February 13, 2020

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FOREWARNING
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1. PLACE, DATE, AND PARTICIPANTS

1.1 Place: Av. Cinco de Mayo no.2, fifth floor, Col. Centro, Mexico City.

1.2. Date of Governing Board meeting: February 12, 2020.

1.3. Participants:
Alejandro Díaz de León-Carrillo, Governor.
Irene Espinosa-Cantellano, Deputy Governor.
Gerardo Esquivel-Hernández, Deputy Governor.
Javier Eduardo Guzmán-Calafell, Deputy Governor.
Jonathan Ernest Heath-Constable, Deputy Governor.
Arturo Herrera-Gutiérrez, Secretary of Finance and Public Credit.
Gabriel Yorio-González, Undersecretary of Finance and Public Credit.
Elías Villanueva-Ochoa, Secretary of Governing Board.

Prior to this meeting, preliminary work by Banco de México's staff analyzing the economic and financial environment, together with 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 pointed out that the world economy continues to decelerate. In this respect, **some** members noted the weakness of industrial production and international trade. **One** member stated that the above stemmed from the impact of trade tensions on such variables and on investment and business confidence. As to economic activity in advanced economies, **some** members agreed that industrial production showed weakness. **One** member mentioned that growth and job creation in these economies were associated to the expansion of the services sector. **Most members stated that labor markets in advanced economies continued showing strength, with historically low unemployment gaps and moderate wage increases.**

Most members pointed out that a gradual recovery of the global economy is expected in 2020 and in 2021. One member added that this would be fundamentally driven by a rebound in emerging economies. **Another** member noted that, in a context of loser financial conditions, uncertainty continues to affect trade, industrial production, investment, and business confidence. He/she considered that, given the environment of uncertainty, a further easing of financial conditions has led to leveraging of households and businesses, rather than capital accumulation. He/she added that this could increase financial vulnerabilities and reduce the margin of maneuver for monetary policy.

Most members indicated that some risks to the global economy have subsided, in light of: i) the US-China phase 1 trade agreement; ii) the agreement of withdrawal of the United Kingdom from the European Union; and, iii) the USMCA ratification by the U.S. Nonetheless, they stressed that factors of uncertainty persist, such as the effects of the coronavirus outbreak. One member cautioned about its possible impact on global value chains. **Another** member specified that growth forecasts for 2020 for China and for the global economy already show downward revisions, although to a lower degree in the case of the global economy. He/she added that, in view of a lower demand by China and other economies, commodity prices, such as energy prices, have decreased, which could affect producing countries. **Most members highlighted certain political and geopolitical risks, such as i) the US electoral process; ii) conflicts in the Middle East; and, iii) the reemergence of tensions between the U.S. and other economies. One** member mentioned the possibility of complications in the United Kingdom's withdrawal from the European Union. **Most members considered that the balance of risks for the world economy is still biased to the downside.**

Most members noted that global inflation remains low. They stated that in advanced economies headline and core inflations remain below their respective central banks' targets. One member noted that the global economic slowdown has contributed to the above. **Another** member added that this has taken place in a context in which labor market strengthening has implied moderate pressures on wages and prices. **Another** member mentioned that the lower energy prices could exert downward pressures on global inflation. Finally, **one** member considered that the balance of risks for global inflation is biased to the downside, although he/she mentioned that in some economies inflation pressures are starting to emerge, as a result of the higher food prices.

Most members underlined that central banks in the advanced economies maintained accommodative monetary stances. One member pointed out that in some cases the monetary stimulus was increased. **Most members mentioned that in January the Federal Reserve left the target range for the federal funds rate unchanged, and that it highlighted that such rate is at an adequate level to reach its objectives. Some** members noted that analysts do not expect changes in the federal funds rate in 2020, although market expectations point to an additional easing. **One** member stated that markets do not anticipate increases in the target rate, as long as a sustained growth in inflation is not observed. **Another** one mentioned that Federal Open Market Committee members do not expect changes in the referred rate in 2020 and anticipate a 25-basis point increment in 2021. **Finally, most members noted the possibility of central banks adopting more accommodative monetary policy stances in view of the risks associated with the coronavirus outbreak.**

In this context, most members emphasized that global financial conditions have continued to loosen. One added that this has also been due to the decline in some of the mentioned risks. **Some** members noted that globally, stock markets registered gains and interest rates exhibited decreases. **One** member highlighted that in the U.S. the yield curve has flattened, even showing an inversion in its shorter maturities, as a reflection of the risks for US economic activity. **Most members indicated that the good performance of global markets has favored capital flows to emerging economies. However, they mentioned that episodes of volatility associated to the coronavirus outbreak have been observed. They also pointed out that there are factors that could contribute to episodes of risk aversion, such as those already mentioned for world economic activity.**

Economic activity in Mexico

All members agreed that economic activity in Mexico has remained stagnant for several quarters. Most members noted that the latest information as of the fourth quarter of 2019 suggests a slight contraction for the year as a whole. One member added that this is accounted for by: i) an unfavorable global context; ii) the beginning of a new administration; iii) some controversial public policy decisions that contributed to generate uncertainty; and, iv) a tight monetary policy for a relatively long period. Regarding this point, he/she mentioned that the high real interest rate in Mexico has negative implications for consumption and investment decisions.

Most members highlighted the weakness in aggregate demand components, emphasizing investment's sluggishness. Some members mentioned that investment has been affected by the public budget underspending and the lack of both legal certainty and domestic and external certainty, which has had an impact on private investment. **Some** members highlighted the unfavorable performance of investment in machinery and equipment in 2019, although **one** of them mentioned that recently it has slightly recovered. **Another** member mentioned that non-residential construction has trended downwards since early 2015 and added that consumption has slowed down since the beginning of the year. **Most members stressed the slowdown of manufacturing exports in late 2019. One** member added that these were affected by an automotive strike and by the industrial weakness in the U.S.

On the supply side, most members stressed the negative performance of the industrial sector. One member pointed out that industrial activity closed the year below expectations. **Some** members highlighted the contraction in construction and mining, although **one** member noted that both have exhibited a slight upward trend after having deteriorated for several years. Finally, **some** members stressed the weakness of the services sector.

Regarding the labor market, **some** members emphasized the decline in the rate of job creation. **One** member highlighted that as of January 2020 approximately half of formal jobs were created as compared to the same period of last year. **Another** member indicated that, although the unemployment rate reached a historic minimum in December 2019, it is necessary to take into account the higher number of withdrawals of funds from Afore Pension Funds Manager accounts due to unemployment, the higher underemployment rate, and that other indicators of formal job creation are at levels similar to those observed in mid-2008, which shows the weakness of the labor market and the deterioration of the quality of employment. He/she indicated that the impact of the economy's weakness on the labor market will certainly be exacerbated in the next months. **Some** members stated that the costs for employment originated by wage increases not associated with productivity growth should be considered. **One** member pointed out that the experience with minimum wage adjustments and the evolution of employment in the Northern border free zone and adjacent municipalities is revealing in such regard.

Most members agreed that stagnation of economic activity has implied that slack conditions have continued to widen. One member noted that exogenous cost pressures, such as those related to wages, could hamper the recovery of production and the narrowing of the negative output gap.

Most members mentioned that, based on the most recent information, GDP growth in 2020 is expected to be lower than the figure released in the Quarterly Report July – September 2019. One member added that GDP growth is also expected to be lower in 2021. **Another** one added that such forecasts are in line with the adjustments made by international organizations and analysts. **Some** members stated that the economic expansion in 2020 will be propelled by the USMCA ratification, the announcement of the energy sector investment plan, the dissipation of transitory shocks that affected exports and manufacturing production, as well as a more efficient public spending, after the first year of the administration. Nevertheless, they considered that there are few elements that anticipate a significant improvement of investment. **One** member added that budget spending on fixed investment will remain at low levels and could even be lower than those programmed. As for consumption, **some** members mentioned that it is likely to recover. **One** member added that this would be supported by the expected growth in the wage bill and in remittances. **Another** member considered that, in his/her opinion, consumption is expected to lose dynamism.

Most members considered that the balance of risks to growth remains biased to the downside. Some members mentioned that this situation has worsened in light of the above mentioned global risks. **Most members added that economic activity is subject to both external and domestic risks.** In the external environment, in addition to the described global risks, **some** members stated that considerable challenges are foreseen regarding the USMCA implementation, given that the increase in investment and the reconfiguration of value chains will take time. **One** member noted that world trade and the integration of global value chains still face considerable risks in the medium term. **Another** member highlighted the potential negative impact of the deceleration of the US economy, and, particularly, of the stagnation of industrial production foreseen in that country, on Mexican exports.

In the domestic environment, most members noted that the persistence of an environment of uncertainty regarding public policies could continue affecting business confidence and investment. In this regard, **one** member mentioned that, in the event of a deterioration of the sovereign or Pemex's debt rating, this would decrease the availability of loanable funds for investment. Finally, **another** member added further reductions in public revenue as an additional risk. With respect to upward risks for growth, **one** member mentioned that economic activity could benefit from a more favorable global context. **Another** member underlined that investment could be boosted by the entry into force of the USMCA, which could contribute to reverse its decreasing trend and consolidate North America's integration. Meanwhile, **some** members considered that the positive impact of the USMCA on investment will be hardly sufficient to boost it, due to the uncertainty over several policies. **One** member pointed out that the above is based on the remarks by specialists and business agents drawn from different surveys.

Inflation in Mexico

All members mentioned that in early 2020 annual headline inflation increased, although **some** of them highlighted that at the end of 2019 it stood below 3%. **Most members underlined that the recent increase was mainly associated with the rise in the non-core component. One** member pointed out that the later was due, among other factors, to comparison base effects and to pressures on certain agricultural product prices. **Another** member highlighted that the monthly inflation rates of December and January were lower than the average of previous years and lower than those anticipated by the market.

Most members stated that core inflation was affected by the increase in the prices subject to the special tax on production and services (IEPS, for its acronym in Spanish) and that it continues to show resistance to decline. The majority considered that its behavior is also due to the evolution of wages. Some members pointed out that data confirms that the subindexes that are more labor intensive and more related to wages, have had the highest increases. **Most members noted that**

core inflation does not appear to have been too sensitive to slack conditions. Some members mentioned that, in the absence of pressures stemming from demand, from the peso exchange rate, or from indirect effects from the non-core component, it can be argued that one of the main factors explaining the behavior of core inflation is the evolution of wages. **One** member stated that certain inertia in price setting may be added to the above. **Another** member highlighted that the prices of food merchandises and of their related services are the ones with the highest increases. **One** member considered that the rise in the core component mainly concentrated in food merchandises affected by the IEPS increase, while non-food merchandise and services price inflation continued to decrease. He/she underlined the reduction observed in inflation of services prices observed from April to January, and in particular of the prices of services other than education and housing, which are the most likely to be related with wage dynamics.

Most members noted that short-, medium-, and long-term headline inflation expectations have remained relatively stable, albeit at levels above 3%, while core inflation expectations for the same terms were revised upwards. One member highlighted that the breakeven inflation and inflationary risk premium implied in fixed income instruments has continued to decrease.

The majority of members mentioned that in light of the recent behavior of the factors affecting the foreseen path of inflation, headline and core inflation are expected to be moderately above the forecasts published in the latest Quarterly Report. Some members pointed out that this adjustment will possibly complicate inflation from attaining the 3% target at the end of the year. **Some** members stated that the foreseen path still considers that inflation will converge to the target within the time frame in which monetary policy operates, although **some** members noted that a temporary rebound is expected. **One** member explained that this is due to a comparison base effect and that such increase is expected to reverse considerably in April. **Another** member noted that in the following quarters the level of core inflation will largely depend on the interaction between, on the one hand, the greater economic slack and the lower prices of energy goods and, on the other, the effects of the minimum wage increase, which may generate cost pressures that affect employment and prices. He/she stated that, although the final result is difficult to anticipate since it is unusual for the economy to face labor cost pressures during the lower part of the business cycle, a slight upward revision in core inflation is expected.

Regarding upside risks to the foreseen trajectory for inflation, most members mentioned core inflation's resistance to decline and the possibility that wage increases affect prices. One member emphasized that minimum wage increases may maintain or intensify the core component's persistence. **Another** member highlighted the minimum wage increases accumulated in the last two years and the mean salaries for IMSS-contribution purposes in 2019. He/she argued that such increases will possibly continue in 2020 and that therefore they should not be considered as a transitory shock but rather as one that will be present in the medium term. He/she stated that it is not clear if wage increases may greatly affect inflation, however, it cannot be concluded either that they will have no impact at all. The same member noted that empirical evidence on this regard should be considered. **Most members added as upside risks a possible exchange rate adjustment, as well as greater-than-expected increases in agricultural and livestock prices. Some** members mentioned the possibility of non-core inflation reversing to levels greater than anticipated due to the high variability of this subindex. **One** member added that, although the gasoline pricing policy favors lower levels and volatility, not all energy good prices are being controlled. **In addition, the majority mentioned the risk of a deterioration of public finances.** Finally, **one** member pointed out that the rebound observed in January, which is considered transitory, will probably occur again in February and has the risk of generating inertia on inflation for the rest of the year. **Another** member stated that inflation risks have decreased. He/she noted that the above described benign global conditions have had a favorable impact on the peso exchange rate and that the recent decrease in commodity prices has a favorable impact on production costs.

As for downside risks for inflation, most members mentioned: i) a further appreciation of the peso exchange rate in response to greater risk appetite; ii) lower international prices of energy goods due to the coronavirus outbreak; and, iii) greater economic slack. One member also added the benign behavior of producer prices. In this context, **some** members pointed out that uncertainty continues as to the balance of risks for the foreseen path of inflation. **Others** stated that it remains biased upwards and **one** member highlighted that risks for inflation have decreased.

Macrofinancial environment

Most members highlighted the positive performance of domestic financial markets. They mentioned that such performance was due to a favorable environment in international financial markets. **Some** members added that Banco de Mexico's monetary policy stance also contributed to the good performance of domestic markets. **The majority pointed out that yields on government securities decreased for all terms. One** member highlighted that the greater reductions were in the longer terms. **Another** member underlined that both nominal and real interest rates have fallen. He/she stated that the components of nominal long-term interest rates show that, in the last months, short-term interest rate expectations and term premia have decreased. **One** member highlighted that the 10-year rate is currently 200 basis point below the level observed towards the end of 2018. **Most members mentioned that the peso appreciated, showing a better performance than the currencies of other emerging economies**. **One** member noted that the stock market improved marginally. **Some** members emphasized that sovereign risk premia decreased. **One** member argued that the sound macroeconomic and monetary policy stance has been key in reducing such premia. **Another** member mentioned that sovereign credit default swaps (CDS) are at nearly half the level observed at the end of 2018. In this regard, **another** member noted that they are still traded above those of comparable economies and incorporate a sovereign rating downgrade. **The majority of members considered that external and domestic risks that may affect the performance of domestic markets persist**. **One** member expressed that the most important risks stem from a possible downgrade of Mexico's sovereign debt and/or Pemex's debt rating, of the evolution of public finances, and of the US presidential elections.

Most members considered that a sound macroeconomic policy stance has been maintained and that, to strengthen the country's macroeconomic framework and growth capacity, in addition to a prudent monetary policy, public finances must be consolidated in a sustainable way. The majority added that measures that generate confidence and certainty are essential. One member added that a healthy and well-capitalized financial system must be maintained, in addition to reducing both Mexico's sovereign and Pemex's credit risk. He/she also noted that strengthening the rule of law and increasing productivity by adopting new technologies and enhancing human capital is also fundamental. **Another** member stated that, if the deterioration in physical capital formation continues, and given the lack of a more productive human capital stock, there is a risk of undermining the foundations of medium- and long-term growth, thus affecting potential growth. **Some** members added that, based on the opinion of business agents and analysts, among the obstacles to economic activity are those related to governance problems (public insecurity, political instability, impunity and corruption) and uncertain domestic economic conditions.

Regarding Pemex's situation, **one** member pointed out that, although a slight rebound in oil production has been observed, the target for 2020 appears optimistic given that investment is lagging behind. He/she noted that the fulfillment of the approved balance for 2019 was not the result of a structural improvement, but rather of the increase in supplier financing, of lower oil derivatives imports, and of a fall in physical investment. **Another** member stated that the loss of Pemex's investment grade may generate financial volatility, although he/she mentioned that markets to a large extent have already discounted the risk of a downgrading of its credit rating. Thus, **some** members argued that questions regarding Pemex's medium-term financial viability have not disappeared. They explained that additional funding by the federal government will probably be required. **One** member mentioned that this year the resulting challenges for public finances are exacerbated in the face of an outlook for economic growth and oil income being lower than previously foreseen. He/she indicated that although in 2020 this situation may be addressed with the use resources from the Budget Revenue Stabilization Fund (FEIP, for its acronym in Spanish), the vulnerability of the public finances would increase in the coming years given the long-term challenges Pemex faces and the probable exhaustion of federal government reserve funds. He/she emphasized the need for implementing actions that allow Pemex to overcome its structural problems as soon as possible. **Some** members mentioned that the risks for both Mexico's sovereign and Pemex's credit ratings have decreased. **One** member highlighted the reduction of the state owned-company's interest rate and its CDS. He/she noted that the recent bond repurchase and refinancing operations were successful, which shows that there is a greater appetite for Pemex's bonds, in line with its improved financial situation.

As for public finances, **one** member highlighted the primary surplus achieved and the stabilization of the public debt as a share of GDP, after having increased between 2008 and 2016. He/she noted that the lax fiscal behavior in those years led to macroeconomic imbalances that affected the exchange rate and inflation. He/she pointed out that, although debt decreased to around 46% of GDP in 2017, this was artificially achieved by the transfer of Banco de México's surplus in 2016 and 2017. He/she stated that the behavior of public finances in 2019 sends a message of credibility and commitment to fiscal discipline. **Another** member mentioned that in 2019 revenues closed below those programmed and that the fiscal balance target was achieved with the use of FEIP resources and that without the use of those resources the primary balance would have been 0.6%. He/she stressed that this situation could continue in 2020 since, according to the consensus of private sector forecasters, economic growth will be half the programmed. He/she warned that, if this scenario materializes, additional resources from the FEIP would be withdrawn. He/she argued that using these resources without implementing measures that permanently increase income aggravates the vulnerability of public finances. He/she added that, if there were significant rises in the international reference prices for gasoline, this may have a high fiscal cost.

Monetary policy

Regarding Banco de México's monetary policy decision, the Governing Board decided unanimously to lower the target for the overnight interbank interest rate by 25 basis points to 7%. Among the elements considered in this decision, the following stand out: the levels attained by headline inflation, its outlook within the time frame in which monetary policy operates, the greater economic slack, and the recent behavior of external and domestic yield curves. As additional factors in making the decision **one** member added: i) the decline of inflation risks; ii) the environment of low international interest rates; iii) the favorable performance of domestic markets; and, iv) the peso exchange rate's strength given external shocks. **Another** member added the lower credit risk premia and the improvement in the country-risk perception, as well as the stability of public finances and the lower uncertainty regarding international trade. He/she argued that, although some latent risks remain, monetary policy has room to maneuver.

Some members considered that given the economic environment, the current monetary policy continues being very restrictive. **One** member specified that Mexico's real interest rate is the highest among a large group of economies, including those that have a credit rating lower than Mexico's. He/she argued that a very restrictive monetary policy for an extended period can jeopardize macroeconomic and financial stability, and affect consumption and investment. He/she mentioned that the analysis by a brokerage estimated a cost associated with the restrictive monetary policy of 0.7% of GDP in 2019 and of 1% in 2020. The same member noted that by affecting growth, it also has effects on the performance of both firms and the stock market, as well as on public finances, by increasing the financial cost of debt and lowering tax collection. The same member added that this makes domestic financial markets less attractive and affects risk premia and the exchange rate. For this reason, he/she considered that insofar as the inflation rate close to the target is consolidated, it will be necessary for monetary policy to transition towards a stance closer to neutral. **Another** member pointed out that the target rate in early 2019 was very restrictive, 3.4% in real terms, and with a spread of 575 basis points against that of the United States. He/she highlighted that, despite the interest rate cuts, an absolute easing was not achieved given that the real rate closed the year at 4.4%. As to the relative monetary policy stance, he/she noted that the spread against the United States decreased only by 25 basis points towards the end of the year, remaining as one of the highest spreads. He/she pointed out that it turns out to be even higher when considering the lower exchange risk, the greater risk appetite, and that no changes are expected in the accommodative monetary policies worldwide. He/she stated that, as to the absolute policy stance, economic slack demands a lower rate of return on capital, and that for such reason there must be consistency with the neutral rate. In sum, he/she considered that both stances point to the need for a greater rate easing in order to attain the primary objective at the lowest possible cost.

Most members estimated that economic stagnation responds to multiple factors. The majority also mentioned that using monetary policy to reactivate the economy would have modest benefits and could imply a high risk. One member indicated that monetary policy has been criticized as causing to a large extent the stagnation. He/she considered that, nevertheless, its impact has been marginal. The same member pointed out that at this point it is important to acknowledge the limits and scope of monetary policy. He/she stated that, on the one hand, an overly restrictive policy may affect investment and consumption but it is not the main factor behind their loss of dynamism. The same member added that, on the other hand, the monetary policy implemented has yielded significant benefits in terms of financial and exchange rate stability and ensuring the purchasing power of wages. **Another** member mentioned that recent research suggests that given the high share of informality in the economy and the low credit penetration, the impact of the interest rate and credit channels to stimulate economic activity is limited, while the expectations channel is the predominant one to control inflation. He/she added that although a more significant monetary policy easing could improve the fiscal balance, it would not correct the structural problems of public finances. He/she also pointed out that the lack of dynamism of investment is due to the lack of certainty on public policies and concerns about domestic factors, such as governance, rule of law, and corruption, which remain as the major obstacles for private investment. In this regard, **another** member mentioned the importance of maintaining an environment of greater certainty, arguing that the central bank can contribute to that by ensuring macroeconomic and financial stability.

One member mentioned that, given the development of core inflation, the challenge is for wage increases not to affect inflation and nullify the improvements in purchasing power attained. He/she estimated that inflationary pressures from the supply side are difficult to control with monetary policy, even more when they are the result of a medium-term policy, such as the wage policy. He/she pointed out that a wage policy is successful when it is able to permanently increase the purchasing power and generate better-paid jobs. He/she argued that caution and prudence must be applied in order to assess the best time to modify the rate of easing, taking into account that the goal is to contribute to improve the purchasing power of wages. Such member considered that although there are elements that suggest lowering the policy rate, given the persistence of core inflation and the permanent shock of wages, the balance of risks is uncertain in the short and medium terms.

Most members pointed out the challenges faced by monetary policy. Some indicated the difficulty in reconciling an ample economic slack with inflationary pressures and mentioned that there is the prospect of postponing the consolidation of inflation around the target. **One** member pointed out that headline and core inflation expectations are converging to 3.5%, which implies that they are settling more firmly at that level, while long-term core inflation expectations have increased. If the aforementioned prevails, it would be a factor of concern that could be considered as a second-round effect on prices. Thus, he/she argued that there are signs that core inflation expectations are un-anchoring, in addition to which an environment of high uncertainty prevails. He/she considered that in this context the challenges for monetary policy have been exacerbated, thus it must continue to be conducted prudently. He/she mentioned that despite the cautious approach that has been followed, the risks of second-round effects on prices have increased. He/she argued that the central bank must focus on attaining its target within the time frame of monetary policy influence. He/she added that, at the same time, it must be ensured that the convergence to the target takes place in an orderly manner, avoiding potential costs for economic activity.

Another member considered that although economic slack has widened more than expected, the challenges faced by the economy are not only those associated with its cyclical position. He/she mentioned that there are other challenges and risk factors, both domestic and external, which affect the economy, the price formation process, and inflation. Such member noted that although under an inflation targeting framework monetary policy must be such that headline and core inflation forecasts remain around their target within the forecast horizon, it must also consider other elements. Among these, he/she mentioned the external environment, the greater amount of economic slack and the need to foster adequate conditions in financial markets. In addition to the above, he/she highlighted that monetary policy decisions must also: i) allow for an orderly adjustment of the economy; ii) consider the behavior of domestic and external yield curves and the corresponding risk premia; iii) maintain interest in Mexico as an investment destination and generate confidence; iv) consider the effects of the relevant relative monetary conditions; and, v) ensure the yield curve incorporates interest rate expectations consistent with the central bank targets within the time frame in which monetary policy operates. He/she argued that the latter implies that the adjustment of the monetary policy stance: i) must be done gradually to maintain the needed flexibility to face a wide range of scenarios and allow the required adjustments to be done in an orderly way; ii) must take into account all information available; iii) must fully respond to all expected factors and features of the Mexican economy and in a wide range of scenarios; and, iv) must lead to an orderly and sustained convergence of headline inflation to its target within the time frame in which monetary policy operates.

The majority of members highlighted the importance of future adjustments being consistent with the evolution of both the balance of risks for inflation and the economic juncture. One member stated that a prudent and gradual approach must be taken given the environment of uncertainty. **Another** member pointed out that under such circumstances the future actions of the monetary policy must rely on the available information at the time of the policy decision since attempting to provide a more precise guideline in an uncertain environment, can affect the central bank's credibility. **One** member added that the message that the monetary policy stance is consistent with the attainment of the inflation target within the time frame in which monetary policy operates must be maintained. **Another** member argued that the rate of the adjustment must be considered period by period, must rely on incoming information, and must maintain a trajectory of inflation converging to the target. He/she underlined that a further deterioration of the balance of risks could limit taking advantage of the margin of maneuver for the relative and absolute policy stances in the future. Such member added that since the rate of adjustment affects expectations, a prudent policy adds to a sounder anchoring and maintains the central bank's credibility. He/she pointed out that the central bank must remain alert as to avoid being complacent with a relatively low inflation but which is above the target. Nevertheless**, one** member considered important that such guideline acknowledges the convenience of adjusting the monetary policy stance to a less restrictive one in a relatively short period, with such an adjustment being conditioned to the favorable evolution of the inflation outlook. He/she argued that based on available information, it is possible to envision a scenario in which the interest rate's neutral zone is attained by the end of this year. He/she estimated that a scenario like the above would not jeopardize the outlook for inflation but it would improve the economic perspectives.

3. MONETARY POLICY DECISION

With the presence of all its members, Banco de México's Governing Board decided unanimously to lower the target for the overnight interbank interest rate by 25 basis points to 7%. To this end, the current levels of headline inflation, the inflation outlook within the time frame in which monetary policy operates, the greater amount of economic slack, and the recent behavior of external and domestic yield curves, were considered.

The Governing Board will take the necessary actions based on incoming data so that the policy rate is consistent with the orderly and sustained convergence of headline inflation to Banco de México's target within the time frame in which monetary policy operates. To strengthen the macroeconomic framework and the country´s growth capacity, in addition to a prudent monetary policy, public finances must be consolidated in a sustainable way.

4. VOTING

Alejandro Díaz de León-Carrillo, Irene Espinosa-Cantellano, Gerardo Esquivel-Hernández, Javier Eduardo Guzmán-Calafell and Jonathan Ernest Heath-Constable voted in favor of lowering the overnight interbank interest rate by 25 basis points to a level of 7%.

ANNEX

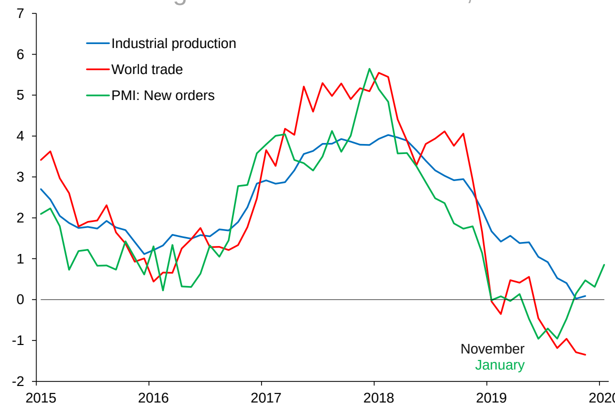
The information in this Annex was prepared for this meeting by the staff of Banco de México's General Directorate of Economic Research and General Directorate of Central Bank Operations. It does not necessarily reflect the considerations of the members of the Governing Board as to the monetary policy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

A.1. External conditions

A.1.1. World economic activity

Available information suggests that during the fourth quarter of 2019 world economic activity continued to decelerate (Chart 1), reflecting the effects of the prevailing environment of uncertainty regarding trade and geopolitical tensions and idiosyncratic factors in some of the major economies, all of which affected trade, manufacturing, and, particularly, investment. The mitigation of certain risks in light of the United States' approval of the new US-Mexico-Canada Agreement (USMCA), the exit of the United Kingdom from the European Union, and the signing of the US-China Phase 1 trade deal, led to a positive performance of financial markets, greater risk appetite, and to a loosening of financial conditions. Nevertheless, in early 2020, there were episodes of volatility, such as those stemming from the escalation of geopolitical tensions between the United States and Iran and from the coronavirus (Covid-19) outbreak. In turn, although the latest data shows a stabilization of business confidence and of certain leading indicators, economic activity has not shown clear signs of recovery. In this context, while growth expectations for the global economy continue pointing to a slight recovery in 2020, the presence of several uncertainty factors implies that the balance of risks for growth continues biased to the downside in the short and, particularly, in the medium term.

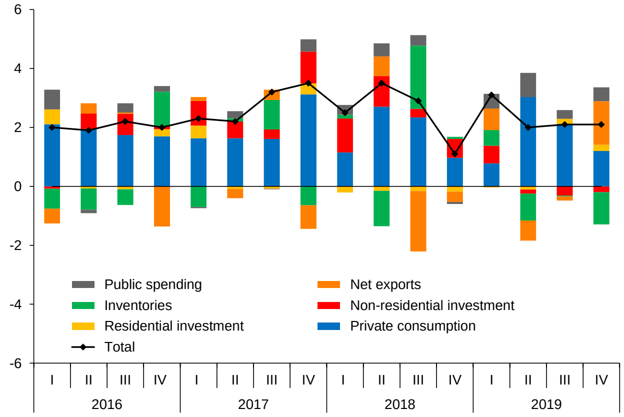
Chart 1
Global Activity Indicators
Annual percentage change of 3-month moving average and deviation from 50, s. a.



s. a. / Seasonally adjusted figures.
Source: CPB Netherlands and Markit.

In the United States, GDP grew at an annualized quarterly rate of 2.1% during the fourth quarter of 2019, rate similar to that registered in the third quarter (Chart 2). Economic activity continued to be driven by residential investment, public spending and private consumption, although the latter has been slowing down. Additionally, as a result of the fall in imports, net exports contributed positively to growth. In contrast, investment in equipment and fixed structures continued to contract during the fourth quarter. US industrial production contracted in December, as a result of a fall in the gas and electricity sectors caused by the lower demand for space heating due to unusually warm weather conditions during that month. This was partially offset by the rebound in mining and the moderate growth of manufacturing, sector which continues exhibiting significant weakness. Key labor market indicators in the United States remain relatively strong. In particular, the growth of the non-farm payroll, the initial requests for unemployment insurance, and the layoff levels continue to suggest tight labor conditions. However, other indicators such as the rate of new jobs created and the index of weekly hours worked have moderated. The unemployment rate was 3.6% in January, around its lowest levels since the end of 1969, while wage growth in that country moderated.

Chart 2
United States: Real GDP and its Components
Annualized quarterly percentage change and contributions in percentage points, s. a.



Source: Bureau of Economic Analysis (BEA).

In the euro area, GDP growth slowed from an annualized quarterly rate of 1.1% during the third quarter to 0.4% in the fourth quarter. In particular, private consumption continued growing, driven by the relative strength of the labor market and the high levels of consumer confidence. Nevertheless, exports remained weak, in an environment of persisting uncertainty that has affected manufacturing activity and investment spending throughout the region. In Japan, GDP growth is estimated to have contracted during the fourth quarter due to transitory factors related to adverse climate conditions and to the VAT increase. In this context, and to offset the negative effects of said tax increase, a fiscal stimulus package was announced which is expected to boost economic activity in 2020 and 2021.

Available information for the fourth quarter of 2019 shows that most emerging economies continued to grow moderately. In China, although GDP growth stabilized and the latest indicators recovered towards the end of 2019, the coronavirus outbreak is anticipated to negatively affect economic activity in that country and in other emerging economies in the short term. As for Latin America, growth seemed to continue weakening in the last part of 2019, although the region's countries continue exhibiting mixed performances.

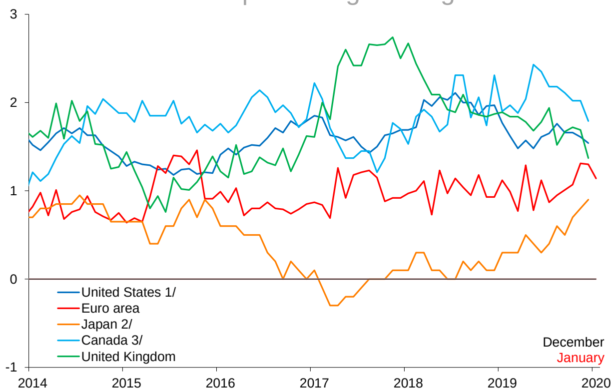
Since Mexico's last monetary policy decision, international commodity prices have trended downward. Crude oil prices increased temporarily at the end of 2019 and in the first days of 2020 due to the extension of oil production cuts starting in 2020 by OPEC members and other producers and the conflict between the United States and Iran. Later, such prices fell as a result of a reduction in the expected demand for crude oil, particularly by China, due to the coronavirus outbreak. The easing of Middle East tensions and the increase in oil and gasoline inventories in the United States made said fall sharper. Industrial metal prices and grain prices also decreased due to fears about the health emergency in China affecting its economy.

A.1.2. Monetary policy and international financial markets

Headline inflation in most advanced economies increased slightly, although it remains below their respective central banks' targets. Such increase was mainly due to the rise in energy goods prices observed at the end of 2019. Nevertheless, core inflation and inflation expectations in these economies remain at low levels (Chart 3). In some emerging economies, such as Brazil, China, India, the Philippines, Poland, Hungary, and Turkey, headline inflation increased due to the rise in food merchandise prices, while in Chile the increase responded to idiosyncratic factors. Core inflation, however, has remained relatively stable in most emerging countries.

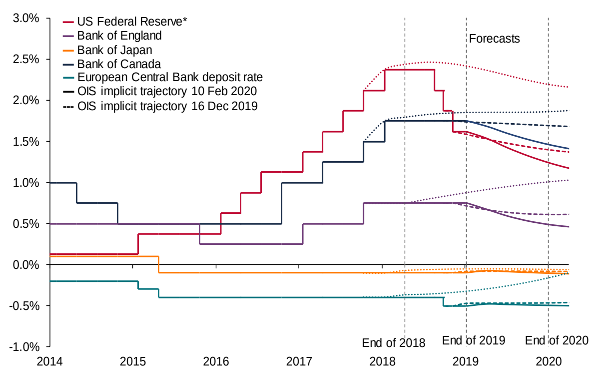
In this context of low inflation levels and risks for the global economy in the short and, particularly, in the medium term, the central banks of the major advanced economies maintained accommodative monetary policy stances. Expectations drawn from market instruments anticipate that these institutions' monetary policies will remain accommodative (Chart 4). In emerging economies, several central banks have continued to ease their policy stances, with the cases of Argentina, China, Brazil, Malaysia, South Africa, Thailand, the Philippines, Russia, and Turkey standing out.

Chart 3
Selected Advanced Economies: Core Inflation
Annual percentage change



1/ Refers to the Personal Consumption Expenditures Price Index (PCE).
2/ Excludes fresh food, energy, and the direct effect of the consumption tax increase of 2014.
3/ Excludes food, energy, and the effect of adjustments on indirect taxes (CPIX).
Source: Haver Analytics, BEA, Statistical Office of the European Union (Eurostat), and Statistics Bureau (Japan).

Chart 4
Reference Rates and Implied Trajectories in OIS Curves[1/]
Percent



1/ OIS: Fixed floating interest rate swap where the fixed interest rate is the effective overnight reference rate.
* In the case of the US observed reference rate, the average interest rate of the federal funds target range is used (1.50% - 1.75%).
Source: Bloomberg.

Some of the major central bank policy decisions during the period were:

i) In January, the US Federal Reserve left unchanged the target range for the federal funds rate, at 1.5-1.75%. In its January statement, that central bank pointed out that the current monetary policy stance is the appropriate to ensure sustained growth, sound labor conditions, and inflation returning to its 2% symmetric target. The most recent implied trajectory in the futures of such rate reflects expectations of between one and two additional 25 basis point reductions in 2020.

ii) In January, the European Central Bank (ECB) left its monetary policy stance unchanged. That central bank reiterated that it expects key ECB interest rates to remain at their present or lower levels until inflation robustly converges to levels sufficiently close to, albeit below, 2%.

iii) In its January meeting, the Bank of England left its policy rate at 0.75% and did not modify the size of its government bond purchases, although two members voted again in favor of cutting their policy rate. The Monetary Policy Committee pointed out that the domestic uncertainty faced by households and businesses has decreased. It highlighted that it will closely assess if the improvement in the economic outlook actually leads to a better performance of economic activity indicators.

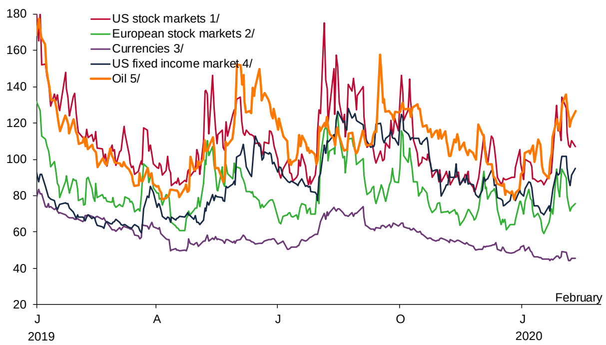
iv) In its January meeting, the Bank of Japan also left its monetary policy stance unchanged. That central bank reiterated that it will leave interest rates at their current or lower levels until the 2% inflation target is attained.

v) In its January meeting, the Bank of Canada left its policy interest rate unchanged at 1.75%. In its January Monetary Policy Report it highlighted that although the Canadian economy continues to grow at a rate close to potential, growth in the short term is expected to be below that forecasted in its October report. The economic outlook was revised due to the effects of global uncertainty and other temporary factors on business investment and exports, as well as to consumers' more cautious behavior.

International financial markets exhibited higher volatility at the beginning of the year (Chart 5). This was initially associated with geopolitical tensions between the United States and Iran and later with concerns associated with the coronavirus outbreak in China. In this scenario, the US dollar strengthened against most currencies (Chart 6). For its part, stock markets recorded gains at the end of 2019 in light of the reduction of certain risks that the global economy had been facing, with the historically high levels of US stock exchanges standing out. More recently, other stock indexes registered losses due largely to the uncertainty associated with the coronavirus outbreak. Interest rates of long-term government bonds decreased in most advanced and emerging economies. In this context, inflows to financial assets of emerging economies continued to recover, although a greater differentiation among economies and by type of asset has been observed (Chart 7).

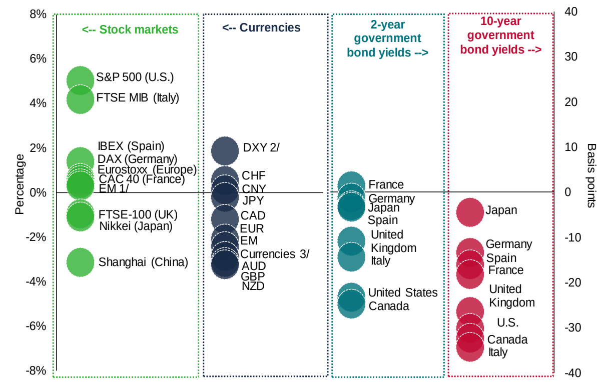
Looking ahead, episodes of greater volatility in financial markets stemming from the high uncertainty about the economic effects of the coronavirus outbreak in China, its spread, and the efficiency of authorities in containing said health emergency are not ruled out. In addition to the above, several risk factors persist, such as the possibility of a new escalation of trade tensions between the United States and its main trade partners, the intensification of geopolitical conflicts, mainly in the Middle East, and risks stemming from climatic factors, among others.

Chart 5
Implicit Volatility of Selected Financial Indicators
31-dic-2015=100



1/VIX: Weighted 1-month implied volatility index for options of the S&P500 published by the Chicago Board Options Exchange. 2/V2X: Weighted 1-month implied volatility index for options of the Euro Stoxx50 published by Deutsche Borse and Goldman Sachs. 3/CVIX: 3-month implied volatility index of the most traded exchange rates with the following weights EURUSD: 35.9%; USDJPY: 21.79%; GBPUSD: 17.95%; USDCHF: 5.13%; USDCAD: 5.13%; AUDUSD: 6.14%; EURJPY: 3.85%; EURGBP: 2.56%; and EURCHF: 1.28%. 4/ MOVE: Implied volatility index for at the money options with a 1-month maturity on 2-, 5-, 10- and 30-year Treasury bills. Index calculated by Merrill Lynch. 5/ OVX: Weighted index of 1-month implied volatility in the oil options market.
Source: Prepared by Banco de México with Bloomberg data.

Chart 6
Change in Selected Financial Indicators from December 16, 2019 to February 10, 2020
Percent, basis points



1/ MSCI Emerging Markets Index (includes 24 countries).
2/ DXY: Weighted average of the nominal exchange rate of the six main world-traded currencies (calculated by Intercontinental Exchange, ICE) with the following weights: EUR (57.6%), JPY (13.6%), GBP (11.9%), CAD (9.1%), SEK (4.2%), and CHF (3.6%).
3/ J.P. Morgan Index constructed from a weighted average of the nominal exchange rate of emerging economies' currencies with the following weights: TRY (8.3%), RUB (8.3%), HUF (8.3%), ZAR (8.3%), BRL (11.1%), MXN (11.1%), CLP (11.1%), CNH (11.1%), INR (11.1%), and SGD (11.1%).
Source: Bloomberg and ICE.

Chart 7
Emerging Economies: Financial Assets Performance from December 16, 2019 to February 10, 2020
Percent, basis points

Region	Country	Currencies	Equity markets	Interest rates 2Y	Interest rates 10Y	CDS
Latin America	Mexico	1.25%	-0.15%	-21	-21	1
	Brazil	-6.18%	0.60%	-21	7	2
	Chile	-4.25%	-5.10%	1	9	6
	Colombia	-2.90%	0.68%	-22	-41	3
	Argentina	-1.90%	9.13%	-898	-245	-437
Emerging Europe	Russia	-2.62%	1.87%	-36	-38	12
	Poland	-2.29%	1.13%	3	10	-9
	Turkey	-2.69%	6.49%	-61	-136	-7
	Czech Republic	-0.48%	1.01%	3	-6	-2
	Hungary	-4.79%	-2.34%	27	26	-26
Asia	Malaysia	-0.10%	-1.69%	-36	-28	0
	India	-0.40%	0.10%	-21	-13	-5
	Philippines	-0.27%	-3.52%	-8	5	0
	Thailand	-3.40%	-0.94%	-34	-44	2
	Indonesia	2.17%	-4.18%	-43	-63	-4
Africa	South Africa	-4.10%	0.17%	-24	-21	12

Note: Interest rates correspond to interest rate swaps for 2-year/10-year maturities. In the case of Argentina, rates in US dollars are used since they are the most liquid ones and those that reflect more adequately the performance of the fixed income market in that country.
Source: Bloomberg.

A.2. Current situation of the Mexican economy

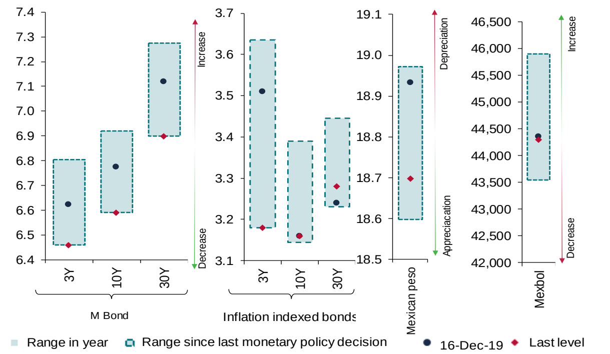
A.2.1. Mexican markets

Since Banco de Mexico's previous monetary policy decision, financial asset prices in Mexico exhibited a slight positive bias in an environment where a decrease in trade policy uncertainty was observed and in which the central banks of the major advanced economies are expected to maintain a high level of monetary stimulus. In the last weeks, the spread of the coronavirus outbreak has led to negative days in Mexico's financial markets and to a moderate increase of volatility in said markets. In particular, the peso/dollar exchange rate fluctuated between 18.56 and 19.08 pesos per US dollar, reaching 18.70 pesos per US dollar at the end of the period (Chart 8). This occurred in a context where both spot and prospective trading conditions remained stable during the period. For its part, forecasters from several financial institutions adjusted downward their peso exchange rate expectations for the end of 2020, from 20.05 to 19.67 pesos per US dollar, while for the end of 2021, they maintained their expectations at 20.00 pesos per US dollar (Chart 9).

Interest rates of government securities decreased between 15 and 25 basis points throughout the entire yield curve, with long-term rates registering the greatest adjustments (Chart 10). This occurred in a context where trading conditions remained stable.

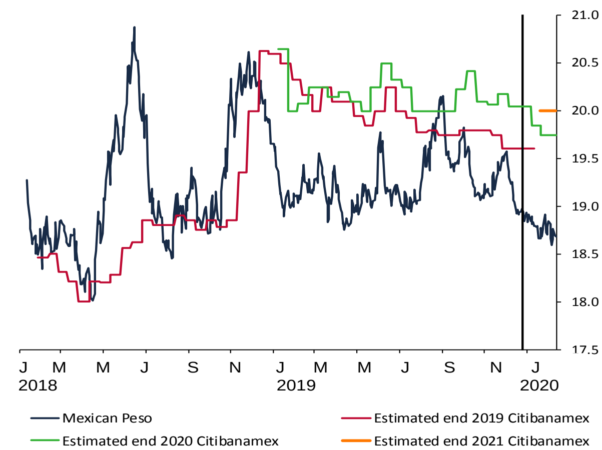
As to expectations regarding the path of the monetary policy target rate, information implied in the Interbank Equilibrium Interest Rate (TIIE, for its acronym in Spanish) swaps curve practically discounts a 25-basis point cut for the monetary policy decision of February, in line with expectations of private sector forecasters surveyed by Citibanamex. For the end of 2020, market variables anticipate a target rate of around 6.00% (Chart 11), while the median of said survey foresees a target rate at 6.50%.

Chart 8
Mexican Markets' Performance and Trading Conditions
Percent, pesos/US dollar and index



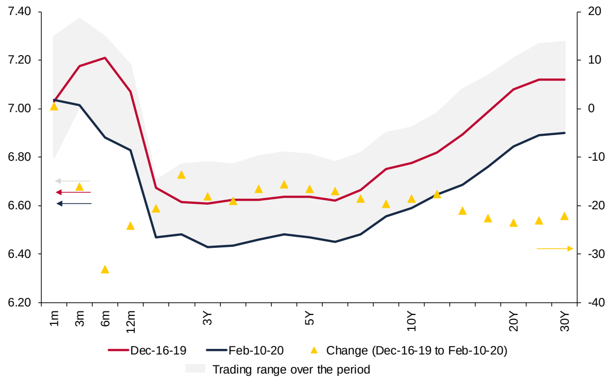
Source: Prepared by Banco de México with Bloomberg and Proveedora Integral de Precios (PIP) data.

Chart 9
Analysts' Mexican Peso Exchange Rate Expectations
Pesos per US dollar



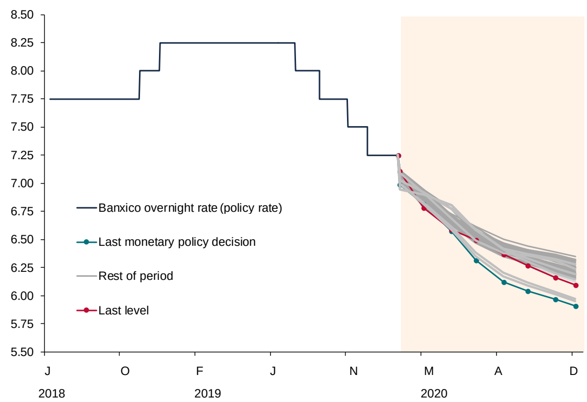
Note: The black vertical line represents Banco de México's latest monetary policy decision.
Source: Bloomberg and Citibanamex survey.

Chart 10
Nominal Yield on Government Securities
Percent, basis points



Source: PIP.

Chart 11
Banxico Overnight Interbank Rate Implied in TIIE IRS Curve
Percent

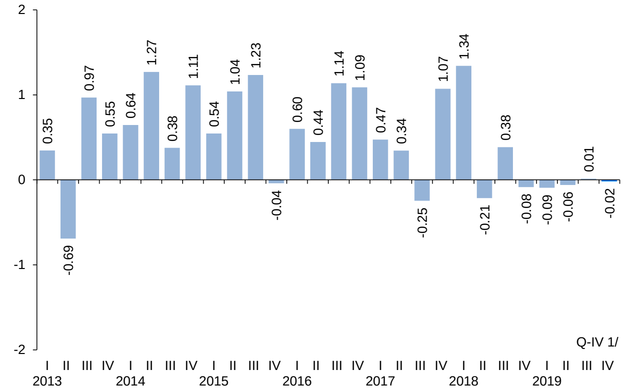


Source: Prepared by Banco de México with Bloomberg data.

A.2.2. Economic activity in Mexico

According to INEGI's GDP flash estimate, the stagnation that Mexico's economic activity has been exhibiting for several quarters continued during the fourth quarter of 2019. Thus, in 2019 as a whole the economy contracted slightly (Chart 12).

Chart 12
Gross Domestic Product
Quarterly percentage change, s. a.

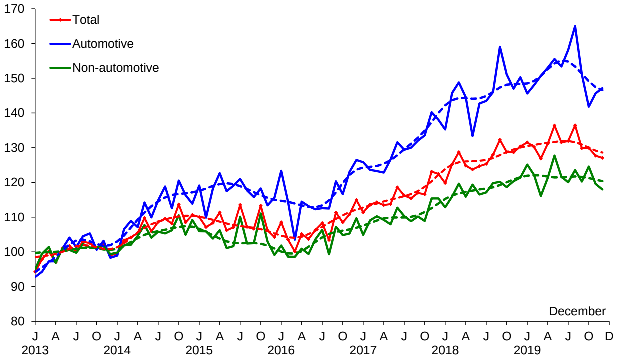


s. a. Seasonally adjusted figures.
1/ The figure for the fourth quarter of 2019 refers to INEGI's GDP flash estimate.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

In the last quarter of 2019, manufacturing exports decreased vis-à-vis the previous quarter (Chart 13). Such evolution was mainly due to the contraction of automotive exports, both to the United States and to the rest of the world, which is consistent with the fall in Mexico's automotive production caused by changes in the production lines of several auto assembly plants and the effects of strikes in this sector in the United States. Similarly, non-automotive manufacturing exports to the United States exhibited lackluster growth, while Mexico's non-automotive exports to countries other than the United States continued trending downward.

During October-November 2019, private consumption registered less dynamism vis-à-vis the recovery at the end of the previous quarter. Such behavior was due to the slowdown of consumption of domestic and imported goods and to a weak consumption of services. Timely indicators of consumption, such as retailer's earnings and sales of manufacturing industries more related with consumption in the domestic market, exhibited low dynamism, while the sales of light vehicles slightly recovered in the early part of 2020. For its part, gross fixed investment continued to contract during October-November 2019. Within this indicator, both spending in construction and machinery and equipment exhibited weakness.

Chart 13
Total Manufacturing Exports
Indices 2013 = 100, s. a.

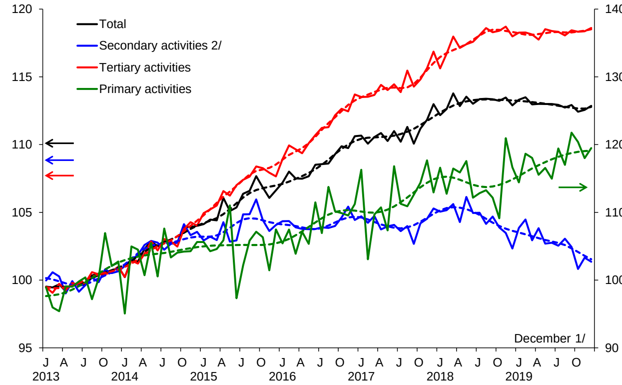


s. a. / Seasonally adjusted series and trend series based on data in nominal USD. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from the Tax Administration Service (SAT, for its acronym in Spanish), the Ministry of the Economy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

As for production, the stagnation of economic activity during the fourth quarter of 2019 reflected the contraction of industrial activity and the lower growth of services (Chart 14). The performance of the secondary sector is associated with the weakness of construction and with manufacturing following a slight downward. In contrast, mining recovered slightly, associated with the uptick of the oil platform (Chart 15). For its part, services registered low growth. This behavior was the result of the fall in wholesale trade; arts, entertainment, and recreation; and other services (except public administration); and of increases in professional services; management of companies and enterprises; transportation; information industries; finance; and real estate and rental and leasing.

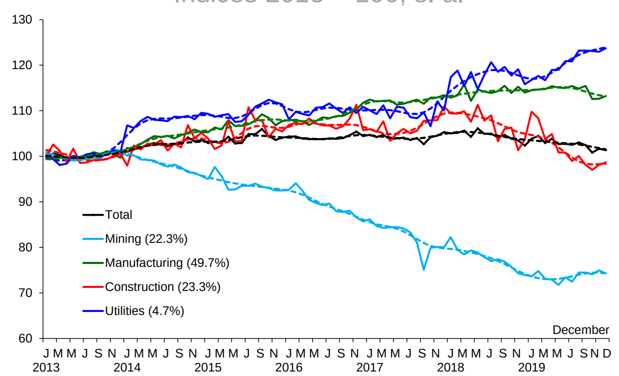
As to the economy's cyclical position, slack conditions are estimated to have continued to widen in the last quarter of 2019, reflecting the persistent stagnation of economic activity (Chart 16). As to the labor market, both national and urban unemployment rates decreased at the end of 2019 (Chart 17). In turn, the creation of IMSS-insured jobs continued to slow down. According to information available for the third quarter of 2019, as a result of the behavior of productivity and average real earnings, unit labor costs for the economy as a whole continued trending upward. At the beginning of the fourth quarter, unit labor costs in the manufacturing sector also increased, remaining at high levels (Chart 18).

Chart 14
Global Index of Economic Activity
Indices 2013 = 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 up to December 2019 correspond to estimates implied by the flash GDP.
2/ Figures up to December 2019 of the Monthly Indicator of Industrial Activity.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

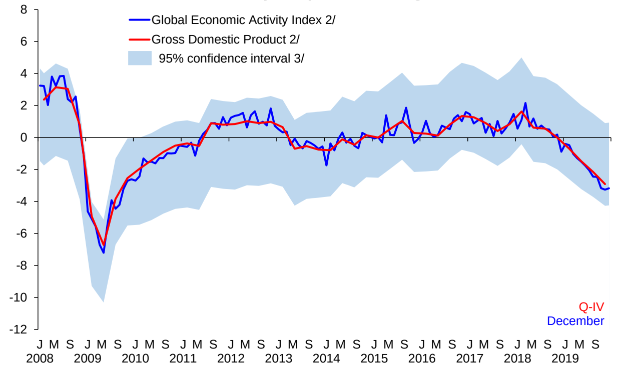
Chart 15
Industrial Activity[1/]
Indices 2013 = 100, s. a.



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 parentheses correspond to its share in the total in 2013.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

Chart 16
Output Gap Estimates 1/ Excluding Oil Industry 4/

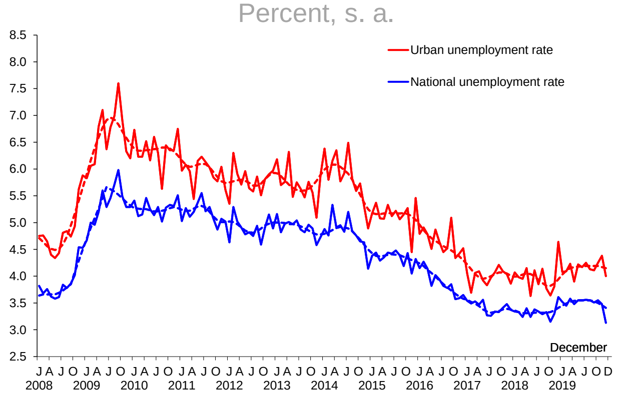
Potential output percentages, s. a.



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/ Fourth quarter of 2019 figure based on the flash GDP estimate and for December based on the IGAE estimate implicit in said flash figure.
3/ Output gap confidence interval calculated with a method of unobserved components.
4/ Excludes both oil and gas extraction, support activities for mining, and petroleum and coal products' manufacturing.
Source: Prepared by Banco de México with INEGI data.

Chart 17
National Unemployment Rate and Urban Unemployment Rate

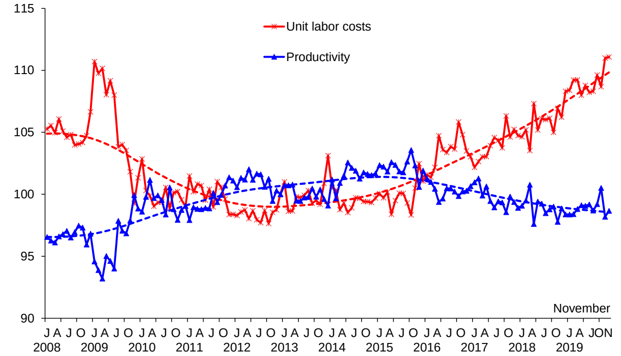
Percent, s. a.



s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: National Survey of Occupations and Employment (ENOE, for its acronym in Spanish), INEGI.

Chart 18
Productivity and Unit Labor Costs in the Manufacturing Sector1/

Indices 2013 = 100, s. a.



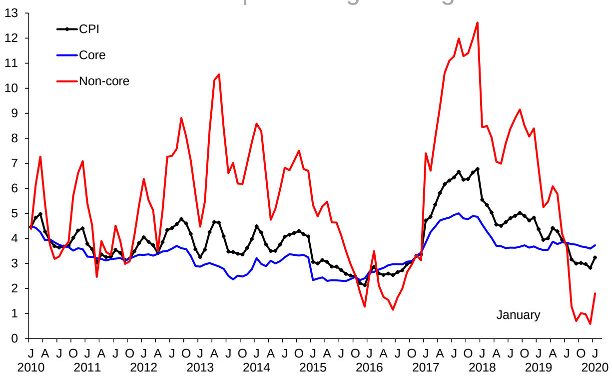
s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line. Trend series estimated by Banco de México.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data from the Monthly Survey of the Manufacturing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

In December 2019, domestic financing to the private sector continued growing at a lower rate. Within it, the deceleration of financing to private firms observed since the second half of 2018 intensified. This trend is explained by the lower growth of bank credit and a lower domestic debt issuance. As to the household segment, mortgages slowed down, while consumer credit continued growing at low rates. As for interest rates, those of firm financing decreased, in line with the reduction of the overnight funding interest rate. Interest rates of mortgages have remained stable since the second quarter of 2017, while in the segment of consumer credit, those of credit cards and personal loans stopped trending upward. With regards to portfolio quality, firm and mortgage delinquency rates remained at low levels, while those related to consumption did not register significant changes and continue at high levels.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation increased from 2.97 to 3.24% between November 2019 and January 2020 (Chart 19 and Table 1). This behavior was due to an increase of 5 basis points in the incidence of core inflation and of 21 basis points in that of non-core inflation.

Chart 19
Consumer Price Index
Annual percentage change



Source: Banco de México and INEGI.

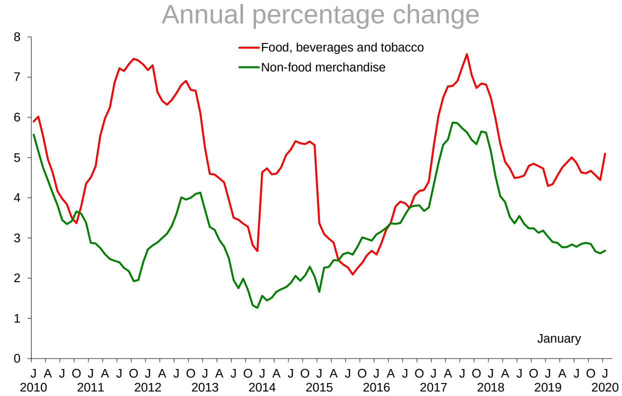
Annual core inflation increased from 3.65 to 3.73% between November 2019 and January 2020. Within this component, the annual rate of change of food merchandise prices increased from 4.56 to 5.10% during the same period, influenced by the increase in cigarette's and sugar-added drinks' excise taxes (IEPS, for its acronym in Spanish). In contrast, the annual rate of change of non-food merchandise prices remained at low and stable levels of 2.66 and 2.68% during said months (Chart 20). For its part, the annual rate of change of services prices decreased from 3.67 to 3.51% (Chart 21) mainly due to the lower increases in telecommunication and tourist services prices vis-à-vis the previous year.

Annual non-core inflation rose from 0.98 to 1.81% between November 2019 and January 2020 (Chart 22 and Table 1). This was basically due to an increase in the annual rate of change of energy goods prices, influenced by an upward effect stemming from the low comparison base on gasoline prices, which had decreased at the beginning of last year mostly due to the reduction of the VAT in the northern border area. As to the subindex of agricultural and livestock product prices, although their annual rate of change decreased between November and December, such behavior partially reverted in January due to the rise in the annual rates of change of fruit and vegetable prices.

As for inflation expectations drawn from Banco de México's Survey of Private Sector Forecasters, between December 2019 and January 2020, those for short-, medium- and long-term headline inflation remained relatively stable, although at levels above 3%. Those corresponding to core inflation for the same terms were revised upwards. Finally, long-term inflation expectations implied in market instruments were slightly revised downwards during the same period, while the inflation risk premium decreased.

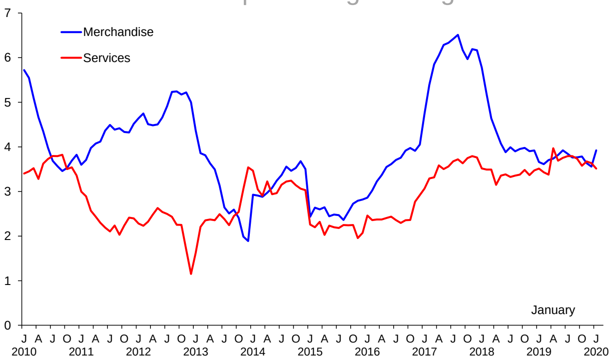
Regarding the risks to inflation, those to the upside include: core inflation's resistance to decline; wage increases affecting the labor market and prices; a possible exchange rate adjustment due to external or domestic factors; increases in agricultural and livestock prices greater than expected; and a deterioration of public finances. As for downside risks: a further appreciation of the peso exchange rate; lower international prices of energy goods due to the coronavirus outbreak; and a greater economic slack. In this context, uncertainty still persists regarding the balance of risks for the referred trajectory of inflation.

Chart 20
Merchandise Core Price Subindex
Annual percentage change



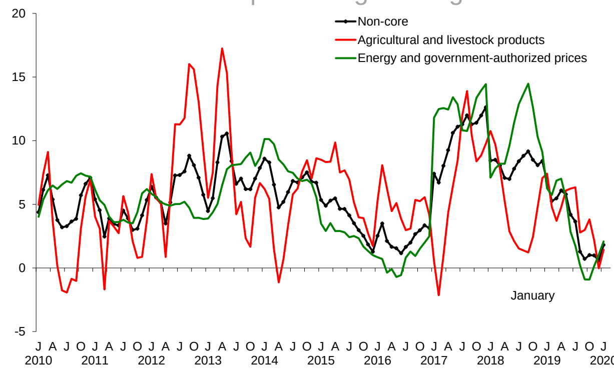
Source: Banco de México and INEGI.

Chart 21
Merchandise and Services Core Price Subindex
Annual percentage change



Source: Banco de México and INEGI.

Chart 22
Non-core Price Subindex
Annual percentage change

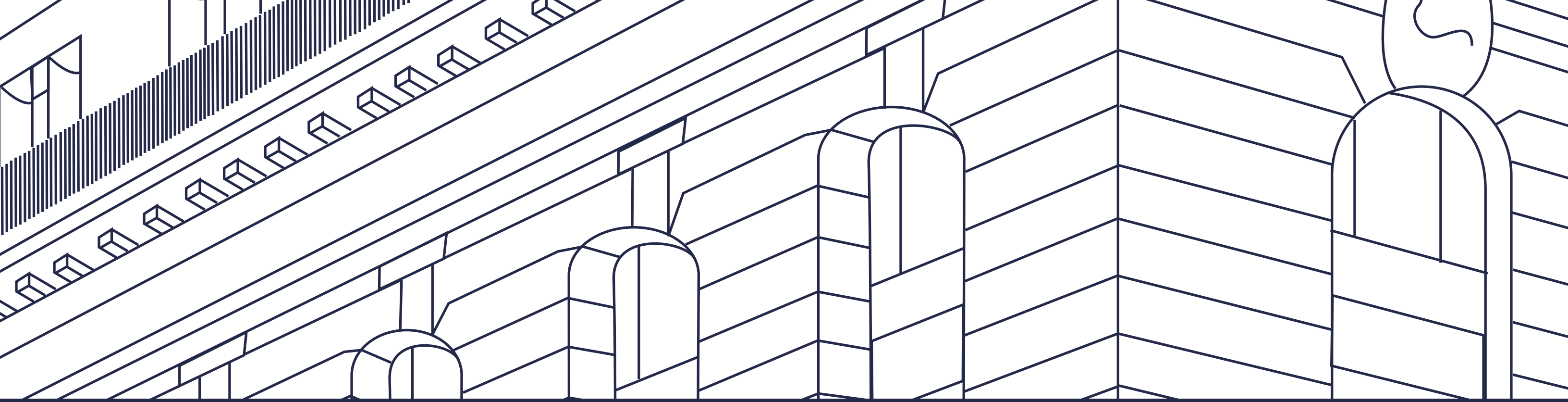


Source: Banco de México and INEGI.

Table 1
Consumer Price Index and Components
Annual percentage change

Item	November 2019	December 2019	January 2020
CPI	**2.97**	**2.83**	**3.24**
Core	**3.65**	**3.59**	**3.73**
Merchandise	**3.63**	**3.56**	**3.92**
Food, beverages and tobacco	4.56	4.45	5.10
Non-food merchandise	2.66	2.62	2.68
Services	**3.67**	**3.64**	**3.51**
Housing	2.88	2.91	2.93
Education (tuitions)	4.73	4.73	4.69
Other services	4.16	4.05	3.78
Non-core	**0.98**	**0.59**	**1.81**
Agricultural and livestock products	**2.18**	**-0.03**	**1.44**
Fruits and vegetables	-1.48	-5.40	-1.76
Livestock products	5.38	4.98	4.45
Energy and government-authorized prices	**0.14**	**1.04**	**2.08**
Energy products	-1.80	-0.54	0.86
Government-authorized prices	5.09	5.05	5.07

Source: INEGI.



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