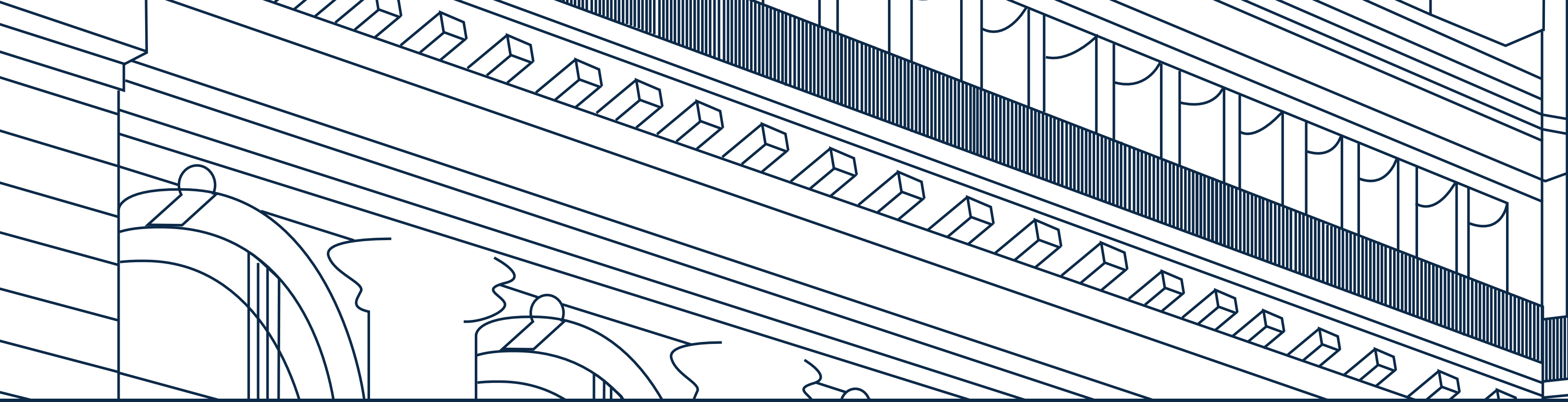

BANCO DE MÉXICO®

# Minutes number 106

## Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on February 8, 2024

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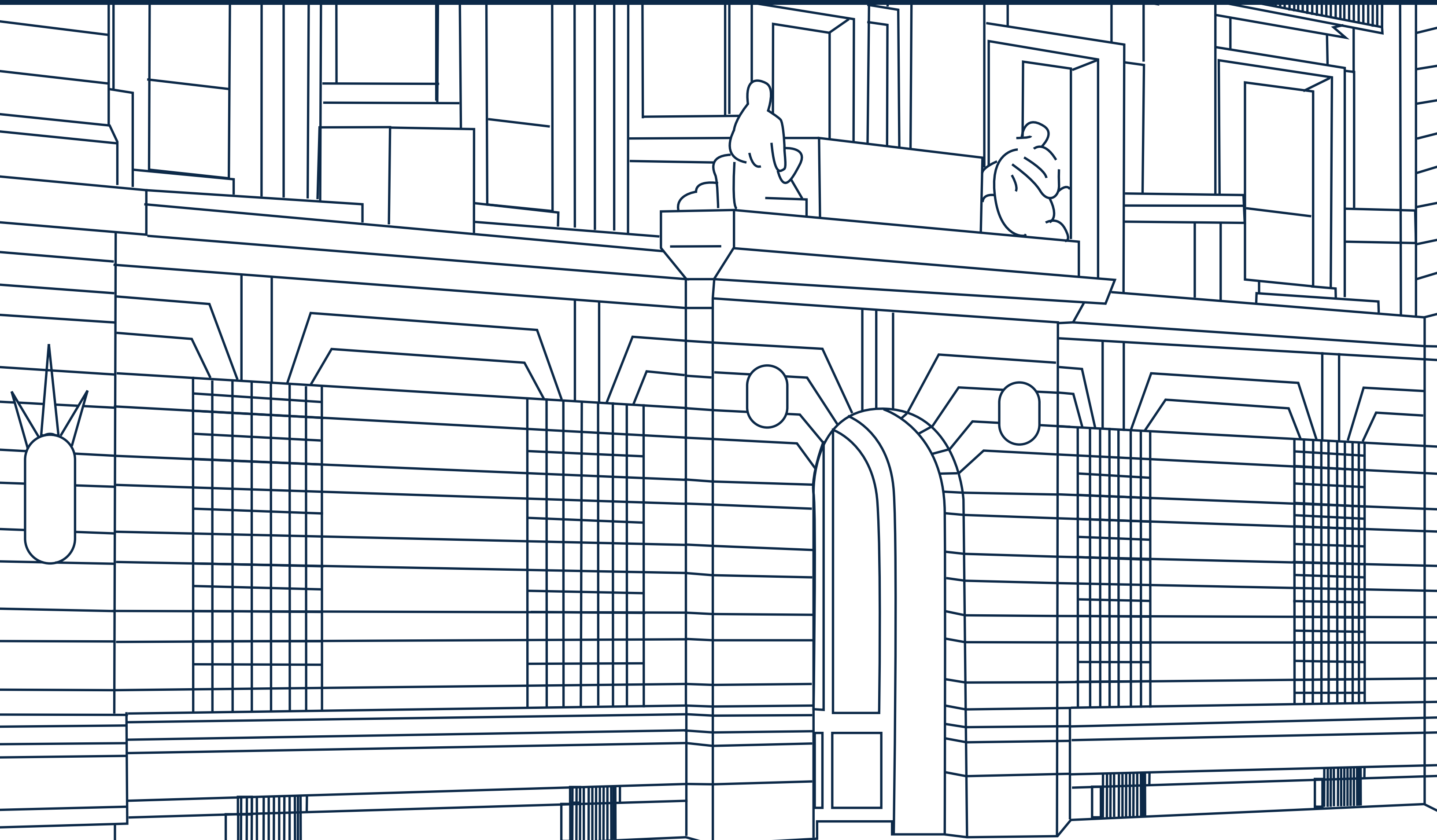

**FOREWARNING**
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## 1. PLACE, DATE AND PARTICIPANTS

**1.1. Place:** Meeting held by virtual means.

**1.2. Date of Governing Board meeting:** February 7, 2024.

**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.
- María Elena Méndez, Secretary of the Governing Board.

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

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

### *International environment*

**Most members highlighted the resilience of world economic activity, although they noted a differentiated performance among economies. One** member pointed out the dynamism exhibited by some economies in 2023, including that of the United States. He/she also mentioned the continuous tightening of labor markets and the boost to consumption observed in that economy. He/she compared the latter with the sluggishness shown by emerging economies, especially the Asian ones. **Another** member stated that during the last quarter of 2023, although the pace of expansion of the US economy moderated, it was higher than expected, while economic activity in the euro area remained stagnant. He/she added that emerging economies registered a lower dynamism during the same period compared to the previous quarter. Regarding labor markets, he/she indicated that they remain tight in the main economies, although in some of them they show signs of moderation. He/she mentioned that unemployment gaps have slightly narrowed and that wage growth has moderated, although it remains at high levels. He/she underlined that, despite the figure for non-farm payrolls at the margin which is consistent with the resilience of the US economy, this indicator has been trending downwards since mid-2022.He/she added that, likewise, a downward trend can be observed for vacancies and for excess demand for labor.

**Some** members indicated that forecasts from international organizations point to global growth of around 3% for 2024. **Some** members underlined that these forecasts consider a heterogeneous behavior among countries. **Most members mentioned that US economic growth is still expected to moderate**, although **some** members stated that the likelihood of a soft landing in that economy has increased. **The majority warned that the outlook for world economic activity faces risks. Some** members considered that this outlook remains uncertain given the expected slowdown in systemically important economies. **One** member highlighted the uncertainty about the impact of the tightening of credit conditions and decreased excess savings in the United States, and the real estate sector problems in China. **Another** member highlighted the risk of an escalation of geopolitical tensions, especially for world trade.

**Most members pointed out that, after decreasing in recent months, headline inflation has recently rebounded in several economies, especially in the advanced ones, due to pressures on energy prices. However, they indicated that, despite the upward adjustment at the margin, a significant decline in inflation has been observed at the global level. One** member attributed the latter to improvements in supply and to sound monetary policy stances in different regions. However, **another** member warned that, in a large number of economies, headline inflation remains above central banks' targets. **Most members argued that core inflation continued declining globally.** However, **one** member noted that, in most cases, it still remains high. **Another** member pointed out that progress in disinflation of the core component mainly reflects a sustained fall in food merchandise inflation. **Some**

members pointed out that, in contrast, services inflation still does not show a clear downward trend, although **one** member stated that it has moderated.

**Some** members indicated that in most economies inflation is expected to converge to their corresponding central banks' targets by 2025. **One** member pointed out that international organizations expect inflation to fall in nearly 80% of the world's economies during 2024. **Another** member mentioned that, looking ahead, various price-related pressures are expected to continue easing as the effects of pandemic-related shocks and the military conflict in Ukraine dissipate. He/she emphasized that this, along with tight monetary conditions worldwide, will continue contributing to global disinflation. **One** member pointed out that in the United States certain leading indicators suggest that shelter inflation, which has contributed significantly to inflation in that country, could moderate towards the second half of 2024.

**Some** members highlighted that, since the last monetary policy decision, international commodity prices have been volatile. **One** member underlined that oil prices were affected by the uncertainty associated with geopolitical conflicts, inventory levels, and a changing outlook for global demand. **Another** member stated that the outlook for commodity prices remains uncertain.

**The majority noted that the central banks of major advanced economies left their reference rates unchanged. One** member specified that the European Central Bank (ECB) kept its reference rates unchanged for the third consecutive meeting and that, despite the recent increase in headline inflation, it did not change its inflation outlook for the medium term. **Most members mentioned that at its first meeting of the year the US Federal Reserve left the target range for the federal funds rate unchanged for the fourth consecutive time. Some** members highlighted that said institution acknowledged that the risks to the fulfillment of its employment and price stability mandates are moving towards a better balance. **Some** members added that the Federal Reserve's chairman stated that the federal funds rate may have already reached its peak. **One** member underlined that he also pointed out the advance in the disinflation process despite the solid economic expansion and argued that it would be appropriate, sometime in 2024, to start reducing the funds rate, if the economy evolves as expected. **However, most members highlighted that said chairman indicated that they will wait until they have more confidence that the decline in inflation is sustainable before reducing the federal funds rate. Some** members stated that the aforementioned contributed to markets adjusting their expectations of the first rate cut towards the second quarter of 2024.

**Some** members noted heterogeneity in the monetary cycles across regions, especially in emerging economies. **One** member attributed this to a differentiated behavior of inflation and economic activity across economies. **Another** member underlined that some Latin American economies continue their monetary normalization. **One** member pointed out that the central banks of Brazil and Chile continued lowering their reference rates, reflecting optimism about their inflation trajectories, while the Central Bank of Colombia has been more moderate about its reference rate cuts. **Another** member indicated that, looking ahead, advanced economies, except for Japan, are expected to begin reducing their rates in the second quarter of 2024. **One** member noted that the ECB and the Bank of England emphasized that they will continue with a cautious and data-dependent approach to ensure that inflation remains on a trend towards their respective targets. **Another** member highlighted that few changes are anticipated in the policy stances of the monetary authorities of emerging European and Asian economies. **One** member added that adjustments in monetary policy stances this year are expected to be consistent with the convergence of inflation rates to their respective targets.

**Some** members noted that international financial markets have been sensitive to both the release of economic figures, mainly in the United States, and to changes in the outlook for reference rates, especially those of the Federal Reserve. **One** member pointed out that market reactions to events in the United States reflect the systemic nature of the US economy and the uncertainty about its evolution. **Another** member noted that in recent weeks markets have responded to data releases and to comments by central bank officers, seeking to anticipate the inflection point of monetary policy, mainly in the United States and Europe. **Some** members recalled that at the end of last year, sovereign interest rates decreased significantly. **One** member attributed this to the continued effects from the perception in financial markets that the Fed's message of high interest rates lasting longer in the major advanced economies is less likely to hold. **Another** member pointed to lower inflation as the cause. **Most members stated that, subsequently, the release of data suggesting that the US economy remains resilient had an impact on international financial**

**markets. Some** members pointed out that government interest rates have partially reversed the decline observed towards the end of 2023. **Some** members added that the US dollar has also recovered. **One** member noted that there has been a recent compression of credit spreads and a rebound in stock markets, particularly in the technology sector. **Some** members highlighted that volatility in these markets has moderated in recent weeks. Regarding emerging markets, **one** member underlined that the beginning of 2024 has been characterized by a slightly adverse performance of their assets, partly reversing the positive performance observed in the last quarter of 2023.

**Some** members stated that, looking ahead, episodes of financial volatility cannot be ruled out in view of the data-dependent stance of various central banks. In that regard, **one** member added that the divergence between what central banks have communicated and what markets expect represents a risk for financial stability, because it could generate sudden changes in the prices of some assets in case of unfavorable financial conditions. Among the risks to financial stability, **some** members pointed out the possibility of instability in light of various upcoming elections around the world this year. **One** member added that a possible escalation of geopolitical conflicts can also generate volatility.

### *Economic activity in Mexico*

**All members mentioned that in the fourth quarter of 2023, the Mexican economy registered a greater-than-expected slowdown. Most members noted that the three sectors of economic activity contributed to the slower pace of expansion. One** member pointed out that the economy grew at a quarterly rate of 0.1% in the fourth quarter, after having registered 0.6, 0.9 and 1.1% in the previous quarters. Thus, **some** members considered that, by expanding 3.1% during the year, the economy exhibited robust growth in 2023. **One** member added that, nevertheless, the slowdown at the end of the year implies a slightly lower expected GDP growth in 2024.

**Regarding the performance of industrial activity, all members stated that manufacturing showed weakness. One** member indicated that such behavior mirrored the sluggishness of this sector in the United States. **Some** members noted a moderation in the rate of growth of the transportation equipment component. **One** member pointed out that this happened after its significant expansion since the end of 2021. **Some** members highlighted that during 2023 the weakness of manufacturing contrasted with the dynamism of the construction sector. **However, most members stated that, as revealed in most recent data, the latter sector grew at a slower-than-expected rate.** In this regard, **some** members argued that, nevertheless, the level of activity in this sector remains high.

**Regarding domestic demand, most members indicated that recently investment moderated its pace of expansion due to a slowdown in non-residential construction and in machinery and equipment. Some** members mentioned that, in spite of the above, investment grew significantly over the last year and remains at high levels. **One** member pointed out that with data up to November, gross fixed capital formation grew at annual rates of over 20%. **Some** members added that consumption maintained its positive trend, although **some** members noted that it showed less dynamism towards the end of 2023. **Some** members indicated that consumption growth has reflected the dynamism of consumption of imported goods. **Some** members mentioned that, in contrast, consumption of domestic goods and services was sluggish. Regarding external demand, **one** member stated that manufacturing exports contracted during the fourth quarter of 2023. **Some** members noted that automotive exports improved slightly at the margin, while non-automotive exports moderated compared to the first half of 2023. In this regard, **one** member considered that aggregate demand has moderated. **Another** member warned that these signs of moderation must continue being monitored.

**Most members argued that economic activity is expected to resume a greater dynamism in the first half of 2024. Some** members noted that spending on public investment is expected to continue supporting economic growth. **One** member pointed out that in election years, domestic demand tends to be more dynamic during the first half of the year. **Another** member added that public construction spending is expected to continue in light of the fiscal expansion plans for the year. However, **one** member noted that there is uncertainty about the dynamism of economic activity in light of the effects that the fiscal stance might have, the slowdown observed at the end of 2023, and the expectation of weaker external demand. **Some** members stated that private spending is also foreseen to continue expanding. Regarding risks to growth, **one** member identified as a risk to the upside the possibility that the effects of nearshoring are greater than anticipated. As a risk to the downside, he/she mentioned a greater-than-expected deceleration of the US economy. He/she considered that risks to growth remain balanced.

**Most members mentioned that, despite the lower quarterly growth rate registered at the end of 2023, the point estimate of the output gap remained positive, although it decreased at the margin and is still not statistically different from zero. One** member pointed out that over the forecast horizon the gap is now estimated to be slightly less positive and to be closing gradually, approaching zero.

**Most members highlighted that the labor market continued showing strength. They agreed that unemployment rates remain low.** However, **some** members indicated that there are signs of easing in the labor market. **One** member added that growth of formal employment has slowed down. **Another** member stated that both the employment-to-working-age population ratio and the number of vacancies have shown signs of moderation. **Some** members mentioned the stabilization of the labor participation rate.

**Most members considered that wages continue increasing at an elevated rate. Some** members pointed out that they show double-digit nominal annual growth rates. **One** member stated that these rates of change are historically high. **Another** member indicated that the annual variation of the nominal daily wage associated with IMSS-insured workers remained above 10% in December, while contractual wage revisions stood at 9.7 and 4.2% in private and public companies, respectively. However, **one** member argued that wage variations of formal workers seem to have begun to stabilize. **Another** member pointed out that these have moderated in the industrial and service sectors. Regarding the recent increases in the minimum wage, **one** member stated that these have had an increasing incidence on the average wage.

### *Inflation in Mexico*

**Most members acknowledged the disinflation process in Mexico. Some** members noted that headline inflation is at levels significantly below the peak of 8.70% registered in August 2022. **One** member pointed out that it is currently 382 basis points below this peak, 248 of which are due to the decline in the core component and 134 to the non-core one. This member pointed out that the above reflects a better balance between the core and non-core contributions.

**All members mentioned that in the latest readings annual headline inflation increased, reaching 4.88% in January 2024. Most members pointed out that this increase in headline inflation was due to a rebound in the non-core component, as the core component has continued to decline. They highlighted that, after having registered historic lows, the non-core component has increased, reaching 5.24% in January. They noted that, at the margin, the rise in this component was due to marked increases in the prices of certain products within the fruits and vegetables subcomponent. Some** members mentioned that this was due to a considerable drop in the supply of these products caused by climate-related factors. **One** member underlined that in January inflation of the fruits and vegetables subcomponent stood at 21.78%. **Some** members emphasized that a large part of this increase was due to upward adjustments in the prices of three vegetables: onion, tomato, and tomatillo. **One** member specified that these three products accounted for more than 70% of the annual variation in this subcomponent in January. He/she noted that these price increases have been among the most extreme over the last two decades. **Another** member highlighted that these vegetables contributed with 84 of the 488 basis points that headline inflation registered in January. **One** member indicated that the annual price changes of just two CPI items jointly contributed with over half of the annual inflation of fruits and vegetables in its latest reading. **Another** member noted that the current level of non-core inflation is very close to its historical average, and thus the risk of a reversion to its historical mean has practically already materialized.

**All members highlighted that core inflation continued trending downwards, registering 4.76% in January 2024. Some** members underlined that since its peak in November 2022, this component has decreased by 375 basis points. **One** member highlighted that various measures of central tendency of core inflation have trended downwards since the second half of 2022, and that extreme variations have been declining. He/she pointed out that more than one third of the CPI items that make up this component show seasonally adjusted and annualized monthly variations of less than or equal to 3%.

**Regarding core inflation's components, most members noted the decline in merchandise inflation. They specified that in January both food and non-food inflation registered 5.54 and 2.97%, respectively. One** member stated that, although food merchandise inflation still remains at high levels, it has declined considerably. He/she pointed out that, after having attained a maximum of 14.14% in December 2022, it has decreased by 860 basis points and its most recent reading is the lowest since May 2021. **Another** member underlined that the merchandise price index has registered seasonally adjusted and annualized monthly variations close to 3%.

**The majority stated that services inflation still does not show a clear downward trend. Some** members pointed out that it was 5.25% in January. **One** member mentioned that, since August 2022, it has registered annual rates above 5%. He/she considered that such persistence is a matter of concern given that services are non-tradable, which makes them more sensitive to domestic pressures, particularly to the economy's cyclical conditions. **Another** member pointed out that services inflation remains high, with pressures perceived in two of its three components. **One** member stated that inflation of services other than housing and education remains stable, but at high levels. **Another** member emphasized that, at the margin, services inflation declined slightly and is below the maximum level of 5.71% attained in March 2023. He/she highlighted that price variations of some of its items have indeed trended downwards.

**Most members mentioned that services inflation continues reflecting the cost-related pressures that have accumulated as a result of the pandemic and the war in Ukraine. One** member stated that their performance corresponds to a necessary adjustment in the economy due to a significant distortion in the relative prices between merchandise and services which was generated as a result of the pandemic. He/she recalled that, amid the economic fallout from this health crisis, merchandise inflation increased before services inflation. In contrast, during the current disinflationary phase, merchandise inflation has decreased at a faster rate. However, he/she underlined that he/she anticipates a decline in services inflation insofar as the effects from the easing of the shocks are observed and monetary tightening has an impact. He/she added that the materialization of this outlook is a factor to monitor.

**Some** members considered that medium- and long-term inflation expectations drawn from surveys remained relatively stable. **One** member pointed out that they have gotten closer to their historical averages, and that their distributions have improved at the margin. **Some** members noted that they remain at levels above target. **One** member stated that expectations for the average of the next four years were at 3.7%, still above their historical average prior to 2020, while those for the next five to eight years remained at 3.5%.

As for short-term inflation expectations, **some** members indicated that those for the end of 2024 increased. **One** member pointed out that over half of surveyed analysts anticipate that by the end of 2024 inflation will exceed the variability range. **Another** member specified that the median of headline inflation expectations for the end of 2025 registered 3.7%, which differs from Banco de México's forecast of 3.1% for the same period. **One** member underlined that expectations for the next 12 months have continued decreasing and have accumulated a 104 basis-point drop since March 2023. **Another** member pointed out that short-term expectations for the core component decreased slightly, while those for the non-core component adjusted upwards. As for expectations implied by market instruments, he/she highlighted that breakeven inflation decreased for the short term, reaching below 4%, while for the long term it remained at higher levels. He/she noted that the slower evolution of expectations drawn from market instruments contrasts with the decline in analysts' medium- and long-term expectations. He/she mentioned that this suggests uncertainty regarding inflation's trajectory.

**Most members mentioned that the central bank's forecast for headline inflation was revised slightly upwards for the short term. They pointed out that supply shocks on non-core inflation basically account for said adjustment. They estimated that these impacts will not be long-lasting, and that for this reason the disinflation process is expected to continue in the following months. Some** members indicated that the incidence of said supply shocks is expected to decrease during the second quarter of 2024. **Most members pointed out that headline inflation is still foreseen to converge to target in the second quarter of 2025. Some** members stated that forecasts for core inflation remained practically at the same levels as in the previous monetary policy meeting. **One** member mentioned that projections for this component were revised slightly downwards for the first quarter of 2024 as a result of lower-than-expected annual variations in merchandise prices in January. **Another** member highlighted that the recent increase in the non-core component is not expected to pass on to core inflation, and it is still expected to be around 3% in the second quarter of 2025.

**All members considered that the balance of risks for the foreseen trajectory of inflation within the forecast horizon remains biased to the upside. One** member mentioned that, in his/her opinion, this balance has accentuated its upward bias and level of uncertainty. He/she pointed out that the risk of disinflation stagnating or reversing has increased. He/she highlighted that the core component has been declining recently at a slower pace. Likewise, he/she noted that non-core inflation has increased more than expected. On the other hand, **another** member emphasized that it had already been anticipated that the disinflation process would be non-linear and heterogeneous. He/she estimated that this does not alter the medium-term outlook for inflation. He/she asserted that, despite the recent rebound in headline inflation, the balance of risks has improved compared to that prevailing at the end of 2022 and at the beginning of 2023. He/she argued that the risks that currently prevail are more akin to those observed in previous inflationary episodes, as opposed to the atypical shocks faced in the aftermath of the pandemic, and thus their materialization would have more limited effects on inflation.

**Among upward risks to inflation, the majority underlined the persistence of core inflation at high levels.** In this regard, **some** members stated that services inflation will likely continue exhibiting some downward rigidity. **One** member pointed out that such rigidity may be the result of services prices not having compensated the totality of the increases observed in the production costs. **Another** member mentioned that the decline in merchandise inflation could also stagnate due to, among other factors, the deceleration in the decline of global inflation.

**Most members warned about the possibility of greater cost-related pressures of various nature. Some** members underlined the risk of an escalation of geopolitical turmoil leading to further increases in transportation costs and to upward pressures on energy prices by affecting the security and continuity of global supply chains. **One** member mentioned the possibility of climate-related, geopolitical and macrofinancial factors may accelerate inflation by disrupting the supply of agricultural and energy products, and merchandise. **Another** member added that a potential interruption of gasoline price policies also constitutes a risk for this component. However, **one** member expressed that, although incidents in the Red Sea have raised sea freight costs between Europe and Asia, their impact on inflation should be significantly lower compared to disruptions caused by pandemic-induced bottlenecks. On the other hand, **another** member mentioned the risk related to wage adjustments, as well as those associated with insecurity. **Some** members forewarned that non-core inflation could also continue to be affected by climate-related factors. **One** member added that said factors could also affect the core component, for instance, through the impact of water scarcity on the prices of some services.

**Some** members argued that the behavior of aggregate demand could also pose a risk to inflation's persistence. **One** member considered that capacity utilization and labor market indicators point to tight conditions, and thus aggregate demand-related pressures on prices cannot be ruled out. **Another** member pointed out that higher public spending planned for this year could reinforce demand-related pressures more than expected and slow down the reduction of inflation. He/she stated that, if the cuts in public spending in 2025 turn out to be smaller than those announced, growth would be higher than forecasted. On the other hand, he/she mentioned that markets expect reference rate cuts in advanced economies to be of greater magnitude than those implied by their central banks' communication. He/she cautioned that these discrepancies could result in capital outflows, foreign exchange depreciations, and inflationary pressures in emerging economies, including Mexico.

Among risks to the downside, **one** member highlighted a greater-than-anticipated deceleration of the world economy, leading to a faster-than-expected decline in global inflation. He/she underlined that the decline in global inflation, especially in the United States, contributes to disinflation in Mexico through lower variations in tradable goods' prices.

### *Macrofinancial environment*

**Some** members indicated that domestic financial markets exhibited an orderly behavior. **The majority mentioned that the Mexican peso appreciated slightly and its trading conditions improved. One** member underlined that such conditions have returned to pre-pandemic levels and that, overall, the Mexican peso remained stable despite the volatility registered in certain trading sessions. **The majority pointed out that the Mexican peso stood out among emerging economies' currencies, favored by a relatively high volatility-adjusted interest rate spread and stable macroeconomic fundamentals. Some** members expressed that both markets and analysts perceive the possibility of facing episodes of exchange rate volatility, and of observing an upward correction in the exchange rate associated, among other factors, with the electoral processes in both Mexico and the United States.

**The majority noted that government bond yields decreased moderately along the entire yield curve. One** member stated that foreign participants showed interest in short-term instruments. He/she attributed such interest to investors seeking to take advantage of interest rate levels and the expectation that these will remain relatively elevated throughout the year, compared to those of other emerging countries. **Some** members highlighted that in December there was also a significant positioning by foreign investors in domestic government debt. **One** member pointed out that the above partly reversed in January. **Another** member added that, during the first days of 2024, two placements of government debt were carried out in international markets. On the other hand, he/she indicated that stock markets have performed favorably and have exhibited gains of over 6% since the last monetary policy decision. **One** member added that these markets exhibited a strong dynamism at the end of 2023, but performed more moderately in January. **Another** member stated that, since the end of 2022, sovereign risk indicators for Mexico, as well as for other emerging economies, have trended downwards.

Regarding total financing in the economy, **some** members highlighted that it continued growing due to the expansion of the domestic component, while the external component decreased. **One** member mentioned that the expansion of monetary sources continued to reflect the acquisition of long-term instruments. **Most members highlighted that credit granted by commercial banks continued increasing. Some** members underlined that mortgage lending kept expanding moderately. They added that the consumer loan portfolio continued growing at a high rate, despite showing some deceleration. **One** member pointed out that such performance has been demand-driven since, according to the survey of banks, overall credit lending conditions have tightened. **Another** member added that demand from businesses for bank credit has maintained an expansion rate above its pre-pandemic annual average. Regarding credit risk, he/she indicated that delinquency levels remain at relatively low and stable levels, despite exhibiting a marginal upward trend.

### *Monetary policy*

**The Governing Board evaluated the effects of the shocks on inflation and its determinants, along with the behavior of medium- and long-term inflation expectations and the price formation process. It acknowledged the disinflationary process in Mexico. Nevertheless, it estimated 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. In the next monetary policy meetings, it will assess, depending on available information, the possibility of adjusting the reference rate. It will take into account the progress in the inflation outlook and the challenges that prevail. It will also consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.**

**One member** indicated that, while it should always be kept in mind that the inflation target refers to headline inflation, when conducting monetary policy, it should be considered that the non-core component is highly volatile and that core inflation better reflects the trend in inflation. He/she recalled that, during the second half of 2022, although headline inflation was already decreasing, the hiking cycle continued. He/she stated that this was because such decline was attributed to the decrease in non-core inflation, while the core component continued increasing. He/she pointed out that it was not until core inflation began to decline markedly that it was deemed that the disinflationary phase had started and that it was unanimously decided to stop increasing the reference rate. He/she highlighted that currently core inflation continues to decline. He/she stated that for monetary policy decisions it is important to consider that the increase in headline inflation reflects a change in relative prices of specific products in the non-core component. He/she added that shocks like the recent ones tend to reverse relatively fast and do not compare to those observed during the pandemic and during the war in Ukraine, which were widespread, deep, and long-lasting. He/she added that it is foreseeable that headline inflation will resume its downward trend in the following months. He/she mentioned that, at the next monetary policy decision meeting, depending on available information, the appropriateness of lowering the reference rate can be assessed, taking into account the visible progress in disinflation and, at the same time, the challenges that still persist. He/she argued that headline inflation remains above target and core inflation continues at relatively high levels despite having declined significantly. He/she underlined that acknowledging the progress in disinflation and discussing the possibility of lowering the reference rate does not imply that victory has been proclaimed in the fight against inflation, as it is recognized that the task is not yet completed. He/she stated that the prevailing level of monetary restriction should be weighed against the evolution of inflation and its components, as well as its outlook, considering that the restrictive policy stance that has been maintained as well as the one prevailing in the future will impact the inflation outlook over the horizon in which monetary policy operates. He/she considered that, given the challenges, whenever macroeconomic conditions allow for cuts in the reference rate, these would be gradual. He/she emphasized that Banco de México must continue with the cautious approach that has guided its decisions. He/she underlined that actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. This is for the benefit of the country's population, primarily its lower-income segments, which are the most affected by inflationary episodes.

**Another member** highlighted that, at this monetary policy meeting, it is important to consider that, while core inflation has exhibited a favorable behavior, the risks of a rebound in the non-core component, which would take it to levels closer to its historical average, have started to materialize to such an extent that it more than compensates for the decline that core inflation continues exhibiting. He/she indicated that, although the central scenario considers that the shocks on relative prices that have affected the non-core component will dissipate in the second quarter of 2024, other risks persist that may jeopardize the foreseen trajectory of inflation towards the 3% target. In this regard, he/she highlighted the possibility that non-core inflation stabilizes at levels above those forecasted for this component by the central bank. He/she pointed out that these forecasts anticipate non-core inflation to be at around half of its historical average throughout 2025. He/she also mentioned as risk factors for the foreseen trajectory for inflation a greater-than-anticipated resilience of the Mexican economy, and possible episodes of depreciation of the Mexican peso during 2024, given internal and external risk factors, as anticipated by some currency market indicators. Additionally, he/she expressed concern about inflation expectations, both drawn from surveys and implicit in market instruments, not decreasing at the required pace to reach the 3% target. He/she deemed that, in view of the environment of high uncertainty and the risks to the upside mentioned above, it is fundamental to maintain the attained level of monetary restriction, and therefore in this meeting the reference rate should remain at its current level. He/she stated that a tone of caution should be maintained in this monetary policy statement, given an environment in which the balance of risks for inflation remains biased to the upside. He/she warned that the fact that it may be necessary to maintain the current level of the reference rate longer than anticipated by market consensus cannot be ruled out. Given the prevailing inflationary dynamics, he/she mentioned that it is extremely risky to include forward guidance and therefore, in his/her opinion, a data-dependent approach should be reinforced. He/she argued that the monetary policy statement should provide flexibility for each of the future decisions, as the economic situation is highly uncertain, both externally and domestically. Therefore, the central bank should not commit to any adjustment of the reference rate within a specific timeframe.

**One member** highlighted that, on this occasion, a first reduction in the reference rate should not be considered, given that headline inflation has recently increased, even more than expected, due to the rebound in the non-core component and taking into account that short- and medium-term inflation expectations increased. He/she also argued that the inflation forecast might be perceived as optimistic since it assumes the increase in non-core inflation is temporary, of which there is no certainty. He/she considered that the recent surprising inflation and economic activity figures have sent mixed signals for determining the monetary policy stance. He/she stated that, before beginning a cycle of consecutive reference rate cuts, core inflation and, particularly, its services subcomponent, must show less persistence and consolidate into a downward trajectory, as anticipated by the central bank's forecasts. He/she mentioned that it will be necessary to make sure that the rebound in non-core inflation does not spill over to core inflation, that monetary policy has its expected impact on aggregate demand and that shocks to non-core inflation are effectively reversed. He/she pointed out that it is also necessary for inflation expectations to return to the variability interval. He/she stated that a signal must be sent that efforts to strengthen the anchoring of inflation expectations will not be spared. He/she underlined that, looking ahead, the current levels of monetary tightening must be maintained. He/she highlighted that, compared to other countries, monetary policy in Mexico is not as effective, and thus a longer-lasting monetary restriction is necessary. He/she pointed out that, since the last reference rate increase, a passive tightening of the monetary policy stance has been observed, and stated that the real ex-ante rate has increased by approximately 110 basis points. In view of the latter, he/she considered that, should the inflation outlook improve significantly, some adjustment to the reference rate could be made in order to maintain a high level of monetary restriction, but without generating excessive astringency. He/she added that the outlook is very uncertain and therefore caution and prudence in managing monetary restriction should prevail in the next monetary policy decisions. He/she underlined that any eventual downward adjustment to the reference rate should not be interpreted as the beginning of a monetary easing cycle. He/she highlighted that, in his/her opinion, it should be communicated that subsequent monetary policy decisions will be completely dependent on the evolution of the data and on the upside risks to inflation not materializing.

**Another member** stated that during 2023 inflation declined significantly and at a speed that has few precedents. He/she pointed out that recently there has been a reversion of the non-core inflation while the core one, which is the most sensitive to monetary policy, has continued to decline. He/she indicated that the Bank’s forecasts suggest that this process will continue, while inflation expectations remain anchored and moving slowly towards their historical averages. However, he/she warned that the gap between observed inflation and its target remains wide and there are several risks to attaining convergence. He/she mentioned that, in order to close the inflation gap, the ex-ante real interest rate has remained in restrictive territory since September 2022. He/she recalled that, although the nominal interest rate has not changed since March 2023, the monetary restriction has increased as inflation and inflation expectations have improved. He/she pointed out that in order to quantify the level of restriction attained, it’s possible to observe that the difference between the ex-ante real rate and the central estimate of its neutral range is more than double the inflationary gap. He/she added that, in the past, when inflation was above 4%, the real rate gap was on average less than one time the inflation gap. He/she underlined that, consistent with the extraordinary shocks that have been faced, the ratio between both gaps is the largest on record during an entire monetary cycle. He/she pointed out that this measure is also higher than the average currently maintained by both emerging and advanced economies, and even greater than that observed in economies that have shown strong resilience, that have faced episodes of exchange rate stress or that face fiscal-related pressures. He/she stated that, looking ahead, given the expected disinflation and the passive increase in the real interest rate, if the reference rate is not adjusted, the ratio between both gaps could increase significantly and above what is necessary. He/she added that, due to the upward bias in the inflation risk balance, the forecast is still susceptible to revision in that direction, which would imply that room to calibrate the monetary policy stance is limited and will need to be thoroughly assessed in each decision meeting. He/she highlighted that the approach should be prudent, cautious, flexible and data-dependent. He/she concluded that in subsequent decisions, if macroeconomic conditions allow, the prevailing level of restriction could be pondered along with the evolution of inflation and its determinants, in compliance with the constitutional mandate, seeking an orderly adjustment of the economy and financial markets.

**One member** highlighted that monetary policy should respond to the overall trend of the inflation outlook and considered that its improvements allow the discussion of whether it is adequate to make an adjustment to the monetary policy stance. He/she highlighted the decline of about 380 basis points in headline and core inflations, as well as decreases in the frequency of price revisions, in the fraction of line items with extreme variations and in the central tendency measures. Likewise, he/she pointed out that, although the balance of risks remains biased upwards, it is less adverse than the one prevailing at the start of 2023. He/she stated that the degree of monetary restriction attained resulted from the atypical nature of the shocks and risks confronted and reiterated that both have mitigated significantly. He/she recalled that the rebound in headline inflation is the result of a significant increase in the price of a few products from the non-core component, which is expected to be temporary, and considered it relevant progress that the recent disinflationary process has been guided by the core component. For that reason, he/she estimated that, in keeping with the tone of caution that has characterized this cycle, in this occasion there is space to adjust the communication so that it captures these improvements as well as the risks that prevail. On the other hand, he/she noted there has been a passive tightening of around 109 basis points and added that when inflation has been at similar levels, nominal and real interest rates have been well below current levels. Thus, he/she emphasized that the monetary policy stance is clearly restrictive by any metric, and argued that it will continue being robust even in case of changes in the relative stance. He/she highlighted that downward adjustments in the interest rate would not prevent the continuation of a restrictive stance, which is necessary given that there is still a distance to cover. Likewise, he/she mentioned that given that monetary policy operates with lags, it will continue fostering the convergence of inflation and added that the speed with which it is transmitted to the different components is heterogeneous. In that regard, he/she noted that the inflation of merchandise prices has declined faster than that of services prices, and indicated that the behavior of these last ones is the result of a necessary adjustment in the economy given the distortion of their relative prices. He/she argued that, the challenge is to adjust the degree of restriction in such a way that it is consistent with an inflation which, although above target, has decreased considerably. He/she stated that the adjustments to the policy stance will be gradual, given the expected non-linearity of the disinflationary process, which would allow an evaluation of its behavior and the monitoring of the prevailing risks. He/she indicated that whether such changes are continuous or not, will depend on the evolution of the inflationary outlook as a whole.

## 3. MONETARY POLICY DECISION

The Governing Board evaluated the effects of the shocks on inflation and its determinants, along with the behavior of medium- and long-term inflation expectations and the price formation process. It acknowledged the disinflationary process in Mexico. Nevertheless, it estimated 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. In the next monetary policy meetings, it will assess, depending on available information, the possibility of adjusting the reference rate. It will take into account the progress in the inflation outlook and the challenges that prevail. It will also consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

## 4. VOTING

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%.

## 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.

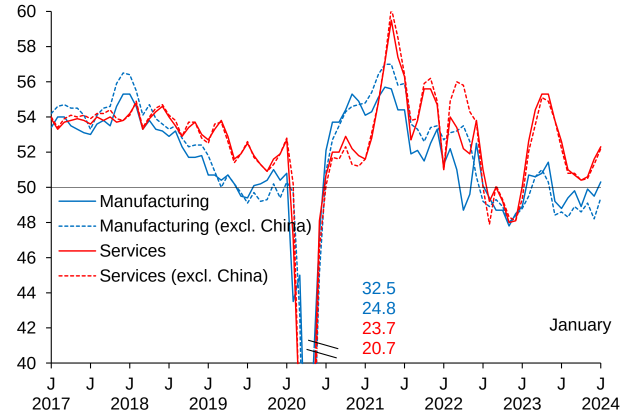
### A.1. External conditions

### A.1.1. World economic activity

During the fourth quarter of 2023, world economic activity is estimated to have grown at a more moderate rate than in the third one; nevertheless, it remains resilient. Overall, advanced economies are expected to have grown at a rate similar to that observed in the third quarter while emerging economies to have exhibited a lower dynamism. Heterogeneity in economic activity persisted across countries. Purchasing Managers' Indices point to a slight recovery in the services sector and sluggishness in manufacturing activity at the global level in early 2024 (Chart 1). Among key global risks, the following stand out: the intensification of geopolitical turmoil, the protraction of inflationary pressures, tight financial conditions, and, to a lesser extent, challenges to financial stability.

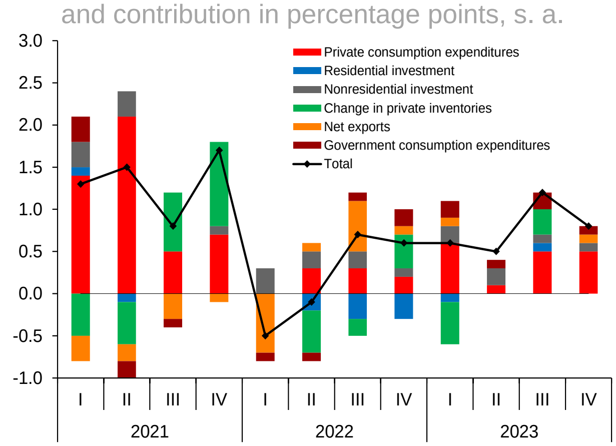
In the United States, economic activity grew at a slower rate during the fourth quarter of 2023, as compared to the third one. Said recovery was greater than expected at the beginning of the quarter and it was relatively dynamic. Gross Domestic Product (GDP) grew at a seasonally adjusted quarterly rate of 0.8%, after having increased 1.2% in the third quarter (Chart 2).[1] The slower rate of growth registered during the fourth quarter reflected the lower contributions from inventory accumulation, residential investment, and from public spending. In contrast, net exports made a positive contribution, and private consumption continued showing resilience.

**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, in the same order as the labels.
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).

[1] Expressed as a seasonally adjusted annualized quarterly rate, US GDP growth was 3.3% in the fourth quarter of 2023, and 4.9% in the third quarter of 2023.

US industrial production grew 0.1% in December 2023, after having remained stagnant in November. Manufacturing activity and mining made progress, which was partially offset by a setback in electricity and gas generation. The automotive industry continued to recover following the resolution of strikes in November in said sector. Purchasing Managers' Indices suggest that manufacturing production would remain weak.

The US labor market remained tight during the fourth quarter of 2023. The non-farm payroll continued expanding, going from an average monthly creation of 213 thousand new jobs during the third quarter to an average of 227 thousand new positions per month during the fourth quarter. In January, this indicator increased by 353 thousand new jobs, making it the largest monthly increase in a year. Initial claims for unemployment insurance remained at low levels, with 224 thousand new claims in the week that ended on January 27. The unemployment rate remained unchanged at 3.7% in January, for the third consecutive month. New vacancies remained at approximately 9.0 million in November and December. During the fourth quarter, wage growth showed relative stability, after having decreased in the previous quarter. In January, however, average hourly wages slightly increased.

In the euro area, economic activity remained stagnant during the fourth quarter of 2023, after GDP contracted at a seasonally adjusted quarterly rate of 0.1% during the previous quarter.[2] Such weak performance was associated with low consumer confidence, the persistence of geopolitical conflicts, and tightening domestic financial conditions, which have increasingly discouraged investment and consumption. The services sector and industrial activity have continued exhibiting weakness. The unemployment rate remained unchanged at 6.4% during November and December.

As for the rest of the main advanced economies, in most cases a moderate growth would have been registered in the fourth quarter of 2023, while their labor markets would have remained tight.

Most major emerging economies are expected to have expanded during the fourth quarter of 2023. However, heterogeneity in the performance of countries and regions' economic activity would have continued. In Asia and Emerging Europe, available information suggests a moderation in the pace of growth in most countries. Specifically, China decelerated. Its GDP grew at a seasonally adjusted quarterly rate of 1.0%, after having expanded at a rate of 1.5% in the third quarter.[3] Said economy continued facing significant risks stemming from problems in its real estate sector. In January, Chinese authorities announced additional monetary and financial measures to boost credit and stimulate economic growth. Finally, Latin American economies are expected to have grown at a somewhat heterogeneous pace.

International commodity prices have shown a mixed behavior since the last monetary policy decision in Mexico. Oil prices increased due to the recent attacks on vessels in the Red Sea, forecasts of higher oil demand this year, and disruptions in US oil production amid low temperatures. Meanwhile, gas prices decreased at the end of January due to lower energy demand stemming from forecasts of warmer temperatures in the United States and increased wind energy generation in Europe, which lowers the demand for gas as an energy source. Grain prices declined due to increases in corn production in the United States and soybean production in South America, as well as in wheat exports from Russia. Sugar prices faced certain upward pressures due to expected lower production attributed to adverse weather conditions in producing regions and to the imposition of taxes on exports in India. Overall, metal prices increased due to expectations of higher demand amid anticipations of a reduction in the Chinese interest rate and liquidity injection by the central bank of said country.

### A.1.2. Monetary policy and international financial markets

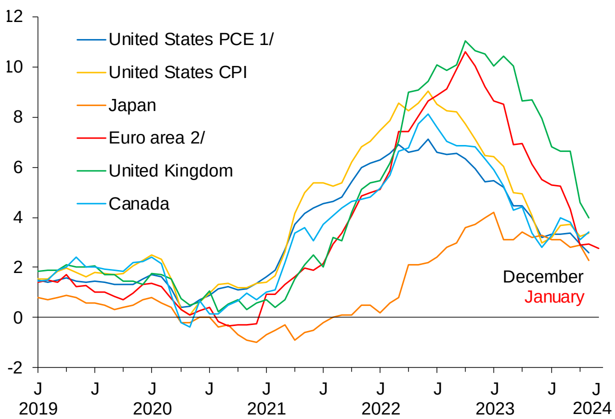
After having trended downwards in previous months, headline inflation increased in most advanced economies (Chart 3). This was generally due to

[2] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 0.1% in the fourth quarter of 2023 and -0.5% in the third quarter of 2023.

[3] Expressed as an annual rate, China's GDP growth was 5.2% in the fourth quarter of 2023 and 4.9% in the third quarter of 2023.

pressures on energy prices. On the other hand, core inflation in this group of countries continued decreasing. In the United States, annual headline inflation measured by the consumer expenditure deflator remained practically unchanged at 2.6% between November and December. This was due to a lesser deflation in energy prices combined with the ongoing decline in food inflation and in the core component. Annual core inflation decreased from 3.2% in November to 2.9% in December. The country's headline inflation measured by the CPI index increased in annual terms from 3.1% in November to 3.4% in December. Annual core inflation declined from 4.0 to 3.9% 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 January.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

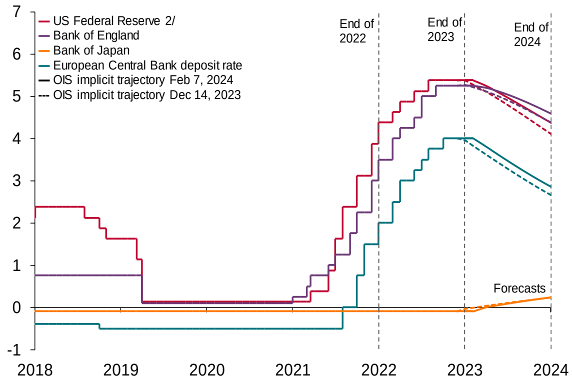
Analysts' short-term inflation forecasts for most major advanced economies continued anticipating a moderation in headline inflation in 2024. However, this year it would remain above their central banks' targets. Longer-term inflation expectations drawn from financial instruments remained relatively stable compared to mid-December figures.

In most emerging economies, annual headline inflation decreased. This was due to lower pressures on energy prices, food prices, and the core component. However, in most of these economies, headline inflation remains above their central banks' targets. In some cases, including Chile, South Africa, the Philippines, India, and Indonesia, headline inflation was within each central bank's variability interval. In China and Thailand, annual headline inflation persisted at negative levels. In most of the major emerging economies, core inflation declined.

In this context, since the last monetary policy decision in Mexico, the central banks of the major advanced and emerging economies have made differentiated decisions regarding their reference rates, depending on the evolution of each country's economic indicators.

In the main advanced economies, central banks left their reference rates unchanged, and most of them continued reducing their securities' holdings gradually. Regarding future adjustments, overall, central banks indicated that their actions will remain dependent on information about the inflation outlook. Additionally, some of them reported that they are prepared to make additional adjustments, if necessary, to bring inflation back to target. The central banks of these economies are expected to have completed their tightening cycle or be close to completing it, thus paving the way for potential reference rate cuts in 2024. As for market expectations on their reference rates, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) indicate that these will decrease by at least 25 basis points for the end of the second quarter in some of these economies (Chart 4).

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




1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate
2/ For the observed reference rate of the U.S., 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 stand out:

i) At its January meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the fourth consecutive decision, between 5.25 and 5.50%. Additionally, the Federal Reserve continued to reduce its balance sheet. It noted that, when considering any adjustment to the target range for the federal funds rate, the Federal Open Market Committee (FOMC) will carefully assess incoming data, the evolution of the economic outlook, and the balance of risks. It added that the Committee does not deem it appropriate to reduce the target range until there is greater confidence that inflation is moving sustainably towards 2%. Additionally, it reiterated that it is prepared to adjust the monetary policy stance as necessary if risks that potentially jeopardize the attainment of the FOMC's objectives arise. During the press conference, the chairman of that institution indicated that they consider that the monetary policy rate is likely at its peak in this tightening cycle, and, if the economy overall evolves as expected, it will probably be appropriate to start reducing the restrictive monetary policy stance at some point this year. In this regard, he indicated that it is unlikely that the Committee will be sufficiently confident at its March meeting to do it at that moment. He noted that reducing the restrictive stance of monetary policy too soon or excessively could lead to a setback in the progress attained in disinflation, and that doing so too late or insufficiently could disproportionately weaken economic activity and employment. He added that the FOMC is prepared to maintain the current target range for the federal funds rate for longer if appropriate. Expectations drawn from financial instruments anticipated a 5.2% rate for the first quarter of 2024 that would subsequently decrease to levels close to 4.4% by the end of 2024 and to 3.4% by the end of 2025.

ii) At its January meeting, the European Central Bank (ECB) left its reference rates unchanged for the third consecutive decision. Thus, its refinancing, key lending, and key deposit rates remained at 4.50, 4.75, and 4.0%, respectively. Its Governing Council reiterated that it considers interest rates to be at levels that, if maintained for a sufficiently long period, will contribute substantially to timely return inflation to its target. The Council reiterated once again that it will continue adopting a data-dependent approach to determine the appropriate duration and degree of monetary tightening. In the press conference, the president of the institution mentioned that the consensus within the Governing Council is that it is still premature to discuss cuts in the reference rate. Regarding its Pandemic Emergency Purchase Program (PEPP), the Governing Council continued with the normalization of its balance sheet and expects to conclude reinvestments of maturing securities purchased under the PEPP by the end of 2024.[4]

In the main emerging economies, since the last monetary policy decision in Mexico, a large number of central banks have cut their reference rates, taking into consideration the specific economic circumstances of their countries. The Central Bank of Brazil reiterated that the members of the Committee anticipate additional cuts of the same magnitude (50 basis points) in the next decisions if the scenario evolves as expected. On the other hand, the Central Bank of Chile increased the pace of rate cuts from 75 basis points in its December decision to 100 basis points in its January meeting. In that last meeting, the Council noted that inflation convergence to its target would materialize earlier than expected and that the reference rate would

[4] During the first half of 2024, the Governing Council will reinvest in full the principal payments of maturing securities purchased under the PEPP. In the second half of that year, it plans to reduce the portfolio by an average monthly amount of EUR 7.5 billion, and then to conclude reinvestments by the end of 2024.

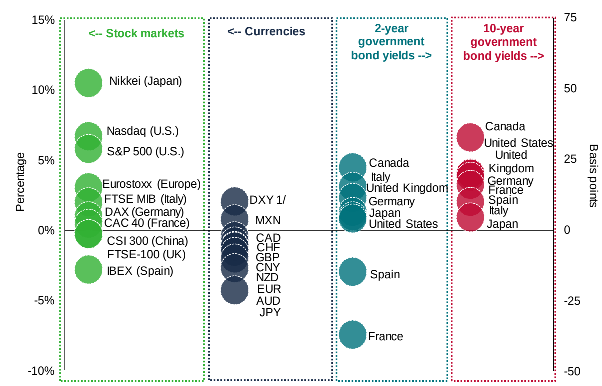
reach its neutral level during the second half of 2024. Although China's reference rates remained unchanged, its central bank continued implementing alternative easing measures. In particular, it announced a 50-basis-point cut in its reserve requirement ratio and continued injecting liquidity through its medium-term credit line. In contrast, the central banks of Russia and Turkey continued increasing their reference rates in their recent monetary policy decisions.

Since the last monetary policy decision in Mexico, international financial conditions remained stable, following the moderate easing observed during the previous months (Chart 5). This behavior reflected increases in long-term interest rates, which were offset by a more favorable performance in stock markets. Thus, global government interest rates generally reversed part of the decline they exhibited in the last months of 2023 (Chart 6). In foreign exchange markets, the US dollar appreciated. The currencies of most emerging economies depreciated against the US dollar (Chart 7). Finally, since the last monetary policy decision, capital inflows into emerging economies have been registered. However, these flows registered a differentiated behavior among asset classes, with net inflows of equity assets and slight outflows from fixed-income assets during most of the period.

**Chart 5**
**Financial Conditions Index[1/]**
Units


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

**Chart 6**
**Change in selected financial indicators from December 14 to February 7, 2023**
Percent; basis points




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

## Chart 7
## Selected emerging economies: financial assets performance as of December 7, 2023

Percent, basis points

| Region | Country | Currencies | Equity markets | 2-year interest rates | 10-year interest rates | CDS |
|---|---|---|---|---|---|---|
| Latin America | Mexico | 2.05% | 6.19% | -7 | -12 | -10 |
| | Brazil | -0.75% | 1.62% | -36 | -30 | -14 |
| | Chile | -8.04% | 1.13% | -77 | -21 | -6 |
| | Colombia | 1.74% | 11.56% | -136 | -110 | -1 |
| | Peru | -1.49% | 22.89% | -88 | -38 | -10 |
| Emerging Europe | Russia | 1.55% | 5.04% | -156 | -200 | N.A. |
| | Poland | 0.59% | 4.02% | -22 | -11 | 1 |
| | Turkey | -5.33% | 8.42% | 281 | 49 | -8 |
| | Czechia | -2.17% | 3.84% | -152 | -40 | -1 |
| | Hungary | -0.18% | 11.89% | -104 | -50 | -10 |
| Asia | China | -0.53% | -7.96% | -31 | -26 | 2 |
| | Malaysia | -0.89% | 5.11% | -4 | 5 | 1 |
| | India | 0.52% | 3.69% | -23 | -18 | 2 |
| | Philippines | -1.11% | 7.58% | 4 | -13 | -5 |
| | Thailand | -0.20% | 0.39% | -14 | -19 | -2 |
| | Indonesia | -0.92% | 1.46% | -37 | -5 | -2 |
| Africa | South Africa | -0.18% | -0.10% | -11 | -17 | -6 |

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

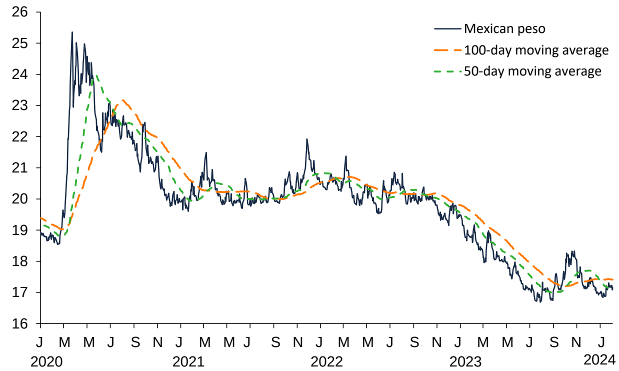
### A.2.1. Mexican markets

In the international context described above, the Mexican peso appreciated. Interest rates on government securities showed mixed movements for the short and medium terms, and moderate increases for the long term.

Since Mexico's last monetary policy decision, the Mexican peso has traded in a range of 76 cents, between 16.78 and 17.54 pesos per US dollar. (Chart 8). During this period, the currency appreciated 2.05%. This adjustment occurred in an environment where trading conditions slightly improved.

## Chart 8
## Mexican peso exchange rate

MXN/USD

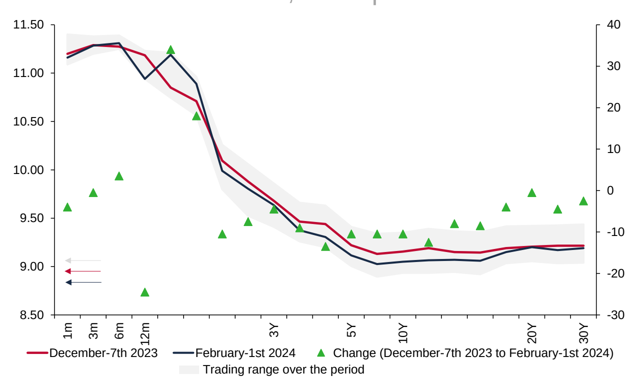



Source: Prepared by Banco de México.

Interest rates on government securities registered decreases in the long-term segment and increases in some short-term nodes (Chart 9). The yields on real-rate instruments exhibited limited changes. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments decreased by up to 12 basis points (Chart 10). Trading conditions in the government debt market slightly improved (Chart 11).

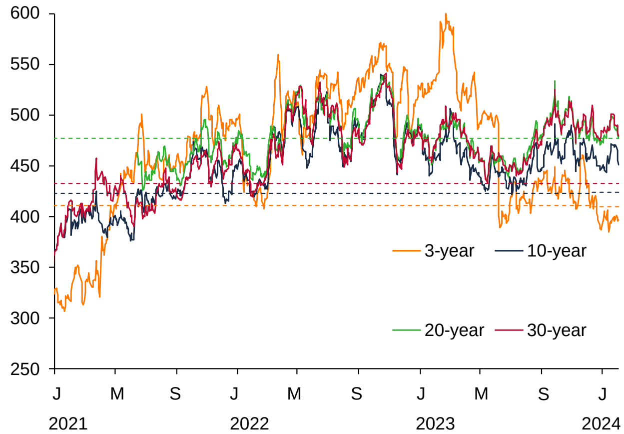
## Chart 9
## Nominal yield curve of government securities

Percent, basis points



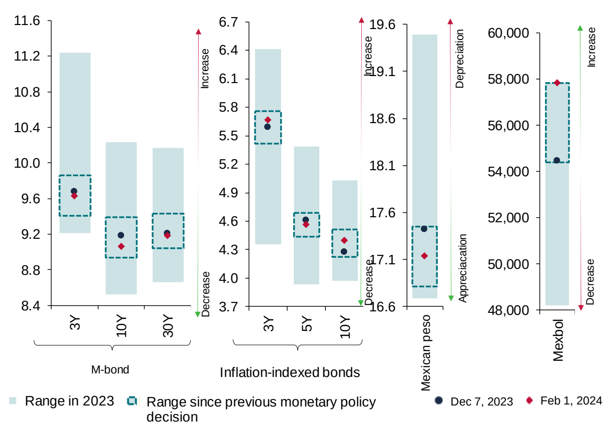

Source: PIP.

### Chart 10
### Breakeven inflation and inflation risk implied in government securities' yields [1/]
Basis points




1/ The horizontal lines refer to the respective averages observed from September 2008 to date.
Source: PIP.

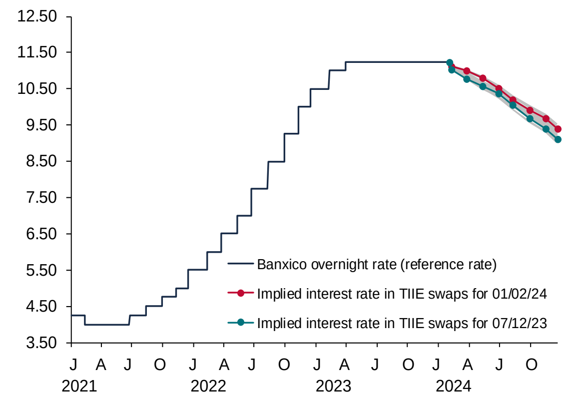
### Chart 11
### Mexican financial markets' performance
Percent, basis points




Source: Prepared by Banco de México.

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve does not incorporate any adjustment for the February decision and a first cut of 25 basis points in March 2024 (Chart 12). Similarly, most analysts surveyed by Citibanamex anticipate that the reference rate will remain unchanged in the February decision and that the first 25 basis-point cut will be made in March 2024.

### Chart 12
### Interbank funding rate implied in TIIE swaps
Percent



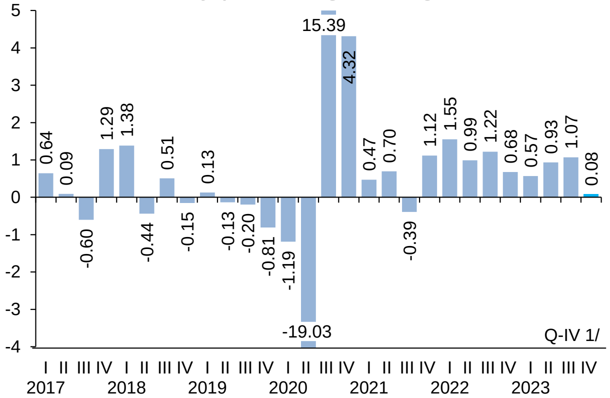

Note: Shaded areas represent the range since the last monetary policy decision.
Source: Prepared by Banco de México with Bloomberg data.

## A.2.2. Economic activity in Mexico

The Mexican economy experienced robust growth in 2023, although during the last quarter economic activity slowed down significantly. According to the flash estimate published by INEGI, Mexico's GDP registered a seasonally adjusted quarterly variation of 0.08% in the last quarter of the year (Chart 13).

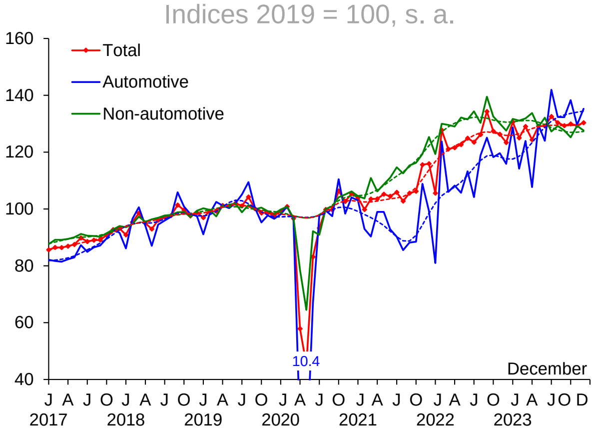
Regarding domestic demand, private consumption continued trending upwards in November 2023. As for its components, consumption of imported goods continued showing a high level of dynamism, while consumption of domestic goods and services remained sluggish. Although gross fixed investment remained at high levels, it slowed as a result of lower growth in construction spending and a certain loss of dynamism of investment in machinery and equipment. As for external demand, during the October-December 2023 period, the average dollar value of manufacturing exports fell slightly with respect to the third quarter. This was the result of decreases in both automotive shipments and the aggregate of all other manufacturing exports (Chart 14).

## 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 corresponfing to the fourth 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.

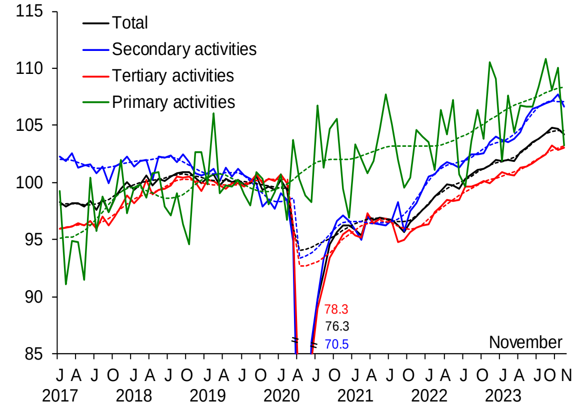
## Chart 14
## Total manufacturing exports
Indices 2019 = 100, s. a.




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

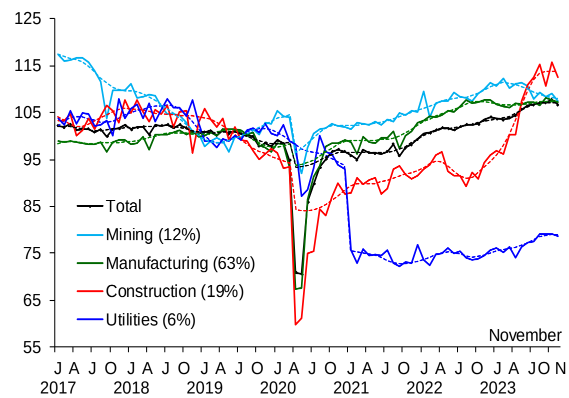
On the production side, during the October-November 2023 period, services showed less dynamism than in previous quarters, with a differentiated behavior among sectors. Industrial activity registered a deceleration in its growth rate (Chart 15). Within manufacturing activity, light vehicle production contracted significantly both in November and December, while the aggregate of the rest of manufacturing production continued showing weakness. Construction was at historically high levels, although with a notable moderation in its rate of expansion (Chart 16).

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




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

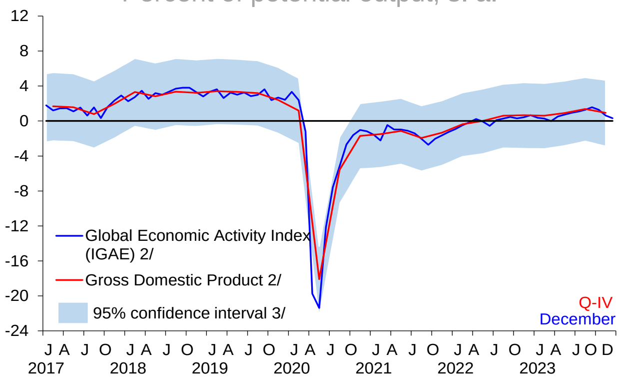
## Chart 16
## Industrial activity [1/]
Indices 2019 = 100, s. a.




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

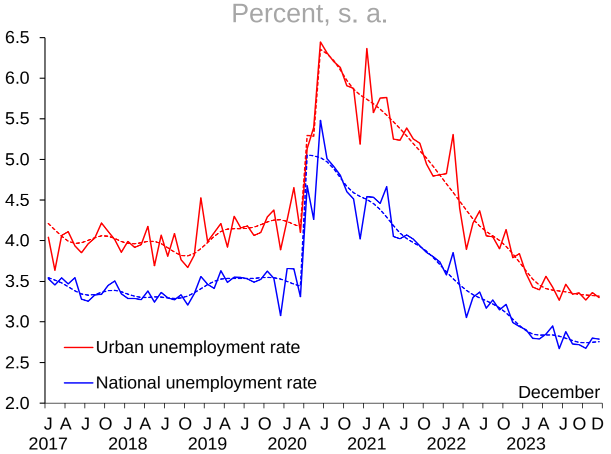
Regarding the cyclical position of the economy, the point estimate of the output gap remained in positive territory in the last quarter of 2023, although it declined at the margin and continued without being statistically different from zero (Chart 17). The labor market continued showing strength. At the end of 2023, with seasonally adjusted figures, the national unemployment rate registered a level similar to that of the previous month, while the urban unemployment rate decreased (Chart 18). Both rates remained at historically low levels. Between the end of 2023 and the beginning of 2024, the number of newly created IMSS-insured jobs continued increasing with seasonally adjusted data, albeit at a slower pace than in the first half of 2023. Finally, in November, unit labor costs in the manufacturing sector increased and partially reversed the decreases of September and October (Chart 19).

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



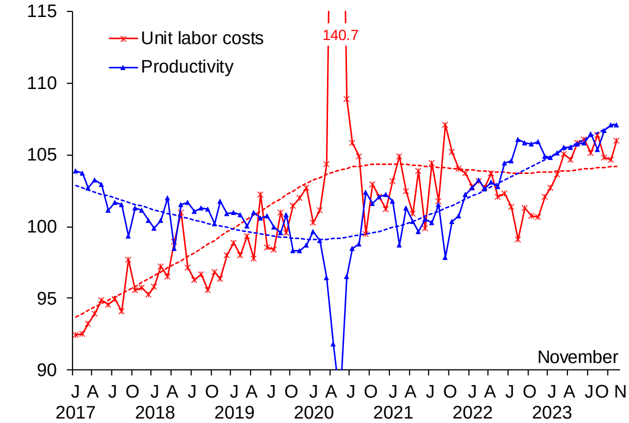

s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ GDP flash estimate up to Q4-2023 and IGAE implicit up to December 2023, consistent with said timely 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 series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from ENOE, ETOE (from April to June 2020), and ENOE new edition (ENOE[N]) from July 2020 to December 2022.

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




s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
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.

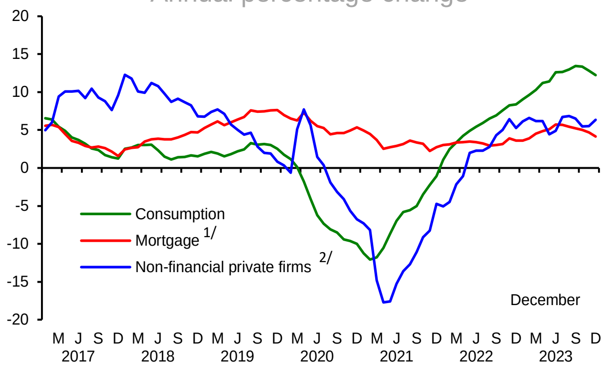
In December 2023, domestic financing to the private sector continued showing dynamism. Within it, bank lending to firms kept expanding, and thus its real annual variation was at levels similar to those observed at the beginning of that year (Chart 20). As for portfolio quality, delinquency rates of commercial bank credit to the private sector remained at low levels in December 2023. In the case of consumer portfolio, although it continues at levels similar to those registered before the onset of the pandemic, delinquency rates increased and extended the upward trend observed since the first half of 2023.

As for lending to households, the bank housing portfolio continued increasing. Meanwhile, commercial bank consumer credit continued registering high growth rates, although some moderation was observed in certain segments. The dynamism of commercial bank credit to the private sector continued to be driven mainly by a greater demand for financing from firms and households. This behavior is in line with the dynamic recovery that Mexico's economic activity has exhibited since 2021 as well as with the strength of the labor market.

As for the cost of financing, interest rates on bank credit to firms remained stable and at high levels in December 2023. Corporate credit intermediation margins continued to be generally lower than those observed prior to the pandemic. Interest rates on mortgages remained at levels similar to those observed prior to the health emergency. Within consumer credit, credit card interest rates have been adjusting with a lag to changes in the reference rate. Last, interest rates on payroll loans have remained relatively stable since August 2021.

As for portfolio quality, delinquency rates of bank credit to the private sector remained at low levels in December 2023. In the case of consumer portfolio, although said rates continue at levels lower than those registered prior to the onset of the pandemic, they showed increases and have extended the upward trend observed since the first half of 2023.

**Chart 20**
**Performing credit from commercial banks to the non-financial private sector**
Annual percentage change

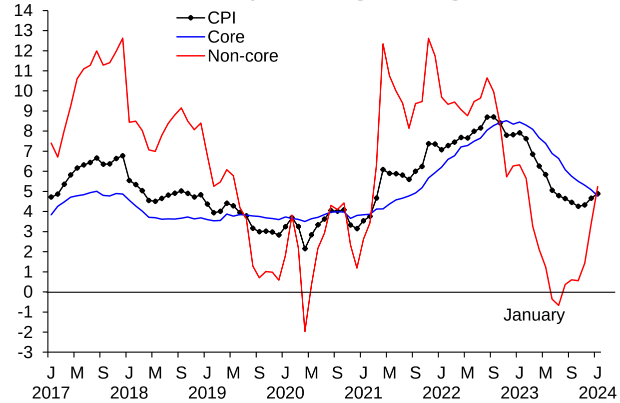



1/ Adjusted to account for the withdrawal from and the incorporation of nonbank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

### A.2.3. Development of inflation and inflation outlook

Annual headline inflation rose from 4.32 to 4.88% between November 2023 and January 2024. This result was due to the increase in non-core inflation, while core inflation continued decreasing (Chart 21 and Table 1).

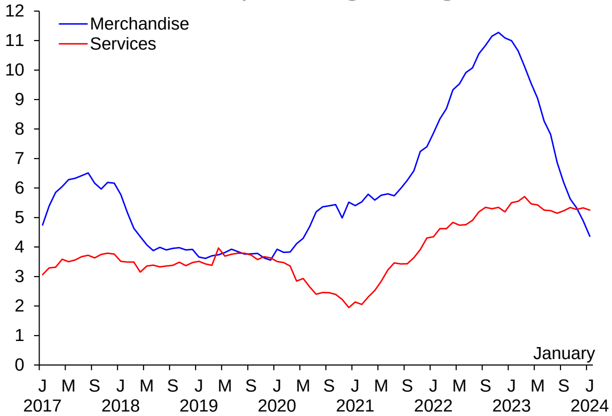
**Chart 21**
**Consumer Price Index**
Annual percentage change




Source: INEGI.

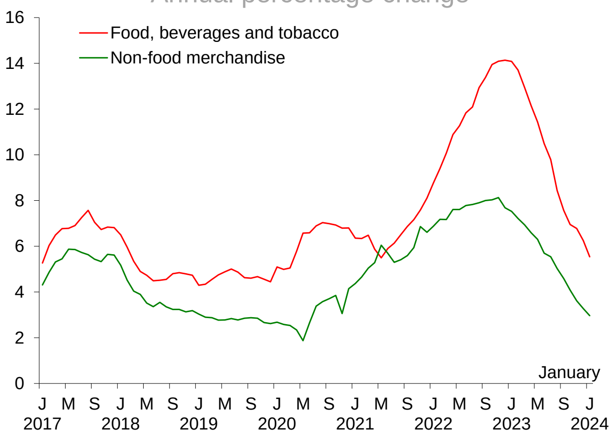
Annual core inflation decreased from 5.30 to 4.76% between November 2023 and January 2024. As for its components, there was a differentiated behavior between merchandise and services inflation. The former remained on a downward trajectory, while the latter continued without showing a clear downward trend (Chart 22). During this period, annual merchandise inflation decreased from 5.33 to 4.37%. This reflected the mitigation of the shocks derived from the pandemic and the military conflict in Ukraine, as well as the lower levels of the exchange rate compared to those observed at the beginning of 2023. In particular, annual food merchandise inflation fell from 6.78 to 5.54% and non-food merchandise inflation decreased from 3.62 to 2.97% (Chart 23). Annual services inflation remained at high levels, affected by pressures related to operating costs and their pass-through to consumer prices due to the recovery of demand after the confinement. During the same period, it went from 5.28 to 5.25%.

**Chart 22**
**Merchandise and services core price subindex**
Annual percentage change




Source: INEGI.

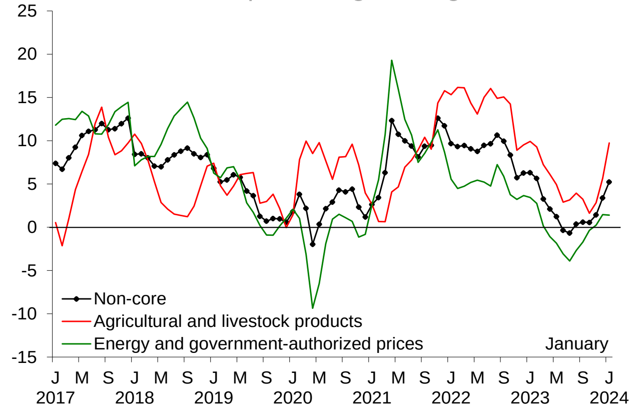
**Chart 23**
**Merchandise core price subindex**
Annual percentage change




Source: INEGI.

Annual non-core inflation increased from 1.43 to 5.24% between November 2023 and January 2024 (Chart 24 and Table 1). This result was mainly due to the increase from 2.85 to 9.75% in the annual inflation of agricultural and livestock products. Within this category, fruit and vegetables inflation rose from 5.59 to 21.78% in the same period. In this regard, in January the annual variations in both tomato and onion prices contributed more than half of the annual inflation of fruits and vegetables. In contrast, the annual inflation of livestock products decreased from 0.62 to -0.19% between these dates. The annual inflation of energy products rose from -1.64 to 0.21% during the same period, mainly influenced by the higher annual variation of L.P. gas prices, which rose from -15.49 to -7.59%.

**Chart 24**
**Non-core price subindex**
Annual percentage change




Source: INEGI.

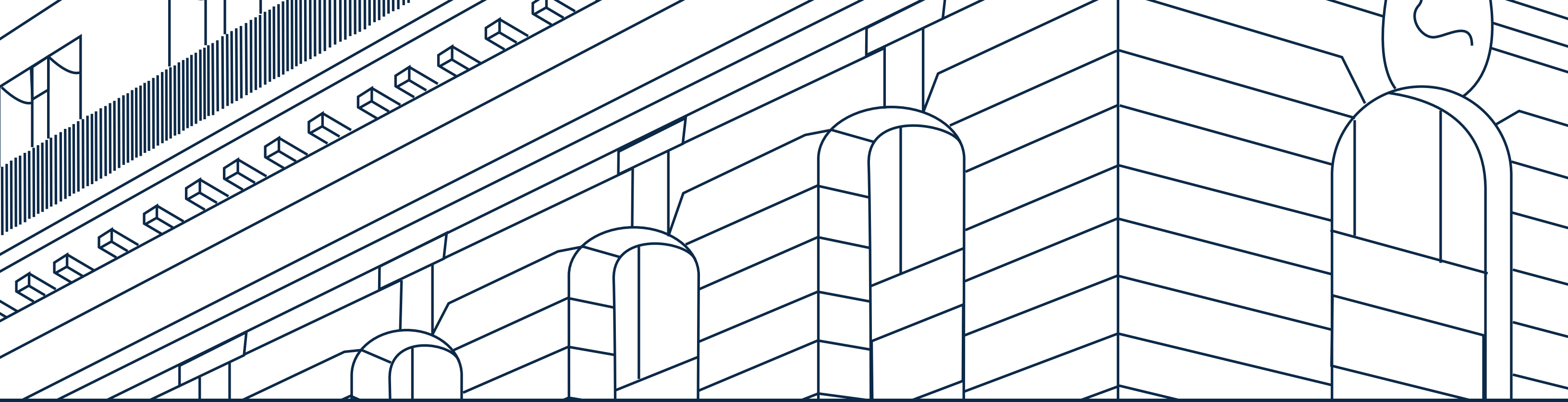
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between November 2023 and January 2024, the median corresponding to headline inflation at the end of 2024 increased from 4.00 to 4.17%. That corresponding to the core component remained stable, going from 4.10 to 4.06%. Inflation expectations for the end of 2025 remained practically unchanged. In particular, the median of headline inflation expectations went from 3.74 to 3.71% while that of the core component went from 3.76 to 3.72%. The median of headline inflation expectations for the next four years decreased from 3.76 to 3.70%, while that corresponding to the core component fell from 3.77 to 3.70%. The medians of headline and core inflation expectations for the long term (5 to 8 years) remained stable, at around 3.50%. Finally, compensation for inflation and inflationary risk was at a level similar to that observed in the previous monetary policy decision, although it registered some volatility during the period. Regarding its components, inflation expectations implied by market instruments decreased slightly. Meanwhile, the inflation risk premium, which declined between November and December, reversed this adjustment in January.

Headline inflation is still foreseen to converge to the 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) foreign exchange depreciation; iii) greater cost-related pressures; iv) a greater-than-expected resilience of the economy; v) climate-related impacts; and vi) the intensification of geopolitical conflicts. 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 registered by Mexico's exchange rate in relation to the first months of 2023 contribute more than anticipated to reduce certain 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 | November 2023 | December 2023 | January 2024 |
|---|---|---|---|
| **CPI** | **4.32** | **4.66** | **4.88** |
| **Core** | **5.30** | **5.09** | **4.76** |
| **Merchandise** | **5.33** | **4.89** | **4.37** |
| Food, beverages and tobacco | 6.78 | 6.25 | 5.54 |
| Non-food merchandise | 3.62 | 3.28 | 2.97 |
| **Services** | **5.28** | **5.33** | **5.25** |
| Housing | 3.74 | 3.64 | 3.64 |
| Education (tuitions) | 6.60 | 6.60 | 6.63 |
| Other services | 6.28 | 6.46 | 6.29 |
| **Non-core** | **1.43** | **3.39** | **5.24** |
| **Agricultural and livestock products** | **2.85** | **5.66** | **9.75** |
| Fruits and vegetables | 5.59 | 11.68 | 21.78 |
| Livestock products | 0.62 | 0.68 | -0.19 |
| **Energy and government-authorized prices** | **0.24** | **1.46** | **1.41** |
| Energy products | -1.64 | 0.06 | 0.21 |
| Government-authorized prices | 4.84 | 4.82 | 4.29 |

Source: INEGI.



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