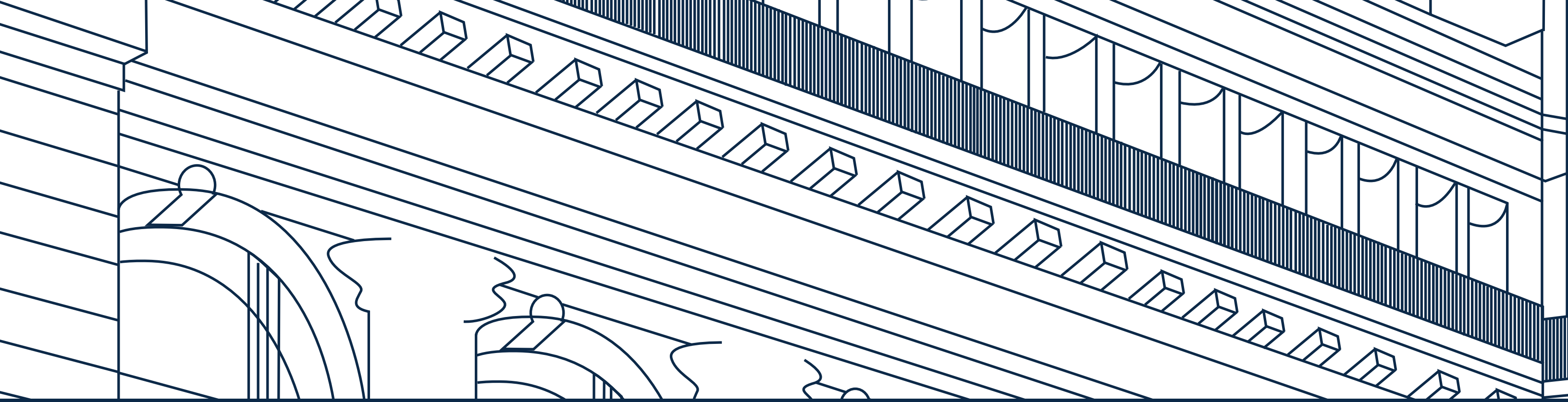

BANCO DE MÉXICO®

Minutes number 107

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on March 21, 2024

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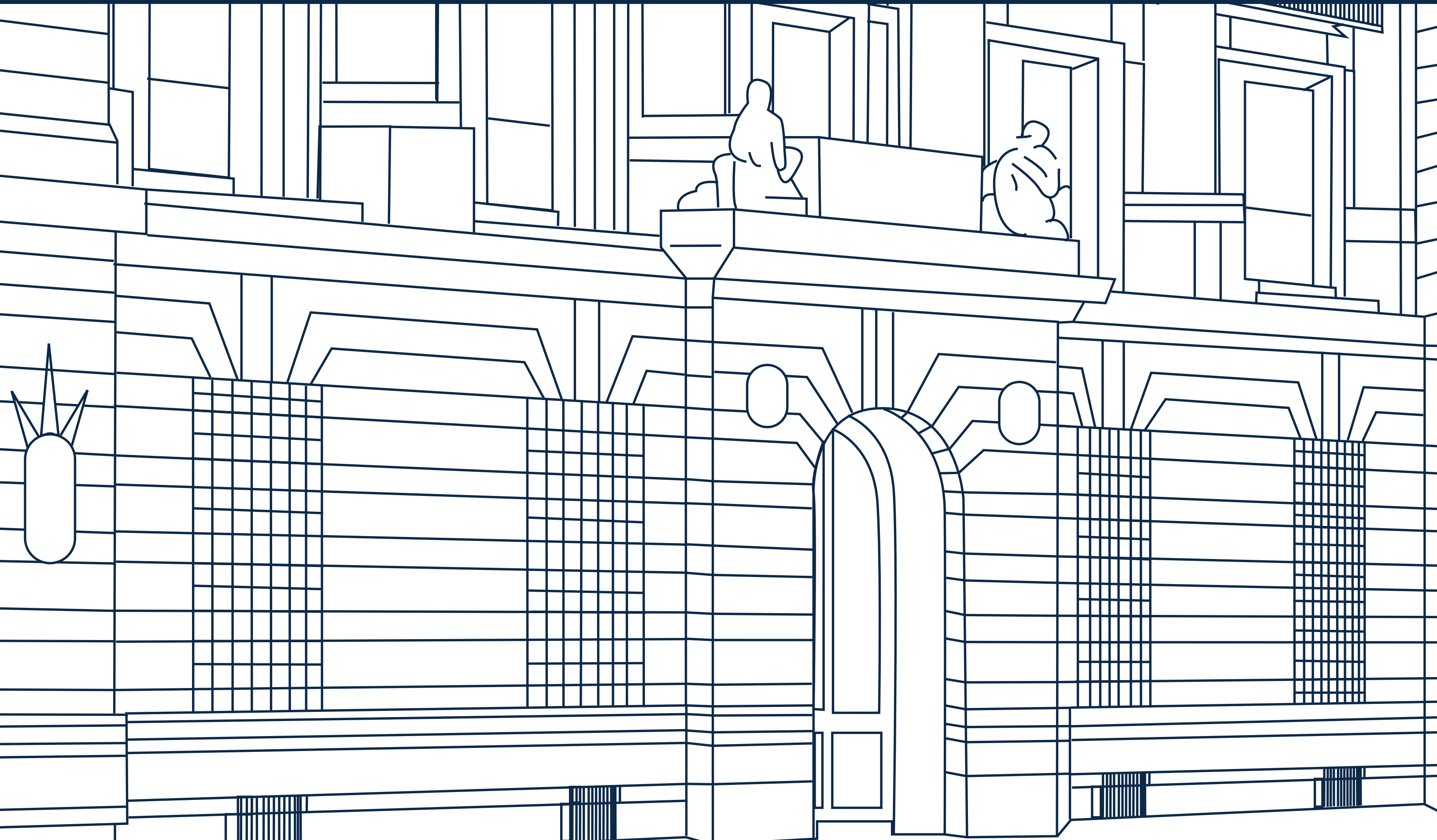

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: March 20, 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 mentioned that global economic activity is expected to grow during the first quarter of 2024 at a slightly higher rate than in the previous quarter. They added that economic performance remains heterogeneous across countries. Some members pointed out that during the first quarter of the year higher dynamism is expected for emerging economies, while advanced economies are anticipated to continue showing sluggishness. **One** member stated that different indicators continue pointing to a weakness in the manufacturing sector in advanced economies. Nevertheless, **some** members noted that private consumption in the United States is expected to continue showing resilience. **One** member highlighted that private consumption in that country has recently exhibited mixed signals. He/she emphasized the lower-than expected growth of retail sales. He/she argued that the above could reflect the fact that consumers are more aware of a labor market that shows signs of moderation, in a context where access to credit has become more limited. **Some** members underlined the expected slowdown in the euro area, given the moderation in consumption. **One** member added the weakening of investment and of external demand in that region, in an environment of tight financial conditions. **Another** member added the slowdown in industrial production. He/she highlighted that the United Kingdom, after having been in a technical recession during the second half of 2023, exhibited modest growth due to the dynamism of services.

Some members noted that economic activity in advanced economies is expected to grow at a lower rate overall in 2024. **One** member stated that the outlook for US economic growth in 2024 was revised to the upside during 2023. Regarding emerging economies, **another** member argued that they are expected to exhibit greater dynamism in 2024 than in 2023, considering this group without China. **One** member underlined that the Chinese economy is foreseen to continue slowing down despite the monetary and fiscal stimuli, given the lesser confidence among economic agents and the difficulties in its real estate sector. **Another** member stated that risks to world economic activity remain balanced and that prospects of a sharp deceleration have become less and less likely. Nevertheless, he/she warned about several risks, such as the possible escalation of geopolitical conflicts; the implementation of protectionist measures in some systemically important economies in a context of electoral processes; the protraction of tight financial conditions; a stronger deceleration of the Chinese economy; and economic impacts caused by climate-related factors, which have been more frequent and severe.

Some members indicated that labor markets in the major economies remain tight. **One** member highlighted the case of the United States. **Another** member pointed out that some of the recent US employment data have been stronger than expected. However, **one** member underlined that unemployment gaps have slightly narrowed, while wage growth rates have moderated and, in some cases, exhibit a decreasing trend. He/she pointed out that the number of job vacancies in that country has shown a sustained decline whereas non-farm payroll has stabilized at levels close to its historical average.

The majority stated that headline inflation continues decreasing in a large number of economies, although **some** members noted that it has done so at a slower rate. **One** member highlighted that disinflation has continued due to the easing of the shocks resulting from the pandemic and the military conflict in Ukraine, as well as central banks' restrictive monetary policy stances. However, **another** member mentioned that in certain cases inflation rebounded in its most recent readings due to the higher energy prices. **One** member indicated that, after these rebounds, it declined. **Most members underlined that both in advanced and emerging economies core inflation has decreased more gradually than headline inflation. In this regard, they highlighted services inflation's resistance to decline. One** member emphasized the recent increase in inflation of services excluding housing in the United States. **Another** member argued that the persistence of services inflation is a widespread phenomenon, even in economies that exhibit some slack, which could be largely explained by a reversal in consumption patterns rather than by demand-related pressures. He/she mentioned that food and merchandise inflation have also declined in a sustained manner.

The majority pointed out that commodity prices have remained relatively stable. One member underlined the decline in sugar and wheat prices, as well as the increase in some energy products and gold prices. He/she mentioned that futures markets anticipate a rebound in some agricultural products' prices.

Most members stated that world inflation is foreseen to continue decreasing. They underlined that in most economies it is estimated that inflation will converge to its target in 2025. One member highlighted that in some cases, such as in the United States, convergence is expected to occur in early 2026. **Another** member mentioned that there are still risks to the global disinflationary process, such as those related to a possible escalation of geopolitical turmoil and adverse climate-related factors.

Some members stated that in their last policy meetings most central banks of advanced economies left their reference rates unchanged once again. **Most members mentioned that in its last five monetary policy meetings the US Federal Reserve left the target range for the federal funds rate unchanged.** Meanwhile, **one** member noted that for the first time in nearly two decades the Bank of Japan increased the range for its target rate after a long period of negative interest rates. He/she added that said central bank removed its yield curve control policy but indicated that it will continue purchasing debt instruments and maintaining an accommodative monetary policy stance. On the other hand, he/she underlined that various monetary authorities in Latin America and Emerging Europe lowered their policy rates, while no adjustments were registered in Asia. **Some** members highlighted that central bank officials in advanced economies have remained cautious about starting a rate cutting cycle. **Some** members emphasized that the chairman of the US Federal Reserve stated that it will not be appropriate to reduce the target range until there is greater confidence that inflation is moving sustainably toward its target. **One** member underlined that the Federal Reserve reiterated that risks to achieving the employment and price stability goals are moving into better balance. **Some** members noted that, in advanced economies, the number of reference rate cuts expected by markets for this year has decreased. **One** member pointed out that markets expect the cycle of rate cuts to remain heterogeneous among economies. **Another** member mentioned that market expectations regarding the start of monetary easing in major economies have been postponed. **One** member argued that, in the environment of uncertainty associated with the disinflationary process, central banks' actions must seek an orderly adjustment of the economy and financial markets, and that for this reason abrupt adjustments in interest rates or an excessively data-dependent strategy could contribute to generating even greater volatility. He/she argued that an approach of gradual adjustments would put central banks in a better position to continue addressing the prevailing challenges more efficiently.

Most members mentioned that the US Federal Reserve is expected to begin cutting interest rates this year. One member pointed out that expectations suggest a first interest rate cut in June. **The majority specified that the median of projections by the members of the Federal Open Market Committee (FOMC) continues anticipating a total reduction of 75-basis-points throughout the year. One** member mentioned that said central bank increased its estimate for the federal funds rate in the long term, compared to what was reported in December 2023. **The majority stated that the normalization of the US monetary policy stance could be slower than previously anticipated.**

Some members underlined that international financial markets exhibited higher risk appetite, although **some** members noted that adjustments in the main variables were largely limited. **One** member attributed the higher risk appetite to the resilience of economic activity, to the lower likelihood of a sharp slowdown materializing, and to expectations regarding an eventual downward adjustment in reference rates by the major central banks. **The majority underlined that government bond yields increased. One** member considered that the above reflected an improvement in economic activity figures in the United States. **Some** members added that stock market indices registered increases, largely driven by the technology sector, and that the US dollar slightly depreciated. **One** member mentioned that emerging markets continue registering heterogeneous behavior by asset class. He/she stated that the equity market registered gains, accompanied by all-time-high inflows, while in the fixed income market outflows continued being observed. **Another** member highlighted that market and analyst expectations regarding the future trajectory of the Federal Reserve's federal funds rate adjusted upwards without volatility episodes. He/she pointed out that, with this adjustment, the discrepancy between the Fed's projections and market and analyst expectations, which had been a matter of concern for financial stability, was significantly reduced. **One** member mentioned that, looking ahead, a temporary bout of volatility in financial markets cannot be ruled out, considering the electoral processes taking place this year.

Economic activity in Mexico

Most members mentioned that economic activity is expected to show greater dynamism during the first quarter of 2024 relative to the weakness of the previous quarter. One member pointed out that this higher growth would occur after a significant slowdown in the fourth quarter of 2023, which resulted from a weakening of the three sectors of the economy. He/she added that, considering this slowdown, GDP grew at a rate of 3.2% in 2023. **Most members pointed out that there was a slight reactivation of industrial activity in January, mainly supported by the construction sector. One** member stated that this rebound occurred after two months of negative readings. He/she highlighted the improvement in the manufacturing industry of transportation equipment. He/she noted that this took place after significant contractions in the production of light vehicles at the end of last year. **Another** member pointed out that manufacturing remained sluggish. **One** member highlighted that the timely indicator of economic activity anticipates that in February the IGAE would have registered an annual variation of 2.4%.

Regarding domestic demand, all members mentioned that consumption continued trending upwards during the fourth quarter of 2023. Some members underlined the growth in consumption of imported goods. **One** member noted that, in contrast, consumption of domestic goods and services continued exhibiting a lower dynamism. **Another** member highlighted that the high growth rate of credit for consumption, revenues from remittances, the wage policy, and the increase in social program transfers would continue stimulating consumption. Regarding investment, **some** members pointed out that it continued supporting aggregate demand, although it slightly stagnated at high levels. **Some** members indicated that it slowed down due to a moderation in the machinery and equipment component. **One** member noted that residential construction weakened. However, **another** member underlined that investment reached an annual variation of 15.4% in December 2023. He/she stated that imports of capital goods rebounded strongly in January. **Regarding external demand, most members mentioned that during the last quarter of 2023 and in early 2024 it continued showing weakness. One** member stated that this could be a lagged effect of the automotive strike in the United States, as well as of a sluggish manufacturing sector in that country. However, **another** member indicated that both automotive and non-automotive exports remain at relatively high levels.

One member considered that in the first half of 2024 investment in infrastructure projects is expected to continue contributing to growth and private consumption to keep expanding. He/she added that the dynamism of economic activity is estimated to decrease in the second half of the year. **Another** member mentioned that in 2024 the expansion of domestic demand is anticipated to outweigh the decline in external demand resulting from the expected slowdown of the US economy. He/she added that the US economy, particularly its industrial production component, is expected to rebound in 2025, thus leading to a significant increase in external demand. He/she expressed that economic activity in Mexico in 2025 could exhibit greater dynamism if fiscal consolidation does not proceed as foreseen. He/she argued that to achieve this consolidation higher public revenues, lower federal spending, and less transfers to Pemex are required. He/she pointed out that, in the possible event of a lack of extraordinary revenue, spending would need to be reduced significantly to bring the deficit down to 2.6%. **One** member explained that domestic spending is anticipated to moderate in 2025 due to the fiscal consolidation efforts planned for that year. He/she underlined that, in contrast, private investment associated with the nearshoring process could provide an additional boost to economic activity. He/she considered that risks to economic activity remain balanced. He/she stated that, even though the US economy could slow down more than expected, the effects of nearshoring could also be greater than anticipated.

Most members mentioned that the output gap remained in positive territory during the fourth quarter of 2023. One member indicated that the economy exhibits tightness. **Some** members noted that the point estimate of this gap decreased at the margin. **One** member stated that it is still not statistically different from zero. **Another** member indicated that it would narrow to a greater extent in 2025. **One** member argued that the evolution of the economy's cyclical conditions should be monitored, given the mixed signals observed in economic activity figures due to their implications for inflation.

Most members pointed out that the labor market remained strong. They underlined that unemployment rates continue at particularly low levels. **One** member indicated that these readings are similar to those registered throughout 2023. However, **another** member underlined that, while the labor market remains strong, there could be signs of moderation. He/she pointed out that growth of formal employment has decelerated since mid-2023. He/she added that, in recent quarters, the rates of formal job creation and destruction have decreased. He/she pointed out that, although net employment creation is positive, it has slowed down. **The majority pointed out that wages continue growing at high rates.** However, **one** member noted that they are growing at slower rates compared to previous years.

Inflation in Mexico

Most members highlighted the progress in disinflation in Mexico. Some members underlined that both headline and core inflation are visibly below the high levels reached during this inflationary episode. **One** member stated that from March 2023 to February 2024 the inflation gap, which refers to the difference between observed inflation and the 3% target, decreased from 3.85 to 1.40 percentage points. He/she added that, during the same period, the core component, which better reflects the trend in inflation, declined by 345 basis points. He/she underlined that during 2023 and so far in 2024, core inflation has clearly shown a downward trend. **Some** members pointed out that disinflation has been the result of both the easing of the shocks and the level of monetary restriction attained.

Most members indicated that, after having increased in late 2023 and in January 2024, annual headline inflation decreased in February to 4.40%. They noted that this decline reflected a slight reversion exhibited by the non-core component, which had been exerting pressure on it, as well as a further decline in the core component. One member highlighted that February's annual headline inflation figure is merely the first decline after three consecutive months of increases. **Another** member pointed out that February's readings were lower than anticipated by the central bank.

The majority mentioned that non-core inflation decreased in February to 3.67%. One member added that this partially reversed the upward trajectory that it had started to follow in 2023. **Some** members underlined that fruit and vegetables inflation, which had undergone significant pressures in December 2023 and January 2024, decreased in February. **One** member warned that, despite the above, it still remains at double-digit levels. **Another** member mentioned that this subindex had been affected by a supply shock associated with climate-related factors. He/she argued that, considering the characteristics of said shock, its effects on headline inflation were anticipated to dissipate and not be long-lasting.

Most members stated that annual core inflation declined in February to 4.64%. One member highlighted that this has been the lowest level since June 2021, when the rate hiking cycle began. However, **another** member specified that the reading of the second fortnight of February was higher than that of the first one. **One** member noted that, despite the decrease, and considering the shocks it has undergone, core inflation remains at levels higher than those exhibited prior to the pandemic. He/she indicated that this component has continuously exhibited figures above 3% for over seven years. He/she considered that its resistance to decline has intensified in recent years. He/she indicated that wage growth rates, relative to those observed before the pandemic, have contributed to the above. He/she argued that wage growth has not been accompanied by increases in labor productivity.

Most members pointed out that core inflation components continued exhibiting a mixed behavior. They highlighted the downward trajectory of merchandise inflation, while recalling that services inflation has not shown a downward inflection point. One member detailed that the former has decreased for fifteen consecutive months, mainly supported by the behavior of non-food merchandise prices, which exhibited monthly and annual variations below their historical averages. He/she asserted that the above has allowed several indicators of core inflation to continue trending downwards. **Another** member stated that the annual variation of non-food merchandise prices registered 2.75% in February, while that of food merchandise prices exhibited 5.25%. **One** member argued that the favorable behavior of merchandise inflation is due to both the fading of shocks and to the exchange rate appreciation, which has helped to reduce the costs of imported intermediate goods and the prices of imported final goods.

All members agreed that services inflation has shown persistence. One member pointed out that it registered 5.30% in February. **Another** member stated that, since September 2022, it has been at levels around such figure. He/she added that more than 70% of the items comprising this subindex are growing at seasonally adjusted annualized monthly rates above 5%, and the figures for both January and February accumulated more new pressures compared to last year, especially in the components of housing and other services. He/she estimated that services inflation is being primarily affected by non-food commodity prices and by wage dynamics, and that, for this reason, in his/her opinion, it is key to maintain inflation expectations anchored. **One** member specified that, regarding the services inflation components, the annual variations of the segments of educational services and other services remained above 6% in February, while that of housing services has stagnated at around 3.7%. **Another** member stated that the elevated levels of services inflation is a global phenomenon. He/she expressed that it is attributed to the continued impact of the shocks associated with the pandemic. He/she argued that, in view of the reversal in consumption patterns, the pass-through of costs in the services sector has taken place in a lagged and incomplete manner. He/she thus considered that its behavior is a necessary adjustment in the economy, although its evolution must be monitored.

The majority mentioned that long-term inflation expectations drawn from the survey conducted by Banco de México remain anchored at 3.5%. One member considered it a challenge that these expectations remain above 3%. Regarding medium-term expectations, **another** member commented that those for the next 4 years are at 3.7%, above the historical average registered prior to 2020. **One** member highlighted that short-term expectations have remained relatively stable. **Another** member stated that expectations for the end of 2024 and 2025 have continued improving. **Some** members noted that inflation expectations for all terms drawn from surveys remain above the central bank's projections. In this regard, **one** member pointed out that in the survey by Citibanamex of March 20, not a single respondent anticipates an inflation rate of 3.5% or less by the end of the year, 71.4% of respondents expect inflation to be above 4%, and 14.3% consider that inflation will surpass the 4.4% level of February. **Another** member argued that, following the recent significant inflationary episode, two stages in the evolution of these expectations should be considered: an initial one, where they consolidate at their historical averages, and a subsequent one, where they become anchored at the 3% target over a longer-term horizon. **Some** members noted that breakeven inflation has declined for all terms. **One** member mentioned that the risk premium has been around its historical average. However, **another** member specified that breakeven inflation still remains at levels above 4% for all terms. He/she attributed its decline to both the fall in inflation expectations implicit in these instruments and to the reduction in inflation risk premia, which appear to be closely correlated with the behavior of headline inflation. **One** member noted that inflation expectations drawn from market instruments for the average of 1-5 years are at around 4.3%, while those for 6-10 years remain at around 3.3%.

The majority mentioned that the central bank's inflation forecasts were adjusted marginally for some quarters. One member noted that the forecast for headline inflation for the first quarter of 2024 was revised downwards, due to a lower-than-anticipated inflation of agricultural and livestock products. **In particular, the majority highlighted slight upward adjustments in the forecast of core inflation for the first quarter of 2024 and the following two quarters. Some** members commented that these revisions consider a more persistent services inflation. However, **one** member added that services inflation is foreseen to decrease gradually in the coming quarters. **Another** member specified that forecasts for 2025 remain unchanged. **Some** members pointed out that headline inflation is still projected to converge to target in the second quarter of 2025. **One** member argued that these inflation forecasts consider the monetary policy actions implemented by Banco de México, as well as prospects of a continued easing of different pressures on inflation. Thus, **some** members underlined that the outlook of a continuing disinflationary process is maintained.

All members considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. However, **some** members stated that this does not mean that the inflationary outlook will be as adverse as the one faced in 2022 and early 2023. **One** member highlighted that at that stage an upward bias implied the possibility that inflation would rise more than anticipated. He/she added that, in the current phase of disinflation, the upward bias means that, if risks materialize, inflation could decline more slowly than expected. **Another** member noted that the inflationary outlook has improved significantly compared to what was observed at the end of 2022. He/she underlined that tail risks such as disruptions in global supply chains, supply-related pressures on commodities, and the possibility of inflation becoming entrenched at elevated levels have been mitigated. In this regard, he/she added that while some inflation components, such as food merchandise, had shown greater persistence, they had registered a significant fall. He/she emphasized that, although some risks prevail, they are now more similar to those faced prior to the pandemic, and therefore their effect on inflation could be more limited.

Among upward risks, all members warned about the persistence of core inflation, particularly its services component. One member stated that this represents the main challenge to achieve the convergence of inflation to its target. However, **some** members considered that this risk may have moderated during the disinflation phase. **One** member pointed out that empirical evidence suggests that this risk diminishes as inflation decreases. **Another** member mentioned that historically the dynamics of this subindex tends to be more persistent. **Some** members added the possibility of demand-related pressures. **One** member underlined that manufacturing capacity utilization reached new highs which, along with a positive output gap, point in that direction. Similarly, **some** members mentioned the challenges that could result from the fiscal stimulus. **One** member noted that the expansionary fiscal policy is reflected in the high growth of the monetary aggregates. **Another** member added the possibility of downgrades in both Mexico's sovereign debt and Pemex's credit ratings.

All members warned about the possibility of greater cost-related pressures of various nature. However, **some** members noted that while this risk is still present, potential cost-related pressures are not anticipated to be of the same magnitude as those observed during the pandemic and at the beginning of the war in Ukraine. **Some** members highlighted the increasing risks stemming from the escalation of geopolitical conflicts. **One** member noted that attacks on vessels in the Red Sea have led to shipping delays and raised sea freight costs. However, he/she indicated that, taking into account that it is a phenomenon confined to this region, their impact is significantly lower than the disruptions caused by pandemic-induced bottlenecks. **Some** members highlighted the risk of a foreign exchange depreciation. **One** member pointed out that episodes of volatility derived from the uncertainty of the presidential elections in Mexico and the United States could also affect the trajectory of inflation.

Most members underlined the risks associated with water scarcity and climate-related impacts. One member stated that shocks related to climate change have been increasingly severe and frequent, resulting in greater adverse effects on prices. As an additional risk, he/she stated that non-core inflation could turn out to be higher than expected and very close to its average levels. In particular, he/she added that while the gasoline price policy has aided in maintaining non-core inflation below its historical average, there is no certainty that this policy will be upheld indefinitely. As for risks to the downside, **another** member noted that the possibility of a greater-than-anticipated deceleration of the global economy has gained relevance. In this regard, he/she noted that in systemically important economies, such as the United States and the euro area, households' financial position has deteriorated, which could affect economic activity amid high interest rates. He/she also argued that the significant credit expansion in Mexico could suggest that households' leverage levels have increased.

Macrofinancial environment

The majority considered that the Mexican peso continues showing resilience mainly due to the country's solid macroeconomic fundamentals compared to those of other emerging economies, as well as to a high volatility-adjusted spread between domestic and external interest rates. They highlighted that the foreign exchange market continues operating in an orderly manner, in a context where markets and most analysts expect a downward adjustment in the interest rate differential between Mexico and the United States. They underlined that since the last monetary policy meeting, the peso has appreciated. They noted that trading conditions in the foreign exchange market improved. One member argued that the reduction in exchange rate volatility and in the implied skew in foreign exchange options suggest a lower demand for hedging amid a possible depreciation of the Mexican peso, which contrasts with other election years. He/she stated that this lower demand, as well as the positioning observed in short-term foreign exchange derivatives markets, could magnify a depreciation of the Mexican peso in the event of an episode of high-risk aversion, and thus periods of volatility cannot be ruled out. **Another** member warned that certain expectations displaying a bias towards depreciation in the medium term still prevail.

Most members noted that government bond yields increased moderately. They highlighted that this was consistent with the increases in sovereign interest rates observed globally. One member stated that capital inflows to peso-denominated financial assets have concentrated in Cetes. He/she added that the derivatives market incorporates a 25-basis-point cut in the reference rate in the March decision, in line with specialists' surveys, while the reference rate is foreseen to end 2024 below 10%. **Another** member pointed out that the Mexican stock market performed negatively, in part resulting from lower-than-expected corporate results. **One** member stated that sovereign risk indicators registered limited adjustments.

Regarding financing in the economy, the majority highlighted that it continued increasing due to the expansion of the domestic component. Some members noted that the external component declined. **One** member mentioned that the expansion of domestic financing sources continued reflecting the acquisition of long-term instruments, which is consistent with the offered yield given the level of the reference rate. **Most members highlighted that credit granted by commercial banks has continued expanding, although they specified that it has occurred at a slower pace. They emphasized that, in particular, the growth of credit granted to firms has moderated. One** member stated that consumer credit has also decelerated. **Some** members added that according to the survey of banks, overall lending conditions have tightened in some segments. **Most members stated that, in general, delinquency rates remain stable. However, they noted these have somewhat increased for the consumer loan portfolio.**

Monetary policy

The Governing Board evaluated the easing of 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 underway since the last time the reference rate was adjusted; nevertheless, it considered the challenges and risks that prevail, which requires monetary policy to continue being managed prudently. Based on the above, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in 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 make its decisions depending on available information. 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 pointed out that the current inflationary episode has gone through different phases, which have had different implications for monetary policy decisions. He/she recalled that inflation came to exhibit a marked upward trend due to the shocks of the pandemic and the military conflict in Ukraine. He/she highlighted that, in response, Banco de México increased the reference rate in a timely and decisive manner. He/she noted that by the end of 2022 the shocks began to ease, which, together with the monetary policy stance attained, contributed to the beginning of the disinflation phase. He/she argued that, considering the above, the magnitude of reference rate increases was reduced. He/she added that in March 2023, the reference rate was set at 11.25%, remaining at that level since then. He/she mentioned that during this period the monetary policy stance continued strengthening, as the real ex-ante rate continued increasing due to the decline in inflation expectations. He/she stated that, considering the average of headline inflation expectations for the next 12 months, the reference rate went from 6.38% in March 2023 to the current level of 7.43%. He/she noted that this figure is clearly above the estimated neutral range of between 1.8 and 3.4%. He/she indicated that in light of an extremely complex inflationary period, a level of monetary restriction unseen since the adoption of the inflation targeting regime has been required. He/she expressed that since the last reference rate increase, the disinflation process has progressed significantly. He/she highlighted that headline and core inflation are at levels significantly below the peaks reached during this inflationary episode. He/she considered that the current environment is less adverse than that faced in 2022 and the first months of 2023. Thus, he/she argued that current and future conditions are conducive to a reduction in the reference rate. He/she emphasized that this does not mean that the fight against inflation has come to an end, nor is it a sign of complacency. He/she underlined that there is still a long road that remains to be covered to reach the target and risks continue to prevail. He/she expressed that monetary policy should continue being managed prudently and that the assessment of additional rate cuts would be made on a meeting-by-meeting basis, depending on available information. He/she added that when macroeconomic conditions allow for additional adjustments, these would be gradual. He/she highlighted that the monetary restriction has been relevant for disinflation and is expected to remain so over the forecast horizon. He/she indicated that the restrictive stance will continue contributing to maintain long-term inflation expectations anchored and to promote an orderly behavior of financial markets, including the foreign exchange market. He/she stated that during this complex inflationary period, the central bank's firm commitment to its primary mandate of price stability has remained unwavering. He/she considered that, looking ahead, in its effort to consolidate an environment of low and stable inflation, said firm commitment will remain a constant.

Another member underlined that the level of monetary restriction attained has facilitated consistent progress in disinflation. He/she pointed out that this has been achieved through both the exchange rate and expectations channels. However, he/she emphasized that, although inflation has decreased, the balance of risks for its expected trajectory remains biased to the upside. Among main risks, he/she highlighted: i) that, despite the monetary restriction, domestic economic activity continues showing resilience and that demand-related pressures may slow down or even reverse the fall in inflation; ii) that core inflation persists at high levels; iii) that non-core inflation stabilizes at levels higher than those estimated by Banco de México's forecasts; and iv) that a greater-than-anticipated depreciation of the national currency is observed. He/she warned that the materialization of these risks could hinder the convergence of inflation to its target over the planning horizon. He/she forewarned about the possibility of Banco de México's inflation forecasts having to be revised upwards in the near future due to an unexpected behavior in some of the determinants of inflation. He/she stated that an inflation rate far from its target, a balance of risks for inflation biased to the upside, and the strength of economic activity and credit, despite a historically high ex-ante real rate, evidence that monetary policy in Mexico has had to face additional challenges, such as pressures stemming from wage increases and an expansionary fiscal policy. In this context, he/she considered that, at this moment, a reference rate cut could be interpreted by markets as Banco de México's tolerance to higher inflation levels. He/she indicated that some analysts and market participants have acknowledged that the macroeconomic environment is still uncertain to consider adjusting the level of monetary restriction. He/she noted that the consensus is that at this meeting the Governing Board will make a first cut to the reference rate. He/she pointed out that, at the same time, the market foresees inflation levels higher than the central bank's forecasts. He/she expressed that prudence must be exercised in the signals conveyed to the markets, in a context in which the disparity between inflation expectations and the central bank's forecasts has been widening.

One member highlighted several factors to consider for this decision before beginning any cycle of reference rate cuts: i) that the balance of risks for inflation remains biased to the upside and is uncertain; ii) that services inflation does not show a downward trend or signs of an imminent decline soon; iii) that analysts' inflation expectations for the end of 2024 are above the central bank's forecasts, and thus they do not anticipate that the intermediate inflation target will be attained; iv) that the output gap is positive and certain indicators suggest demand-related pressures; v) that the labor market continues showing strength; and vi) that credit growth is not slowing down, while the monetary base is growing above 14%. In this context, he/she considered that it is still not time to begin a rate cutting cycle. However, he/she expressed that there is some room for an isolated fine-tuning in order to maintain a restrictive, but not overly restrictive, monetary policy stance. He/she pointed out that since the last reference rate increase, the real ex-ante rate has risen by more than 100 basis points due to the decline in one-year inflation expectations. He/she noted that this rate, currently near 7.5%, allows some room for a 25-basis-point reduction to ensure a restrictive stance within the range of 7 to 7.5%. He/she added that the interest rate spread relative to the United States provides a certain margin to set the target rate irrespective of the Federal Reserve’s anticipated monetary policy stance. He/she stated that in a context that calls for prudence, before making an additional adjustment to the reference rate, there should be greater certainty about the convergence of inflation to its target before considering a monetary easing cycle. He/she noted that a major challenge in implementing the fine tuning will be to convince markets that it is not yet time to start a cutting cycle, and thus the premature expectation by analysts that this cycle will materialize must be avoided. He/she also cautioned against comparing the current monetary policy stance with that of other episodes as each has its own difficulties, circumstances, and causes. He/she warned that, based on international evidence, the most common mistake in inflationary episodes is to begin monetary policy easing prematurely. He/she indicated that the central bank’s credibility in its commitment to its primary mandate must be maintained. He/she underlined that it must be made clear that the focus is centered on the long term. He/she expressed that it must be communicated that the decline in inflation is insufficient and that there is still a long road to be covered. He/she considered that if inflation and its expectations do not decrease in a clear and continuous manner in the coming months, the target rate should not be lowered. He/she pointed out that, in his/her opinion, monetary policy in Mexico has limited effectiveness, and thus a restrictive, elevated and lasting monetary policy stance is required. He/she warned that unlike previous episodes, this time inflationary persistence is higher. He/she added that the current global monetary conditions, the domestic economy's cyclical position, and the expansionary fiscal policy are consistent with the need for a more restrictive policy stance. Therefore, he/she argued that room to lower the target rate might be very limited. He/she finally pointed out that a firm stance must be taken in view of an uncertain inflationary outlook biased to the upside.

Another member noted that, although the disinflation process has continued and inflation expectations remain stable and anchored, the current situation is still uncertain. In this regard, he/she mentioned that inflation forecasts were revised marginally upwards for the next three quarters and that the balance of risks for inflation continues to be biased to the upside. He/she argued that the monetary restriction attained since September 2022 has operated with different lags in each of the transmission channels. He/she pointed out that the real rate has reached a level of 7.43%, while the multilateral real exchange rate has accumulated an appreciation of 18% since September 2022. He/she highlighted that the acquisition of long-term instruments by the private sector has remained at around 2% of GDP for the last year and a half, which is twice the average level observed between 2010 and 2018. He/she emphasized that domestic financing has recently shown some moderation in its growth rate, especially for firms, where the pass-through to financing rates has been more widespread throughout this tightening cycle. He/she estimated that the monetary policy stance will continue to be robust and will remain in restrictive territory if the reference rate is reduced by 25 basis points. He/she stated that the transmission channels will continue operating to enable the orderly and sustained convergence of inflation to the target. He/she noted that Mexico's real interest rate in relation to the inflationary gap is higher than that of most emerging countries and that its magnitude has allowed to face the inflationary challenges. He/she expressed that, given the complexity of the disinflationary process and the tight conditions in the economy, especially in the labor market, it will be necessary to maintain a restrictive stance in the forecast horizon. He/she indicated that future monetary policy actions should be dependent on incoming data and on the evolution of inflation determinants. He/she considered that the monetary policy statement should convey a cautious tone. He/she added that the proposed reduction should not be interpreted as a normalization process of monetary policy or complacency with the level of inflation, but rather as one that seeks to calibrate the current level of monetary restriction with the evolution of inflation and its outlook. He/she stated that communication should encourage markets to adjust their expectations to what is likely to be a slower and longer-lasting cycle compared to past episodes, with a clear commitment to strengthen the country's economic and financial stability.

One member elaborated on the reasons he/she considers that a reduction in the reference rate is not premature. He/she highlighted the importance of making an appropriate assessment of the inflationary outlook, considering the origin of pressures, their nature, dynamics, and the road covered. He/she recalled that during 2021 and 2022 an inflationary period clearly different from the previous ones was faced, characterized by atypical shocks that led to tail risks, whose effects have been perceived in a differentiated and lagged manner. He/she highlighted that given this scenario, fifteen consecutive increases were made, accumulating 725 basis points, elevating the reference rate to its historical high, and maintaining it at that level for practically one year, which represents the longest pause observed after a rate hiking cycle. He/she pointed out that, as a result of this forceful monetary policy action and the mitigation of shocks, significant progress has been made in the disinflationary process, and thus we are now in a better position. He/she also deemed necessary not only to monitor whether the balance of risks remains biased to the upside, but also its evolution in response to the mitigation of tail risks, taking into account disruptions in supply chains, supply-related pressures, or if inflation becomes entrenched at elevated levels. He/she added that the passive tightening of around 100 basis points unseen in previous cycles has been achieved thanks to the progress in communication tools, such as the use of forward guidance. He/she pointed out that maintaining a restrictive stance will continue to be necessary, as challenges prevail and there is a road that remains to be covered. He/she stated that even if the rate is lowered, the monetary policy stance would remain clearly in restrictive territory, would continue exerting an influence through its channels, and would remain sufficiently robust in light of changes in the policy stance relative to other economies. He/she deemed it highly relevant that monetary policy should be implemented gradually, not only in terms of magnitude but duration. He/she considered that this is appropriate in an environment where challenges, such as the persistence of services inflation, prevail. He/she noted that gradualism in terms of duration means that one adjustment does not imply a continuous cycle has begun. He/she stated that while it is not prudent to set a specific range for the ex-ante real rate, given the challenges imposed on communication, it is appropriate to adjust its level in view of the significant improvement in the inflationary landscape and outlook, although this does not imply bringing it back to its pre-pandemic levels. Finally, he/she highlighted that the challenge ahead is to adjust the level of tightening in a way that acknowledges the significant progress in inflationary dynamics, while also addressing the challenges that still prevail on the path towards the 3% target.

3. MONETARY POLICY DECISION

The Governing Board evaluated the easing of 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 underway since the last time the reference rate was adjusted; nevertheless, it considered the challenges and risks that prevail, which requires monetary policy to continue being managed prudently. Based on the above, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in 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 make its decisions depending on available information. 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

Voting in favor of lowering the target for the overnight interbank interest rate by 25 basis points to 11.00% were Victoria Rodríguez, Galia Borja, Jonathan Heath, and Omar Mejía. Irene Espinosa voted in favor of maintaining the target at 11.25%.

5. DISSIDENT OPINIONS / VOTES

Vote. Irene Espinosa

The level of monetary restriction attained so far has allowed the disinflation process to progress, mainly through the exchange rate and expectations channels, given that domestic demand and credit do not show signs of weakness. Moreover, the labor market remains tight and the point estimate for the output gap continues in positive territory, which confirms the Mexican economy's resilience. Headline inflation is still far from target, the balance of risks for our inflation forecasts remains biased to the upside, and economic activity continues exhibiting dynamism despite the historical increase in the real interest rate. This is evidence that monetary policy has had to face additional challenges, such as pressures from wage increases and an expansionary fiscal policy, to steer inflation towards the 3% target. Furthermore, the fact that markets anticipate that inflation will be higher than our forecasts indicates that is premature to begin reducing monetary restriction. Doing so could jeopardize the convergence of inflation and thus the credibility of this central bank's commitment to its primary mandate of price stability.

ANNEX

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

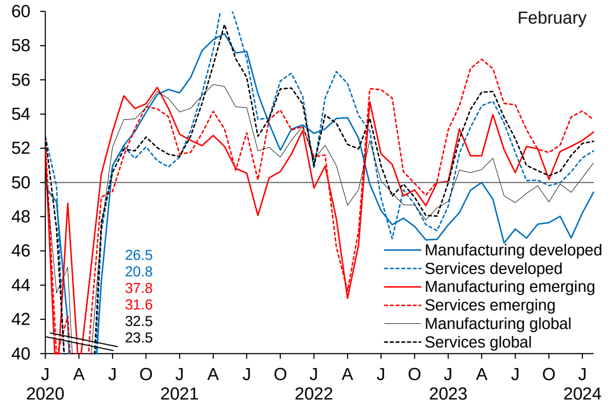
A.1. External conditions

A.1.1. World economic activity

World economic activity is expected to have grown during the first quarter of 2024 at a slightly higher rate than that observed in the previous quarter. Nevertheless, the dynamics of economic activity would continue being heterogeneous across countries. Overall, compared to the fourth quarter of 2023, growth is expected to be sluggish in advanced economies and more dynamic in emerging economies. Purchasing Managers' Indices point to a modest growth in services and manufacturing activity at the global level. Nevertheless, manufacturing in advanced economies would have remained weak (Chart 1). Among 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.

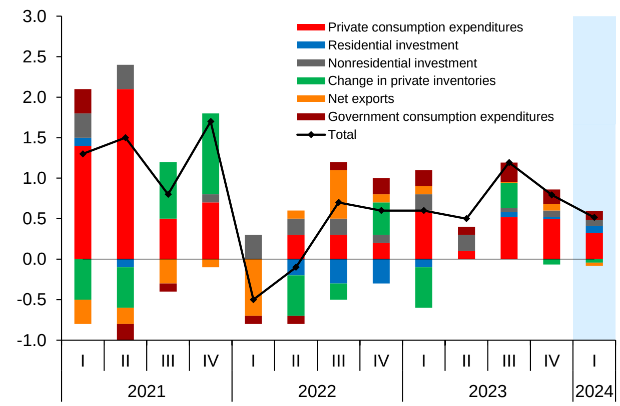
In the United States, available indicators point to a moderate growth during the first quarter of 2024 compared to the previous quarter, although analysts' expectations have been revised upwards. The above took place after Gross Domestic Product (GDP) grew at a seasonally adjusted quarterly rate of 0.8% during the fourth quarter of 2023.[1] The moderation in growth registered during the first quarter of the year would reflect the lower contributions from net exports, public spending, and private consumption (Chart 2).

Chart 1
Purchasing Managers' Index: production component for advanced, emerging and global economies
Diffusion index, s. a. 1/



s. a. / Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points is considered an increase compared to the previous month and below 50 points, a 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.
Note: The shaded area refers to Atlanta Federal Reserve's GDPNow forecasts as of March 19.
Source: BEA and Federal Reserve Bank of Atlanta.

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 3.2% in the fourth quarter of 2023.

In February 2024, US industrial production grew at a seasonally adjusted monthly rate of 0.1%, after having contracted in the previous month. This result is attributed to progress in the mining and manufacturing sectors, due partly to the recovery from adverse weather conditions in January. Purchasing Managers' Indices suggest that manufacturing production would remain somewhat sluggish.

The US labor market remained tight. The non-farm payroll continued expanding, going from a creation of 229 thousand new jobs in January to 275 thousand new positions in February. However, the figures for this indicator corresponding to the previous two months were revised downwards. Initial claims for unemployment insurance remained at low levels, registering 209 thousand new claims in the week that ended on March 9. Nevertheless, some indicators have shown signs of less tight conditions. The unemployment rate increased from 3.7% in January to 3.9% in February. New vacancies remained at approximately 8.9 million in January, significantly below the peak level reached in March 2022, although they continue being above pre-pandemic levels. In February, average hourly wages grew at a slower annual rate of 4.5%, after having increased in January to 4.7%.

In the euro area, economic activity is expected to have remained weak during the first quarter of 2024, after GDP stagnated during the fourth quarter of 2023.[2] Economic activity would continue being affected by the moderation in consumption, investment and external demand, in an environment of tight financial conditions. The labor market in this region remains robust. The unemployment rate declined from 6.5% in December to 6.4% in January, in a context in which the labor participation rate has been increasing.

For the rest of the major advanced economies, in general, moderate growth is expected in the first quarter of 2024. In particular, economic activity in the United Kingdom is expected to recover, after having contracted during the previous two quarters. Labor markets in this group of economies would have remained tight.

Economic activity in most major emerging economies is expected to have registered greater dynamism in the first quarter of 2024. In the particular case of China, during the first quarter of the year economic activity is expected to have increased at a faster pace than in the previous quarter, in which it grew at a seasonally adjusted quarterly rate of 1.0%.[3] During January and February, there was an expansion in consumption, industrial production and fixed investment in that country. During the first quarter of the year, growth was also supported by the increase in exports and tourism associated with the Lunar New Year holiday, which was celebrated without mobility restrictions for the first time since the onset of the pandemic. However, said economy continues facing significant risks stemming from the weakness of its real estate sector, low confidence by economic agents, as well as trade and technological restrictions imposed by some countries.

International commodity prices have shown a mixed behavior since Mexico’s last monetary policy decision. Oil prices increased on the expectation of higher demand from the United States, while inventories decreased worldwide. Moreover, potential supply disruptions due to geopolitical tensions in the Middle East and Russia, and the agreement between members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+) to extend production cuts, pressured prices upwards. However, the expectation of higher production in the United States has helped to partially contain these price pressures. Meanwhile, reference gas prices decreased between February and early March, as a result of lower demand due to warmer temperatures in the northern hemisphere. Subsequently, prices rose in reaction to the announcement of lower US gas production in the first quarter of the year and to the attacks on Russian infrastructure. Grain prices declined due to increases in corn production in the United States and Brazil, as well as to a greater accumulation of inventories in the United States. A higher wheat production in Russia also contributed to this decline, while China registered a lower demand. Metal prices, in general, trended upwards in light of the outlook for less restrictive financial conditions due to greater confidence regarding the beginning of a rate cutting cycle by the major central

[2] Expressed as a seasonally adjusted quarterly rate, the change in euro area GDP was 0.0% during the fourth quarter of 2023. Expressed as an annualized rate, the change was -0.2%.

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

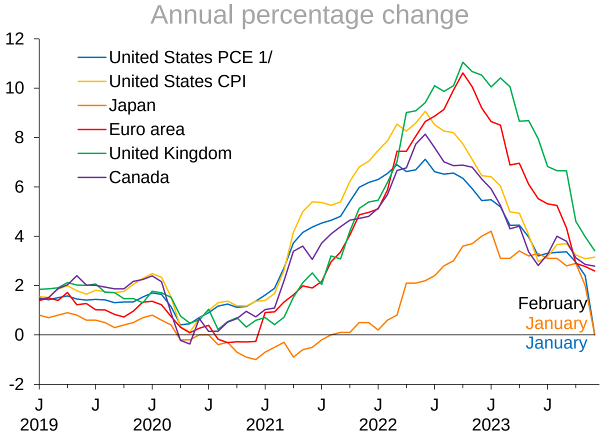
banks. The increase in gold prices, which reached historical highs, was noteworthy.

A.1.2. Monetary policy and international financial markets

Headline annual inflation continued declining in most advanced economies (Chart 3). In some cases, its most recent reading rebounded due, in general, to higher pressures on energy prices. Core inflation continued declining gradually, with some persistence in services inflation. In the United States, annual headline inflation measured by the CPI increased from 3.1% in January to 3.2% in February. This was due to a lower deflation in energy prices, while food and core inflation continued declining. The annual variation of the latter fell from 3.9% in January to 3.8% in February. However, on average, monthly core inflation accelerated in the last two months, driven partly by the services component. Headline inflation in that country, measured by the Personal Consumption Expenditures Price Index (PCEPI), decreased in annual terms from 2.6% in December to 2.4% in January. Annual core inflation went from 2.9% to 2.8% in the same time period.

Analysts' inflation forecasts for most major advanced economies foresee a moderation in headline inflation throughout 2024 from its current levels. However, they estimate that it would remain at levels above their central banks' inflation targets. Longer-term inflation expectations drawn from financial instruments for these economies remained relatively stable compared to early-February figures.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



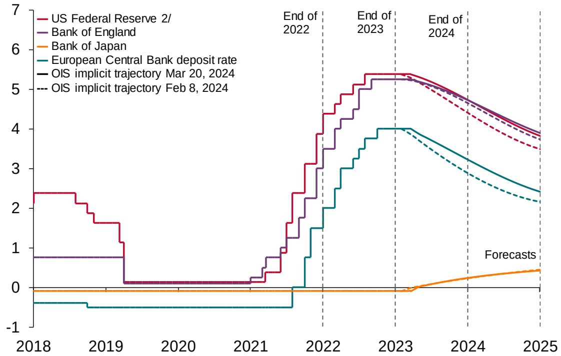
1/ The personal consumption expenditures price index is used.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

Since Mexico's last monetary policy decision, annual headline inflation declined in a large number of emerging economies. This was due to lower pressures on the prices of food, the core component and, in some cases, of energy. In most of the main emerging economies, core inflation declined. Although in most of these economies headline inflation remains above their respective central banks' specific targets, in some of them headline inflation was within each central bank's variability interval. Such was the case in South Africa, Czechia, Hungary, Poland, Philippines, India, Indonesia, and Brazil. In Thailand, annual headline inflation persisted at negative levels, while in China it rebounded to 0.7% in February, after having registered negative rates for four consecutive months. This was due to pressures on food prices and, to a lesser extent, on transportation and communication.

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

In the main advanced economies, most central banks left their reference rates unchanged and continued reducing their securities' holdings gradually. Regarding future actions, overall, central banks indicated that their decisions will remain dependent on information about the inflation outlook. Some of these institutions also reported that they are prepared to make additional adjustments, if necessary, in order to bring inflation back to target. As for market expectations on reference rates, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) registered a moderation in expectations of rate cuts (Chart 4). These thus anticipate that reference rates will be lowered by at least 25 basis points by the end of the third quarter in these economies.

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: Bloomberg.

At its March meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the fifth consecutive decision, between 5.25 and 5.50%. Additionally, it continued reducing its balance sheet. It reiterated 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 indicated again that the Committee judges that the risks associated with achieving its employment and inflation goals are moving into better balance. It reiterated that the Committee does not expect it to be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%. It also emphasized that the Committee would be prepared to adjust the stance of monetary policy as appropriate, if risks emerge that could impede the attainment of the Committee's goals.

During the press conference, the Federal Reserve chairman reiterated that the reference rate is likely at its peak for this monetary 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. He indicated that they are committed to both sides of their dual mandate and that an unexpected weakening in the labor market could also warrant a monetary policy response. He again mentioned that the FOMC is prepared to maintain the current target range for the federal funds rate for longer, if appropriate. Finally, he commented on the reduction in the size of its balance sheet and indicated that, although no decision was made during the meeting, the Committee judged, in general, that it would be appropriate to slow down the pace of the reduction relatively soon.

Regarding adjustments to the Committee's forecasts, between December and March the median for the annual growth rate was revised upwards from 1.4 to 2.1% for the fourth quarter of 2024, from 1.8 to 2.0% for the fourth quarter of 2025, and from 1.9 to 2.0% for the fourth quarter of 2026. The median of headline inflation forecasts remained unchanged at 2.4% for the end of 2024, was revised slightly upwards from 2.1 to 2.2% for that of 2025, and remained at 2.0% for that of 2026. The median of the Committee's expectations for the federal funds rate for the end of 2024 remained at 4.6%, and thus three 25-basis-point cuts continue to be anticipated for 2024. However, there were members who revised their estimates to the upside. The median of expectations for the federal funds rate for the end of 2025 increased from 3.6 to 3.9%, which implies that expectations of reference rate cuts for that year were revised from 100 to 75 basis points. For the end of 2026, the expected level rose from 2.9 to 3.1%. Expectations drawn from financial instruments anticipate an interest rate level of 5.2% for the end of the second quarter of 2024, and subsequently decrease to levels close to 4.7% for the end of that year and to 3.8% for the end of 2025.

At its March meeting, the European Central Bank (ECB) left its reference rates unchanged for the fourth 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 a timely return of 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.

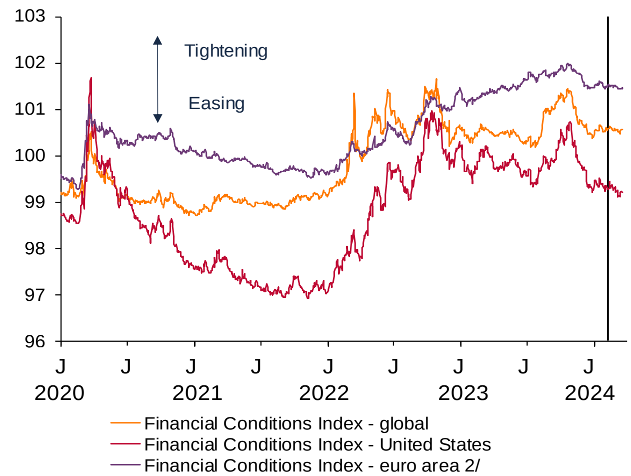
At the press conference, the ECB president pointed out that no interest rate cuts were discussed, but that debate on the reduction of its restrictive stance had begun. She noted that progress in disinflation continues, but that there is still not enough confidence and that more evidence is needed regarding progress of inflation convergence towards its target. Regarding its Pandemic Emergency Purchase Program (PEPP), the Governing Council continued with the normalization of its balance sheet and reiterated that it expects to conclude the reinvestments of maturing securities purchased under the PEPP by the end of 2024.

At its March meeting, the Bank of Japan raised its reference rate from -0.1% to a range of 0.0 to 0.1%, after having kept it at negative levels for more than eight years. This was the first reference rate increase since 2007. It also eliminated the yield curve control that kept the target level of the interest rate on ten-year Japanese government bonds (JGBs) at around 0%. Despite the above, said central bank anticipated that it will maintain accommodative financial conditions for some time.[4]

In the main emerging economies, since Mexico's last monetary policy decision some central banks have cut their reference rates, taking into consideration the specific economic circumstances of their countries. In China, the central bank cut the five-year Loan Prime Rate (LPR) by 25 basis points in February, and in March it left it, along with the short- and medium-term monetary policy rates, unchanged. Some central banks decided not to further adjust their reference rates after having done so in previous decisions. The Central Reserve Bank of Peru left its reference rate unchanged after having lowered it for the sixth consecutive time. The central banks of Russia and Turkey also kept them unchanged after raising them consecutively in several previous meetings.

Since Mexico's last monetary policy decision, international financial conditions remained relatively stable (Chart 5). Medium- and long-term rates in the main advanced economies increased moderately from the level registered at the beginning of February. Meanwhile, stock markets in both advanced and emerging economies performed favorably (Chart 6). In foreign exchange markets, the US dollar depreciated slightly. However, the currencies of most emerging economies depreciated marginally against the US dollar (Chart 7). Finally, since the last monetary policy decision, capital inflows into emerging economies have been registered. However, these flows exhibited a differentiated behavior among asset classes, with net inflows of equity assets and slight outflows from fixed-income assets during most of the period.

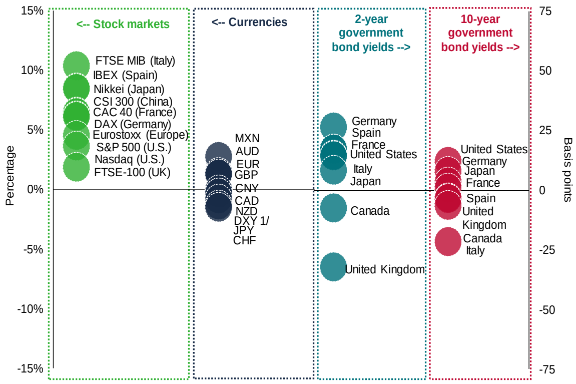
Chart 5
Financial conditions index[1/]
Units



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: Bloomberg and Goldman Sachs.

[4] The Bank of Japan considered that the 2% inflation target could be achieved in a stable and sustainable manner towards the end of its economic projection period. It noted that the quantitative and qualitative monetary easing (QQE) scheme with yield curve control, as well as the negative interest rate have fulfilled their function. However, it will continue with purchases of JGBs in approximately the same amount as before and, in the case of a rapid increase in long-term interest rates, the central bank will respond nimbly by increasing the amount of such purchases and by adopting measures such as fixed-rate purchase operations and the Funds-Supplying Operations against Pooled Collateral Additionally, it suspended purchases of exchange-traded funds (ETFs) and real estate investment trusts (J-REITs). It will also reduce gradually the amount of commercial paper (CP) and corporate bond purchases to suspend them in about a year. Finally, it indicated that it will grant loans under several of its funding programs with an interest rate of 0.1% and a duration of one year.

Chart 6
Change in selected financial indicators from February 8 to March 20, 2024
Percent; basis points



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

Chart 7
Selected emerging economies: financial assets performance as of February 1, 2024
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	2.22%	-3.06%	21	20	-6
	Brazil	-1.57%	-0.62%	18	33	-13
	Chile	-0.87%	6.76%	-1	33	-4
	Colombia	-0.14%	0.43%	-2	55	-23
	Peru	3.27%	7.86%	33	42	-8
Emerging Europe	Russia	-1.30%	2.08%	-350	0	N.A.
	Poland	0.65%	4.30%	37	32	0
	Turkey	-5.94%	2.75%	350	-32	-27
	Czechia	-1.30%	1.94%	-39	4	-3
	Hungary	-3.30%	-0.51%	40	48	-7
Asia	China	-0.19%	9.65%	-6	-9	2
	Malaysia	0.99%	2.03%	4	7	-7
	India	0.18%	2.03%	6	-2	0
	Philippines	1.28%	5.21%	-10	8	-5
	Thailand	-0.47%	1.97%	-13	-14	-2
	Indonesia	1.16%	3.22%	8	10	-8
Africa	South Africa	-0.73%	-1.52%	46	58	-11

Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year swap rates were used. The latest CDS data for Russia is as of June 1, 2022.
Source: Bloomberg.

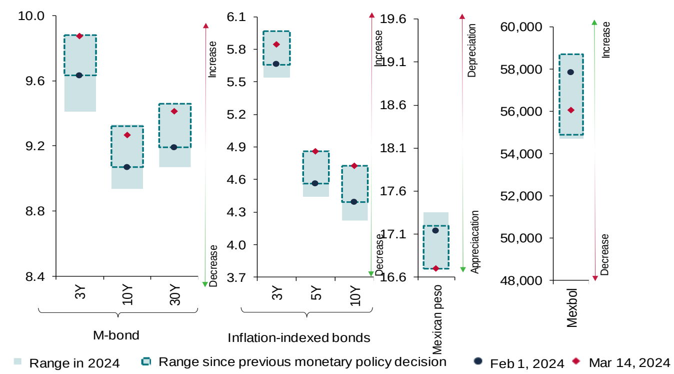
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described, the Mexican peso appreciated against the US dollar since Mexico's last monetary policy decision and its volatility decreased. Interest rates registered moderate adjustments to the upside (Chart 8). Stock markets were affected by corporate reports mentioning a less favorable outlook than anticipated.

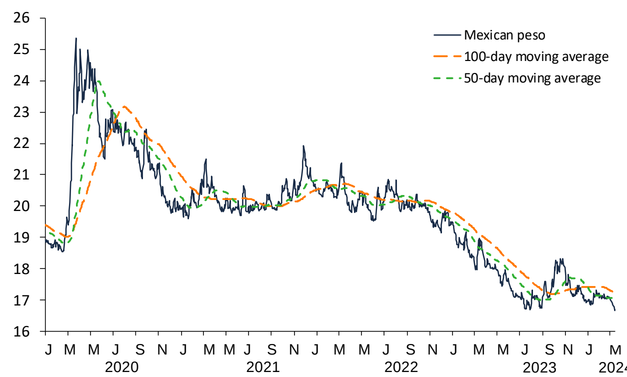
The Mexican peso traded in a range of 63 cents, between 16.65 and 17.28 pesos per US dollar since the last monetary policy decision. During the period, the Mexican peso appreciated by 2.22%, primarily influenced by the nominal interest rate spread between Mexico and the United States (Chart 9). This occurred in an environment characterized by the best trading conditions since early 2020.

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



Source: Bloomberg and PIP.

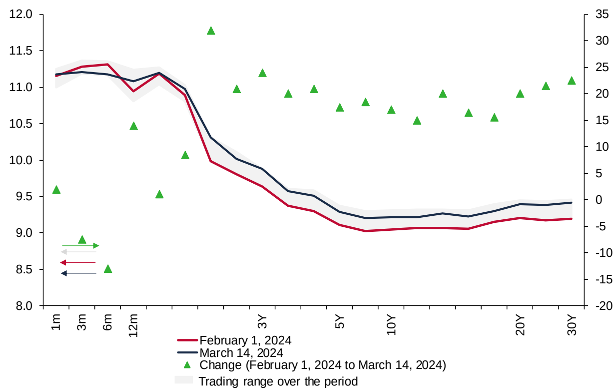
Chart 9
Mexican peso exchange rate
MXN/USD



Source: Bloomberg.

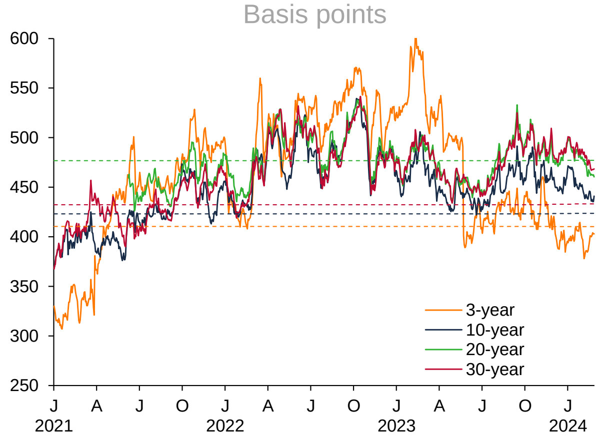
Interest rates on government securities increased up to 32 basis points along the entire curve (Chart 10). The yields on real-rate instruments increased up to 55 basis points. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments decreased by up to 20 basis points (Chart 11). These adjustments occurred in an environment where trading conditions somewhat improved.

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



Source: PIP.

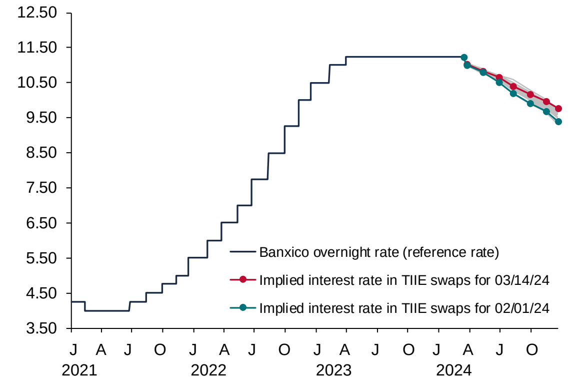
Chart 11
Breakeven inflation and inflation risk implied in government securities' yields[1/]
Basis points



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

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve incorporates the first 25-basis-point cut in March 2024 and an expectation of 9.78% for the target rate for the end of 2024 (Chart 12). Similarly, most analysts surveyed by Citibanamex anticipate that the first 25 basis-point cut will be made in March 2024.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent

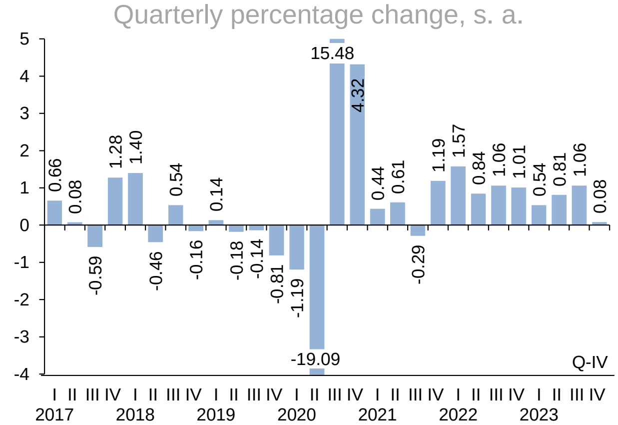


Note: Shaded areas represent the range since the last monetary policy decision.
Source: PIP.

A.2.2. Economic activity in Mexico

The Mexican economy slowed down considerably at the end of 2023, as Mexico's GDP registered a seasonally adjusted quarterly variation of 0.08% (Chart 13). While information for the first quarter of 2024 is limited, economic activity is expected to have shown greater dynamism during said period compared to the weakness observed in the fourth quarter of 2023.

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

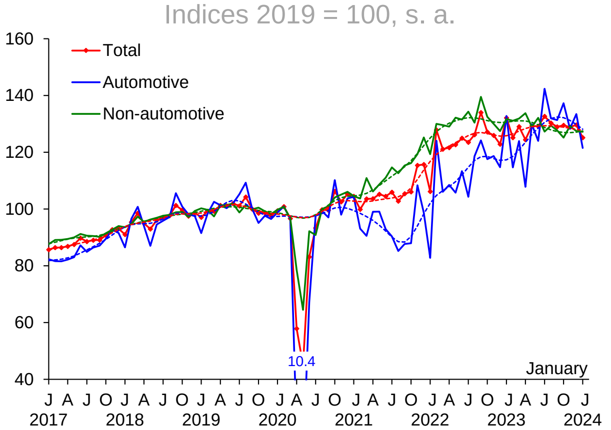


s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the evolution of domestic demand, available information up to the fourth quarter of 2023 indicates that private consumption continued trending upwards, reflecting a moderate positive trajectory of consumption of domestic goods and services, while consumption of imported goods remained at high levels. Gross fixed investment, which had been exhibiting dynamism in previous quarters, lost momentum. As for this indicator's components, the machinery and equipment segment slowed down significantly, while investment in construction slightly contracted. Regarding external demand, in early 2024, the value of manufacturing exports decreased and remained sluggish. This was the result of decreases in automotive shipments and stagnation in the rest of manufacturing exports (Chart 14).

Chart 14
Total manufacturing exports

Indices 2019 = 100, s. a.

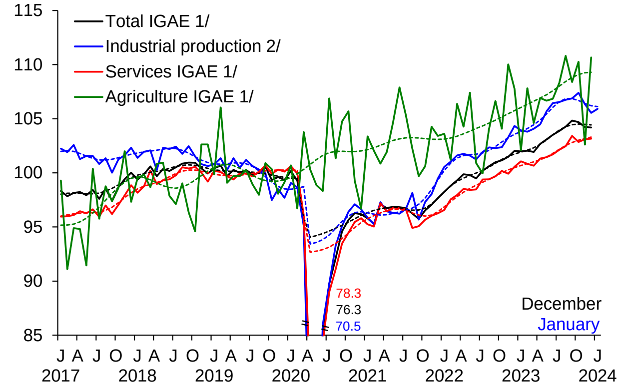


s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Prepared by Banco de México with data from the Tax Administration Service (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, at the end of 2023, services exhibited sluggishness and a differentiated behavior across sectors (Chart 15). In January 2024, industrial production increased moderately, after having decreased at a monthly rate for two consecutive months (Chart 16). Within its components, construction increased and remained at historically high levels. Manufacturing production grew at the margin, while still exhibiting weakness.

Chart 15
Indicators of economic activity

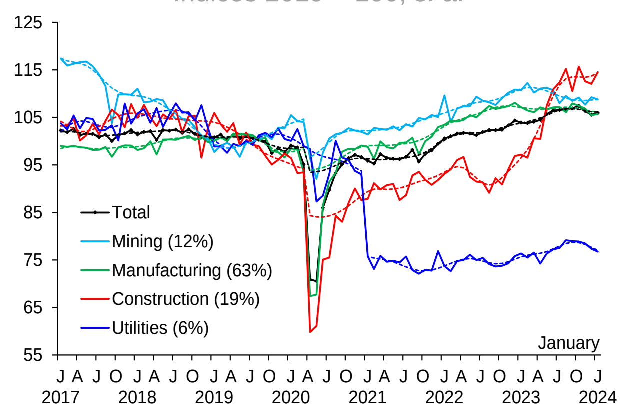
Indices 2019 = 100, s. a.



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/ Figures as of December 2023.
2/ Figures as of January 2024 from the Monthly Indicator of Industrial Activity.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 16
Industrial activity[1/]

Indices 2019 = 100, s. a.

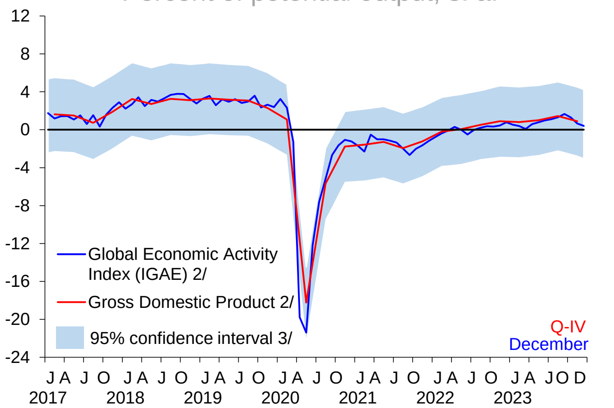


s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the cyclical position of the economy, as a result of the deceleration of the economy observed in the fourth quarter of 2023, the point estimate of the output gap decreased at the margin, although it remained in positive territory and continued without being statistically different from zero (Chart 17). In January 2024, the labor market continued showing strength. Specifically, based on seasonally adjusted figures, both national and urban unemployment rates remained at low levels, similar to those registered in December 2023 (Chart 18). In February 2024, the number of newly created IMSS-insured jobs continued increasing, with seasonally adjusted data.

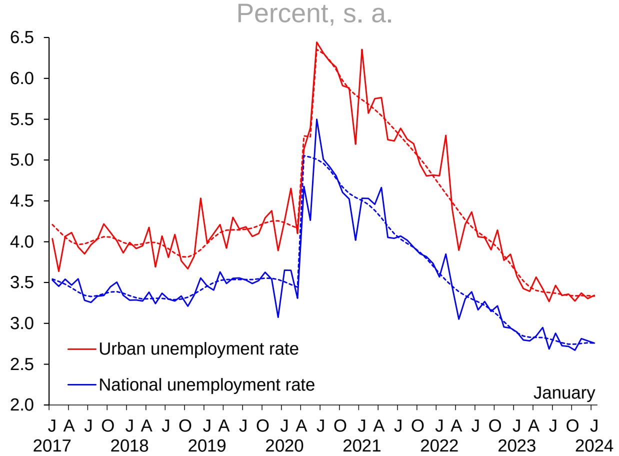
Lastly, in January 2024, unit labor costs in the manufacturing sector decreased, although they remained at relatively high levels (Chart 19).

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



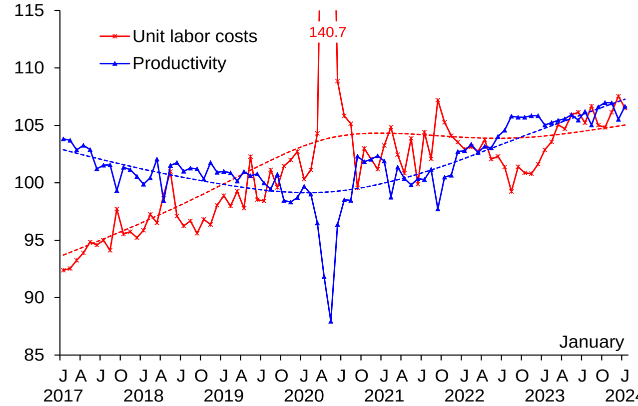
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ GDP flash estimate up to the fourth quarter of 2023 and IGAE up to December 2023.
3/ Output gap confidence 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 to December 2022).

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



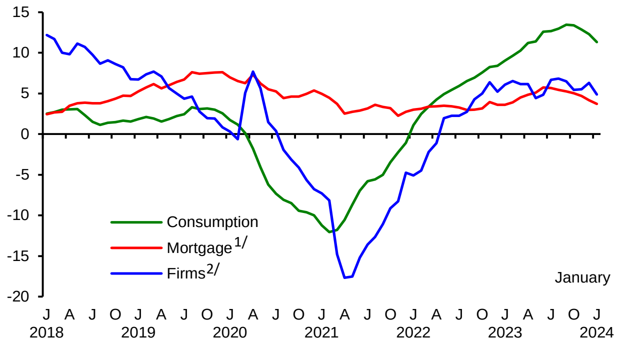
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly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

In January 2024, domestic financing to the private sector showed some moderation in its growth rate, after having exhibited dynamism in 2023. Regarding its components, bank lending to firms and households reduced its growth rate slightly with respect to the previous months (Chart 20). However, high growth rates continued to be observed in several segments, especially in consumer credit.

As for the cost of financing, interest rates on bank credit to firms did not show significant changes in January 2024 and thus remained at high levels. However, corporate credit intermediation margins in this segment continued to be generally lower than pre-pandemic ones. Interest rates on mortgages remained at levels similar to those observed prior to the health emergency. Within consumer credit, credit card interest rates continued increasing slightly in October 2023, and thus they have been adjusting with a lag to changes in the reference rate. Lastly, 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 January 2024. In the case of consumer portfolio, these indicators increased during that month, extending the upward trend observed since the first half of 2023. Despite the above, said rates remain at levels lower than those registered prior to the onset of the pandemic.

Chart 20
Performing credit from commercial banks to the private sector
Annual percentage change



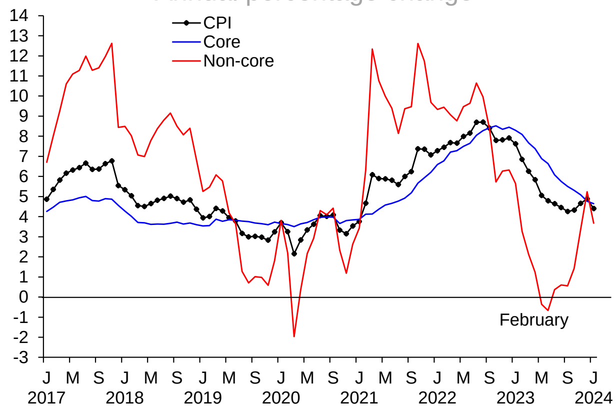
1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation decreased from 4.88% in January to 4.40% in February 2024. This result mainly derived from the reduction in non-core inflation, although the core component also contributed to the decrease (Chart 21 and Table 1).

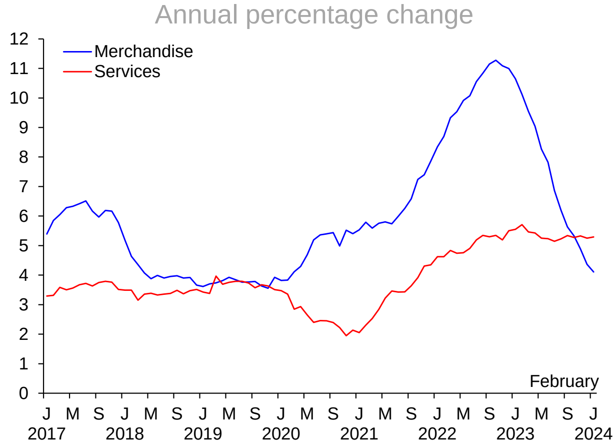
Annual core inflation decreased from 4.76 to 4.64% between January and February 2024. This performance reflected the continued decline in annual merchandise inflation, while services inflation remained without showing a clear inflection point to the downside (Chart 22). During the mentioned period, annual merchandise inflation decreased from 4.37 to 4.11%, marking fifteen consecutive months of decline. Specifically, annual food merchandise inflation decreased from 5.54 to 5.25% and non-food merchandise inflation did so from 2.97 to 2.75% (Chart 23). Meanwhile, annual services inflation increased from 5.25 to 5.30% during the same period, as it remained affected by pressures related to operating costs and their pass-through to consumer prices. As to its components, annual housing inflation increased from 3.64 to 3.73% and inflation of services other than housing and education adjusted upwards from 6.29 to 6.36%. Annual inflation of education services remained at high levels, although during the referred period it fell from 6.63 to 6.39%.

Chart 21
Consumer Price Index
Annual percentage change



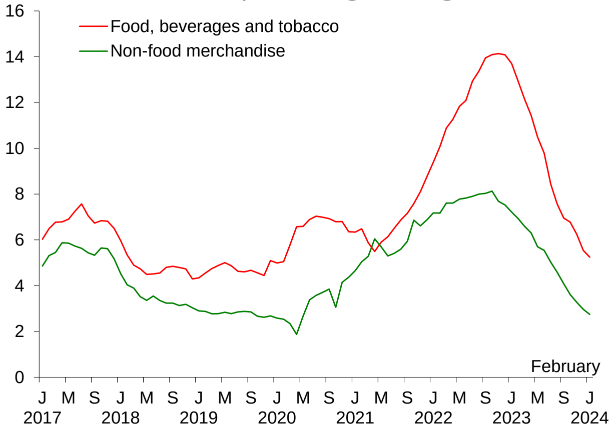
Source: INEGI.

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



Source: INEGI.

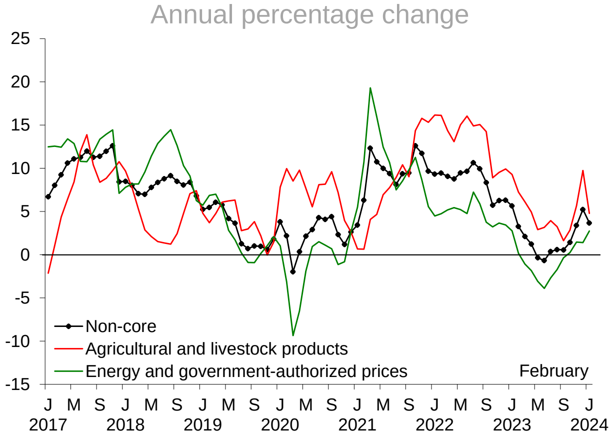
Chart 23
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Between January and February 2024, annual non-core inflation decreased from 5.24 to 3.67% as a result of the decline from 9.75 to 4.77% in annual inflation of agricultural products (Chart 24 and Table 1). Within the latter component, annual inflation of fruit and vegetables decreased from 21.78 to 15.00% and inflation of livestock products declined from -0.19 to -3.23%. In contrast, annual inflation of energy products rose from 0.21 to 2.28% during the same period, driven mainly by the increase from 2.12 to 3.86% in the annual variations of gasoline prices and from -7.59 to -2.18% in LP gas prices.

Chart 24
Non-core price subindex
Annual percentage change



Source: INEGI.

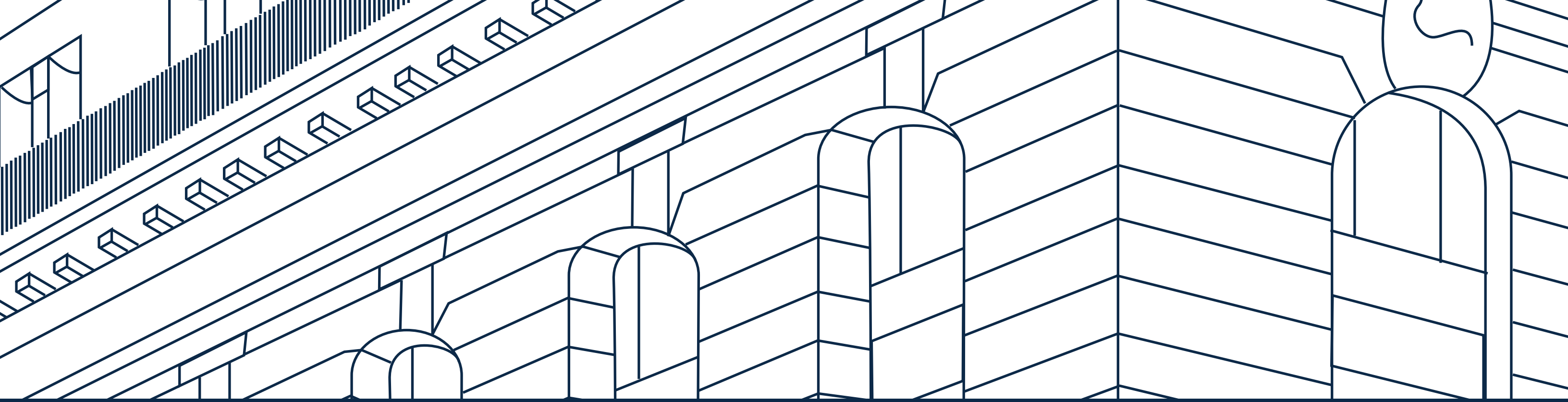
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between January and February 2024 the median for headline inflation for the end of 2024 decreased from 4.17 to 4.10% and that for core inflation remained stable at 4.06%. Expectations for headline inflation for the end of 2025 decreased marginally. The median of headline inflation expectations adjusted from 3.71 to 3.70%, while that of core inflation shifted from 3.72 to 3.69%. The medians of headline inflation expectations for the next four years adjusted slightly downwards, from 3.70 to 3.68% both for headline and core inflation. The medians of headline and core inflation expectations for the long term (5 to 8 years) remained stable at 3.50%. Finally, breakeven inflation has decreased since the previous monetary policy decision. Regarding its components, inflation expectations implied by market instruments decreased slightly. Similarly, the inflation risk premium adjusted downwards.

Headline inflation is still projected to converge to its target in the second quarter of 2025. This forecast is subject to risks. On the upside: i) persistence of core inflation; 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 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 is considered to remain biased to the upside.

Table 1
Consumer Price Index and components
Annual percentage change

Item	December 2023	January 2024	February 2024
CPI	**4.66**	**4.88**	**4.40**
Core	**5.09**	**4.76**	**4.64**
Merchandise	**4.89**	**4.37**	**4.11**
Food, beverages and tobacco	6.25	5.54	5.25
Non-food merchandise	3.28	2.97	2.75
Services	**5.33**	**5.25**	**5.30**
Housing	3.64	3.64	3.73
Education (tuitions)	6.60	6.63	6.39
Other services	6.46	6.29	6.36
Non-core	**3.39**	**5.24**	**3.67**
Agricultural and livestock products	**5.66**	**9.75**	**4.77**
Fruits and vegetables	11.68	21.78	15.00
Livestock products	0.68	-0.19	-3.23
Energy and government-authorized prices	**1.46**	**1.41**	**2.75**
Energy products	0.06	0.21	2.28
Government-authorized prices	4.82	4.29	3.87

Source:INEGI.



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