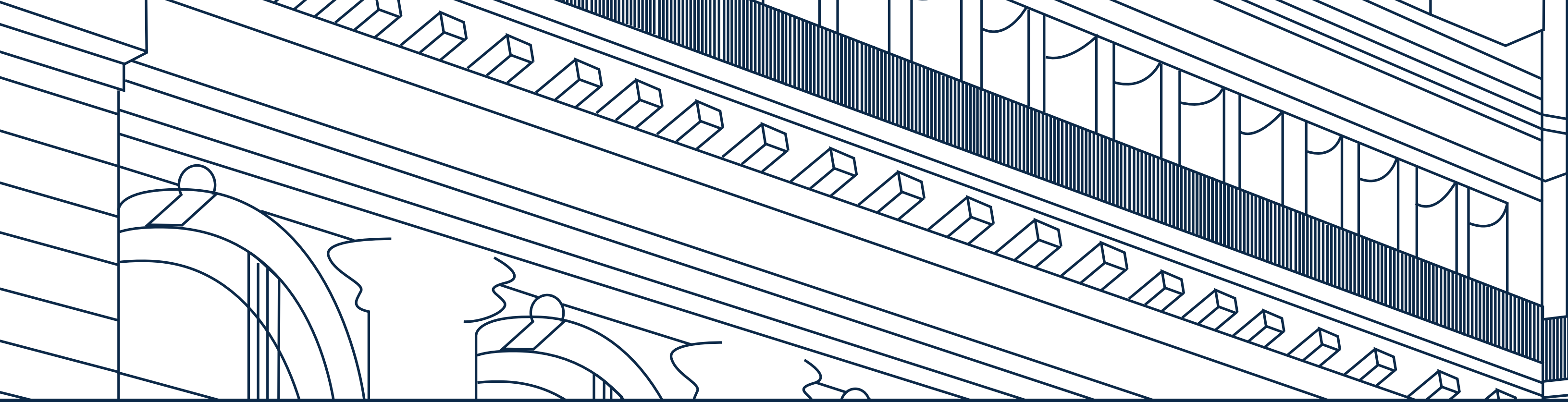

BANCO DE MÉXICO®

Minutes number 102

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on August 10, 2023

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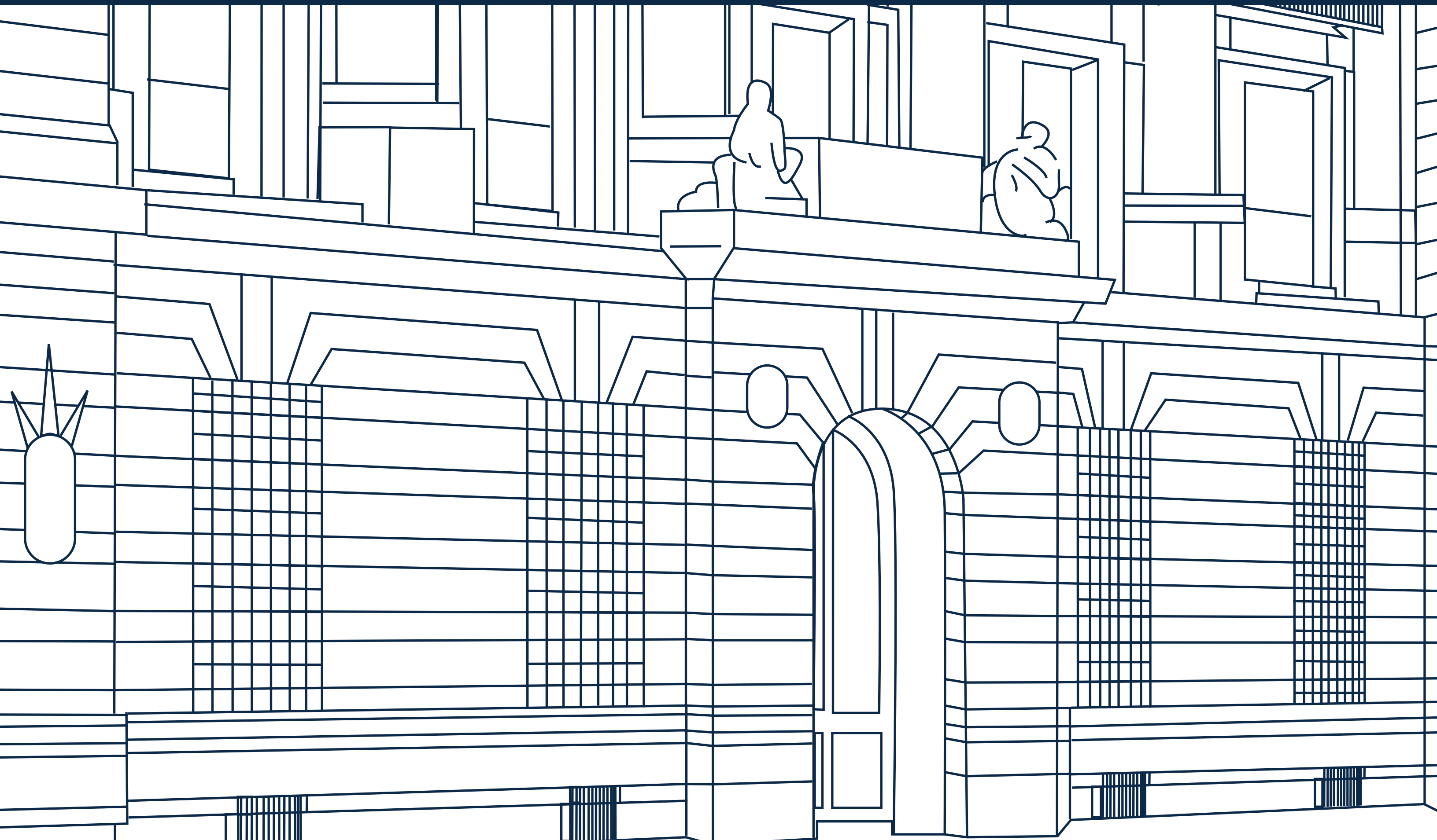

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: August 9, 2023.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Rogelio Eduardo Ramírez, Secretary of Finance and Public Credit.
- Gabriel Yorio, Undersecretary of Finance and Public Credit.
- Eduardo Magallón, Alternate Secretary of the Governing Board.

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

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

International environment

Most members pointed out that the global economy continued growing during the second quarter. Some members stated that, although this occurred at a slower pace than in the previous quarter, it was faster than expected. **One** member mentioned that the above took place in an environment of high uncertainty and of tightening of global monetary conditions. **Most members highlighted that the performance of the global economy has been driven, in part, by the services sector.** In a related manner, **some** members stated that the favorable evolution of consumption contributed to the resilience of economic activity. **One** member added the positive performance of investment in some countries. **Another** member indicated that the normalization of global supply chains has also supported world economic growth.

Most members noted that economic growth exhibits heterogeneity across regions. One member underlined that economic activity in the euro area expanded marginally, while Latin American countries recovered moderately. In contrast, **some** members highlighted the resilience of the US economy. **One** member pointed out that economic activity figures in the United States have been higher than expected. **Another** considered that an unsynchronized deceleration among the various sectors of the US economy has probably prevented an abrupt weakening of aggregate activity, as some sectors have been contracting while others have been expanding. He/she added that this would be associated with the asymmetric effects of the shocks derived from the pandemic as well as with the various lags with which monetary policy operates, affecting industrial production faster and more notably than tertiary activities.

Some members stated that world growth prospects for 2023 continue implying a deceleration, although slightly less intense than previously anticipated. **One** member mentioned that, considering the recent revisions, 3% growth is foreseen for both 2023 and 2024. **Another** member pointed out that the expected slowdown would result, in part, from the dissipation of the effects of the fiscal support provided during the pandemic and the lagged impact of tight monetary conditions; he/she highlighted that this impact has been more apparent in the manufacturing sector, mainly in advanced economies. He/she mentioned that the balance of risks to global economic activity remains biased to the downside due to different factors, such as the resurgence of concerns over the banking systems in advanced economies and a greater-than-expected weakness in the Chinese economy. **One** member noted that favorable revisions to the growth outlook for Asian economies, particularly for China, are not foreseen.

In the case of the United States, **one** member pointed out that growth forecasts have been revised upwards during this year. However, **another** member mentioned that the US economy is still expected to slow down as of the third quarter. **Despite the above, the majority considered that the probability of an upcoming recession has diminished. One** member indicated that, although monetary policy is operating, the economy has adjusted more gradually than in other hiking cycles, and thus, the perception that a soft landing could materialize has increased.

Regarding global labor markets, **some** members highlighted that these remain tight in several countries. However, **one** member argued that labor markets exhibit certain signs of a better balance between supply and demand. He/she pointed out that US non-farm payroll growth kept moderating, while the labor force continued trending upwards. He/she underlined that nominal wage growth has stabilized in the United States, in contrast to the euro area and the United Kingdom, where it is still trending upwards.

All members indicated that although headline inflation continued decreasing in most economies, it remains at high levels. Most members highlighted that it still lies above central bank targets in a large number of economies. They attributed the decrease in global headline inflation to lower pressures on energy and food prices. Some members mentioned that, overall, inflation is expected to converge to its target between 2024 and 2025. **One** member stated that the convergence process is still subject to high uncertainty. **Most members highlighted that, globally, the core component has shown resistance to decline. One** member pointed out that this component continues exhibiting persistence, which may still be reflecting effects of the shocks from the pandemic, geopolitical tensions and tight labor markets, which overall have led to a pass-through of costs to consumers. Nevertheless, **another** member considered that there are a number of differentiated dynamics among economies. He/she stated that, for example, in the United States, lower contributions of services to core inflation have been observed, while services inflation continues trending upwards in the euro area.

Among the risks to the global inflation outlook, **some** members mentioned the possibility of a surge in international commodity prices, especially following Russia's exit from the Black Sea grain export deal. As an additional risk, **one** member added the climate-related factors affecting various crops around the world. In addition, he/she warned about the possibility of disruptions in production chains, especially of semiconductors, in view of the trade tensions between China and the United States, and in the context of a high demand for such inputs by the technology sectors associated with artificial intelligence.

Most members pointed out that central banks of the major advanced economies raised their reference rates. All members mentioned as an example the case of the US Federal Reserve and **some** members of the European Central Bank. **One** member stated that the Bank of Japan adjusted its yield curve control program, raising the upper limit for its long-term interest rate. **Nevertheless, most members considered that central banks in advanced economies appear to be nearing the end of their hiking cycles. They observed that said authorities indicated that their subsequent actions will be dependent on incoming data. One** member highlighted that further interest rate increases have not been ruled out. **Another** member added that these institutions reiterated their commitment to maintain high interest rates for an extended period. As for emerging economies, **some** members stated that in most of these economies the monetary authorities left their reference rates unchanged, while some adjusted them downwards. **All members mentioned that the central banks of Brazil and Chile lowered their reference rates in response to specific macroeconomic conditions in each economy. One** member underlined that in both cases headline inflation has been declining. He/she pointed out that in Brazil inflation has been below 4.75% since March, which is the upper limit of the tolerance band, whereas in Chile economic activity has weakened considerably. **Another** member noted that, although inflation in Chile has not converged to the central bank's target, as it has in Brazil, the high level of unemployment and the outlook for lower growth motivated the interest rate cut. **One** member stated that these economies typically have more pronounced monetary policy cycles. **Some** members indicated that, in light of the particular macroeconomic conditions faced by each country, monetary policy is likely to remain heterogeneous at a global level. **One** member argued that this heterogeneity responds, in part, to the focalization of the diverse monetary tightening cycles.

All members mentioned that, in its July meeting, the US Federal Reserve increased the target range of the federal funds rate by 25 basis points. One member noted that this is consistent with the median of the most recent projections by the Federal Open Market Committee (FOMC) members. **Some** members highlighted that the chairman of that institution argued that interest rate decreases would take place once a sustained downward trend in inflation is confirmed. **One** member underlined that the chairman of that institution does not deem it appropriate to make interest rate cuts this year.

Another member pointed out that, in addition, he indicated that they no longer expect a recession for this year. **Some** members stated that even an additional increase is possible during the remainder of 2023.

Most members pointed out that international financial markets have recently registered volatility. They explained that this volatility was mainly caused by concerns regarding the fiscal situation in the United States. Nevertheless, they indicated that the downgrade in US credit ratings had a moderate effect on markets. One member underlined that the revisions to expectations regarding the end of the monetary authorities' restrictive cycle in advanced economies also contributed to the recent financial volatility. **Some** members highlighted that financial markets' sensitivity to economic data has increased due to the data-dependent approach that a number of central banks have stressed. **Most members underlined the greater risk aversion and higher volatility registered during the period. In this context, they noted that long-term interest rates increased. One** member pointed out that the main stock market indices had mixed results. **Some** members stated that the effects have also been felt in foreign exchange markets. In this regard, **some** members mentioned the recent appreciation of the US dollar. In this context, **one** member forewarned that the high levels of public debt accumulated after the pandemic, along with tight financial conditions, could undermine governments' ability to repay. He/she added that further downgrades in sovereign credit ratings could pose a risk to global economic growth and financial stability.

Economic activity in Mexico

All members highlighted that the Mexican economy has shown resilience. Most members pointed out that, according to GDP flash estimates, the economy registered higher-than-anticipated growth during the second quarter of the year. One member added that this would imply an expansion for the seventh consecutive quarter, something not seen since the end of 2015. **Most members pointed out that said growth was driven by the three major sectors of the economy. In particular, they highlighted the performance of industrial production and services. One** member noted that growth was supported by domestic spending. He/she underlined the contribution of greater investment in public infrastructure projects and growth in those subcomponents of services which had lagged behind the most during the post-pandemic recovery process. **Another** member highlighted that the services sector is the one that has contributed to growth the most. **One** member added that the performance of the components of tertiary activities has been heterogenous. **Some** members mentioned that the strong labor market has also contributed to the favorable performance of economic activity.

Some members attributed the favorable performance of industrial production to a significant increase in civil engineering construction projects. **One** member pointed out that this reflected the significant dynamism in public construction associated with railway works. In contrast, he/she mentioned that private sector construction shows significant sluggishness and has not regained its pre-pandemic levels yet. **Another** member pointed out that, within private construction, the industrial, commercial and service construction sector has recently improved. He/she considered that this segment is the one that could best reflect the nearshoring process. He/she mentioned that the positive trend observed in credit for industrial parks and warehouses suggests that said expansion could continue. However, he/she stated that, although manufacturing activity continues growing and remains at high levels, it has recently lost momentum influenced by the slowdown in US manufacturing activity.

Most members noted that domestic demand has continued to grow. They stated that said expansion has been supported by consumption. One member pointed out that it has grown at a higher-than-anticipated rate. **Another** member asserted that it is at historical highs. Regarding the determinants of consumption, **one** member mentioned that, although remittances in US dollars remain at high levels, their value in Mexican pesos and in real terms has decreased during the year, and thus, in his/her opinion, this factor hardly explains the current dynamism of household spending. In contrast, he/she indicated that the strengthening of the labor market could indeed be supporting consumption, especially that of services. He/she added that the National Survey of Household Income and Expenditure (ENIGH, for its acronym in Spanish) suggests that there has been a reallocation of resources towards lower income deciles, which have a higher marginal propensity to consume, possibly contributing to a higher-than-expected growth in domestic spending. **Most members stated that investment maintained its pace of recovery. One** member mentioned that there was a significant reactivation of non-residential construction.

Some members highlighted that, during the second quarter of 2023, the value of exports decreased slightly with respect to that observed in the previous quarter. Despite the aforementioned, **some** members noted that exports remain at high levels. **One** member argued that Mexico's increased share in US imports has offset the effects of the slowdown in total US imports. **Another** member stated that manufacturing exports have recovered from the contraction observed at the beginning of the year. **One** member added that, in turn, imports exhibit solid growth in the components of consumer and capital goods.

As for the risks to Mexican economic activity, **some** members argued that these are balanced. **One** member stated that on the one hand there is still a possibility of a noticeable slowdown in the US economy, particularly in 2024. On the other hand, he/she considered that the reconfiguration of global production chains could give a greater boost to domestic economic activity. **Most members highlighted that the estimate of the output gap continues to narrow. One** member noted that it is not statistically different from zero and **another** member stated that the point estimate is virtually at zero. **One** member added that it is anticipated to remain close to zero during 2023 and 2024.

All members pointed out that the labor market continued to show strength. Most members underlined the dynamism of employment and the fact that the unemployment rate remains at historic lows. One member mentioned that the labor force participation rate has returned to levels close to those observed prior to the pandemic. **Another** member added that an expanded measure of unemployment that includes part-time workers and individuals out of the labor market but who are available for work is also at extremely low levels. He/she indicated that the unemployment gap is estimated to be negative and that over the past 10 months it has continued to widen. In this context, **some** members stated that the labor market remains tight. **Most members noted the relatively high magnitude of wage revisions. Some** members indicated that there was an increase in the growth rate of real wages of IMSS-insured workers. **One** member stated that such increase responds to the disinflationary process and the stabilization of nominal wages. **Another** member noted that contractual wage revisions accelerated, particularly in private sector companies. He/she added that the estimate of the output gap practically at zero, along with the strength of consumption and of the labor market, do not only show an economy that is resilient, but one that is actually vigorous and that the strength of the labor market could be causing pressures on the cost structure.

Inflation in Mexico

Most members stated that the disinflation process in Mexico remains underway as a result of the mitigation of the shocks associated with the pandemic and the military conflict. In this regard, they highlighted the better functioning of supply chains and the reduction in commodity prices. They added that the appreciation of the Mexican peso has contributed to ease price-related pressures. Some members forewarned that this process has also relied on comparison base effects.

All members pointed out that, since the last monetary policy meeting, headline inflation has continued decreasing and registered 4.79% in July. Some members indicated that it has decreased for six consecutive months. **The majority pointed out that since September 2022, when it reached its highest level in this inflationary episode, it had already accumulated a reduction of 3.91 percentage points, 2.82 of which are attributed to non-core inflation. In this context, they underlined that the latter component, which is the most volatile, has contributed significantly to the fall in headline inflation.** Nevertheless, **some** members highlighted that the core component has also contributed to the disinflationary process and that its contribution has recently increased. **One** member estimated that of the 2.06 percentage points by which headline inflation has decreased over the past four months, 1.05 are attributable to core inflation.

All members mentioned that after the decline in core inflation since the last monetary policy meeting, the core component registered 6.64% in July. Some members highlighted that, since November 2022, when it reached its highest level during this inflationary period, it has decreased by a total of 1.87 percentage points, 1.45 of which took place over the last four months. **One** member considered that the latest figures have been positive and confirm a downward trajectory of its annual variation. He/she pointed out that the most recent readings have been below the anticipated level. He/she added that the seasonally adjusted annualized monthly changes are already near the upper limit of the variability interval. **Another** member argued that the percentage of the core consumption basket that displays a seasonally adjusted annualized monthly inflation above 10%

has been decreasing, from a maximum of about 50% of the basket to only 6% in the latest data. However, he/she noted that the share of the basket with variations of less than 3% is still below its historical average. He/she argued that this suggests that, although progress has been made in the disinflationary process, there is still a long road ahead.

Despite the decline in the core component, most members highlighted that it remains at high levels. One member stressed that the fundamental problem of the disinflationary process continues to be the fact that core inflation is far from target. **Most members pointed out that it exhibits a persistent behavior. One** member mentioned that, while said persistence may be, in part, due to shocks from the pandemic and the geopolitical conflict, it may also respond to a contamination of the price formation process, as suggested by the increased frequency and magnitude of price adjustments. He/she also argued that, while external pressures on this component have diminished, domestic pressures have increased. He/she underlined that, in his/her opinion, the latter are due, in part, to demand-related pressures, higher inflation expectations, and to the wage policy. He/she stated that the favorable performance of private consumption is evidence of demand-related pressures. He/she considered that wage growth remains at levels that are not compatible with the inflation target and warned that wage dynamics do not show signs of moderation. **Some** members argued that this persistence would be reflecting the dynamics of services prices.

Within core inflation, most members noted that the merchandise component has continued to decline. Some members considered that this has mirrored the mitigation of global shocks. **One** member highlighted that merchandise inflation has decreased for seven consecutive months. **However, most members agreed that it still remains at high levels. One** member mentioned that annual food merchandise inflation is still close to double-digit levels. **Most members considered that services inflation still does not show a clear downward inflection point. They underlined that it remains high. One** member pointed out that this is observed not only in Mexico but also in other economies. **Another** stated that, although it is above its historical mean, several of the shocks observed during the year have not accumulated, as it occurred in 2021 and 2022. **One** member delved into the fact that, since the last monetary policy decision, inflation of services other than housing and education decreased slightly. In this regard, **another** member added that inflation of food services and of transportation services remain at high levels. **Some** members highlighted that inflation of education services continues trending upwards. **One** member indicated that this is also observed in housing inflation.

Most members argued that the normalization of households' consumption patterns has affected the evolution of services inflation. Some members mentioned that the evolution of services inflation has reflected the lagged effect of accumulated cost-related pressures from global shocks. **One** member stated that, while households reallocated their spending from services to merchandise at the beginning of the pandemic, the demand for services has been growing insofar as the population's mobility has increased. He/she considered that this process has taken time, as evidenced by the slow recovery observed in the activity indicators of entertainment and of food preparation and temporary accommodation services. Thus, these reflect the cost-related pressures which accumulated in the context of the ongoing recovery of demand that the sector is experiencing. **Another** member considered that the high levels of services inflation are not necessarily associated with domestic pressures. He/she acknowledged that there is a certain effect of the dynamism of the economy and of the labor market on services prices, but he/she considered that this effect does not appear to be of sufficient magnitude to account for the high levels of services inflation. He/she stated that, in any case, these factors have contributed to the persistence of core inflation, and that it is important to monitor them. He/she added that, for the conduct of monetary policy, it is necessary to appropriately distinguish the factors behind the inflationary dynamics.

Most members pointed out that in July non-core inflation registered a negative annual variation of -0.67%. They underlined that it is at historic lows. They added that annual variations of less than zero had not been observed in the past, except at the beginning of the pandemic. One member highlighted the sharp decline in this component since August 2022 when it registered double-digit levels. He/she also emphasized the significant reductions in energy inflation and in agricultural and livestock goods' inflation during this period. **Another** member considered that the decline in non-core inflation is due to the mitigation of global shocks. He/she stated that the significant fall in energy prices, mainly of LP gas, and the low agricultural and livestock product prices have contributed to the disinflationary process.

All members highlighted that longer-term inflation expectations drawn from surveys remained stable at levels above target. One member pointed out that, although medium and long-term expectations increased slightly throughout this inflationary episode, overall, these have remained anchored. He/she pointed out that, despite their positive performance, the distribution of these expectations exhibits some bimodality, with a bias towards high readings. He/she mentioned that this phenomenon had already occurred in previous episodes, and that it was corrected in due course. However, **another** member warned that medium- and long-term expectations remain above the target and do not exhibit a downward trend. **Most members mentioned that short-term expectations decreased. One** member considered that, although inflation expectations' readings have improved, there is still work to do, and thus it is important for monetary policy to continue contributing to its improvement. **Another** member pointed out that core inflation expectations for the end of 2024 are still above the upper limit of the target range. Regarding expectations drawn from market instruments, **one** member stated that break-even inflation shows a downward trend due to the decline in the inflation risk premium, which is below its historical average. He/she mentioned that the behavior of expectations is consistent with allowing the disinflationary process to evolve as expected.

Most members highlighted that Banco de México's forecasts continue anticipating that inflation will converge to the 3% target in the fourth quarter of 2024. One member mentioned that, for this meeting, headline inflation forecasts remained practically unchanged. **Most members underlined that those corresponding to core inflation were revised marginally upwards for the short term. One** member pointed out that this revision was offset by a downward adjustment in the forecast of the non-core component. **Another** member highlighted that, at the margin, significant improvements in core inflation figures must be observed for annual rates to continue decreasing. In this regard, he/she stated that core inflation could remain beyond the target range longer than expected. **Some** members estimated that the base effect which has favored annual inflation will begin to decrease towards 2024. In this regard, **one** member noted that it can be anticipated that the convergence process will face difficulties next year. **Another** member pointed out that at this stage of the disinflationary process it can be expected that the speed at which the components of inflation decrease will be heterogeneous, the process will be non-linear, and inflation may rebound at certain moments.

All members agreed that the balance of risks regarding the expected trajectory for inflation over the forecast horizon remains biased to the upside. Among risks to inflation, they highlighted the persistence of the core component at high levels. Some members added as an upward risk the possibility of greater cost-related pressures, mainly from the strong labor market and domestic demand. **One** member warned about the possibility that economic growth above 3% narrows the output gap and leads to inflationary pressures. **Another** member noted the risk of an exchange rate depreciation in light of episodes of international financial volatility. He/she stated that there is a risk of a correction in markets' expectations regarding the Federal Reserve's future monetary policy stance, which could affect the expected trajectory of the peso and, therefore, the convergence of inflation to the target. **One** member added that insecurity and possible additional increases to the minimum wage could also lead to cost increments for firms. **Most members pointed out the risk of non-core inflation increasing more than expected in the next months. One** member considered a matter of concern the expectation that the favorable dynamics of the non-core component reverses in a context in which core inflation is still at high levels. **Another** member estimated that an additional risk derives from the fact that, since the non-core component is the main factor that has allowed the decline in headline inflation, and since the inflation of this subindex has reached its lowest historical point, it is foreseeable that it will return to values in line with its historical mean, which are more elevated than the values forecasted by Banco de México, thus making the convergence to the target more difficult. **One** member stated that the high incidence of non-core inflation on the improvement of the inflationary outlook constitutes a structural weakness for headline inflation dynamics. He/she mentioned the risk of price-related pressures on agricultural and livestock products due to the impact of the "*El Niño*" meteorological phenomenon. **Another** member noted that some elements that have favored the convergence of inflation, such as the decline in commodity prices and base effects, could contribute less to such convergence towards the end of the year. **Some** members stated that additional shocks cannot be ruled out in view of a highly uncertain environment. **Most members considered that, in light of the risks, the improvement in the inflationary outlook remains fragile.**

Macrofinancial environment

Regarding financing in the economy, **one** member pointed out that both total and domestic financing continued increasing. **Most members noted that bank consumer lending continued to expand. One** member associated the above with the strength of the labor market. **Some** members noted that credit to firms also continued growing. However, **one** member noted that its rate of expansion has stabilized. He/she also indicated that the latest information points to an increase in the demand for bank lending, from both firms and households, and to a decrease in the supply of bank lending for some sectors. Looking ahead, he/she pointed out that the demand for credit is expected to continue showing dynamism and its supply, to continue exhibiting heterogeneity, although it is not necessarily expected that lending conditions will tighten. He/she highlighted that firms and households continue substituting liquid assets for long-term instruments. **Another** member underlined that delinquency rates remain at relatively low and stable levels.

Most members highlighted that the Mexican peso continued to display the resilient performance that it has been presenting. One member pointed out that in July of this year the nominal exchange rate reached levels unseen since December 2015, while in real terms it reached levels similar to those observed in May 2013. **Another** member indicated that the peso has accumulated a gain of around 12% in 2023. **Among the factors that have explained the resilience of the national currency in the medium run, most members mentioned the volatility-adjusted domestic and foreign interest rate spread, as well as Mexico's solid macroeconomic fundamentals compared to other emerging economies. Some** members added that the positive outlook on the nearshoring process has also contributed to the above. **One** member noted the high inflow of remittances, the weakening of the dollar, and the uncertainty about the start of an easing cycle by the US Federal Reserve.

Some members noted that recently domestic financial markets registered volatility, in line with global financial markets. **One** member stated that, since the last policy meeting, the Mexican peso traded in a wide range of around 80 cents, and finished the period with a slight depreciation. **Most members highlighted that, despite the recent volatility associated with an increase in risk aversion, trading conditions in the foreign exchange market remained at adequate levels. One** member pointed out that long positions continued being taken on the Mexican peso in the derivatives market, in order to take advantage of the interest rate spread. He/she stated that this accumulation is comparable in magnitude to remittance flows during the quarter. He/she added that non-resident investors took advantage of recent exchange rate fluctuations to increase their positions in *M-Bonos*, which in turn contributed to limit the upward adjustment in the exchange rate. He/she argued that, in a floating exchange rate regime, exchange rate fluctuations work as an automatic stabilizer by absorbing eventual shocks. He/she noted that in such a regime, the authorities do not aim for a certain exchange rate, but rather focus on ensuring orderly trading conditions in the foreign exchange market.

Most members noted that long-term interest rates on government bond yields rose as a result of the recent episode of higher risk aversion. One member pointed out that the yield curve maintained stable operating metrics. **Another** member stated that the stock market declined during this period, affected by the communications sector. **Some** members indicated that one rating agency downgraded Pemex's credit rating while another one changed its outlook from stable to negative. **One** member warned about the higher financial cost that this company could face and the possible difficulties to meet its short-term refinancing needs. He/she argued that the multiple rating downgrades between January 2019 and July 2023 signal the company's recent financial deterioration. He/she mentioned that the lack of investment in maintenance, the lack of changes in its business strategy, and an outlook for lower capital expenditures have increased its dependence on federal resources, which could be a risk to sovereign debt ratings. He/she added that the Mexican banking system has significant exposure to this company. **Another** member considered that the downgrade of this company's rating had a limited impact on domestic financial markets. He/she stated that Mexico’s sovereign risk premia remained practically unchanged.

Monetary policy

The Governing Board evaluated the magnitude and diversity of the inflationary shocks and their determinants, along with the evolution of medium- and long-term inflation expectations and the price formation process. It considered that the disinflationary process is underway given that diverse pressures have eased. Nevertheless, it deemed that these continue

having an incidence on inflation, and thus it remains high. Also, that the inflationary outlook is still very complex. Based on the above, and considering the monetary policy stance already attained, with the presence of all its members, the Board decided unanimously to maintain the target for the overnight interbank interest rate at 11.25%. With this decision, the monetary policy stance remains in the trajectory required for inflation to converge to its 3% target within the forecast horizon.

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

One member highlighted that it is essential to continue with a very cautious approach, carefully assessing the outlook for inflation and its determinants. He/she underlined that since the last monetary policy meeting, the disinflation process in Mexico continued underway. However, he/she warned that the outlook is still complex and uncertain. He/she pointed out that although inflation has decreased, its path towards the target is still lengthy and faces significant challenges. For this reason, he/she considered that the reference rate must still remain at its current level for an extended period. He/she stated that this will give more time for the disinflationary process to continue and to become more generalized among the inflation components. He/she added that it will also allow to evaluate the behavior of inflation determinants. He/she underlined that the disinflation process responds to monetary policy actions, as well as to the fading of the effects of inflationary shocks. He/she highlighted that in this episode, Banco de México's decisions have contributed to the anchoring of inflation expectations, especially longer terms ones. He/she pointed out that, despite the magnitude of inflationary pressures, such expectations have remained stable. He/she added that monetary policy has also contributed to the resilient performance of the Mexican peso, in an environment of tight global monetary conditions. He/she argued that the anchoring of longer-term inflation expectations has prevented inflationary shocks from leading to even higher inflation levels. He/she stated that the behavior of the national currency has also contributed to the disinflationary process. He/she reiterated that this does not mean that there is a target for the interest rate spread or for the level of the exchange rate. He/she stated that, although Banco de México takes into consideration developments in international monetary policy, this is merely one among many factors that are analyzed at each meeting. He/she pointed out that central bank decisions obey particular macroeconomic conditions prevailing in each economy. He/she argued that due to the above, there is currently a certain heterogeneity in the decisions made by the monetary authorities. He/she mentioned that, in the case of Mexico, the central bank will continue making its monetary policy decisions based on the country's inflation outlook. He/she concluded by emphasizing that, in accordance with its constitutional mandate, the consolidation of an environment of price stability must remain monetary policy's priority. He/she highlighted that this is for the benefit of the Mexican population, especially the lower-income segments, which are affected to a greater extent by the regressive effects of the inflationary phenomenon.

Another member considered that it is essential to preserve the achieved level of monetary tightening in order to continue reducing inflation as expected and to mitigate the upside risks to inflation. He/she argued that the high uncertainty regarding the inflationary process and a balance of risks biased to the upside make it necessary to continue operating cautiously, favoring a flexible monetary policy stance, dependent on incoming data. He/she pointed out that for this reason maintaining the level of monetary restriction longer than expected or even that a further tightening is required, cannot be ruled out. He/she stated that the monetary policy statement should acknowledge that the favorable evolution of inflation has mainly responded to external factors and to the non-core component, and that, on the contrary, domestic pressures may hinder the convergence of inflation to the target. He/she indicated that there are two risk factors with significant implications for monetary policy conduction in the short and medium terms that urge caution against rushing with the withdrawal of monetary restriction. He/she mentioned as a first factor the accumulated lag in physical investment and the fall in productivity, which may have reduced the potential growth of the economy. He/she estimated that, if this were the case, inflationary demand pressures could materialize even when traditional estimates of the output gap do not indicate an overutilization of productive capacity. He/she noted as a second factor Pemex's financial situation given its possible impact on public finances, financial stability, and the exchange rate. He/she stated that these two factors reinforce the convenience of maintaining the monetary policy stance in restrictive territory during the entire planning horizon. He/she expressed that this is a necessary condition not only to induce the convergence of inflation to the target, but also to manage the risks associated with such convergence.

One member stated that, despite its improvement, the inflationary outlook continues facing domestic and idiosyncratic risks and structural factors, which calls for maintaining the current level of the reference rate for an indefinite period. He/she considered that, given the increasing domestic pressures on inflation, monetary policy should continue considering the international context as a secondary factor. In this regard, he/she mentioned that there is still a wide interest rate spread between Mexico and the United States, and that global risks are contained. He/she noted that although the exchange rate has contributed to mitigate external price-related pressures its level is not a goal in the decision-making process. He/she argued that the beginning of monetary easing in some emerging economies responds to contexts different from that of Mexico, and therefore cannot be taken as a reference to determine the central bank's policy stance. He/she warned that in light of the still high level of headline and core inflation expectations for 2024, it is essential to stress that a restrictive stance will be maintained to ensure the anchoring of inflation expectations. He/she argued that it will be important to monitor that the effects of this stance are fully transmitted to the economy. He/she warned that several analysts as well as markets are discounting cuts in the reference rate before the end of 2023. However, he/she pointed out that it is still premature to consider a possible cut, even in the case of a fine-tuning to avoid an overly restrictive stance. He/she noted that, for now, the further tightening of the restrictive stance will continue through passive monetary policy management. He/she estimated that normalization towards a neutral stance is foreseen beyond the forecast horizon. Finally, he/she expressed that in the forward guidance, the period during which the policy rate will remain in place must still be characterized as extended, as such period may cover the rest of the year. He/she stated that, for this reason, it is essential that such guide signals that the inflationary problem has not yet been resolved and that it stresses the commitment to the primary mandate of price stability.

Another member considered that the disinflation process continues to advance, although some elements that have worked in favor of convergence may contribute less towards the end of the year, and the balance of risks remains biased to the upside. He/she pointed out that the nature of the observed shocks starting with the pandemic has led to an environment of high uncertainty which could extend the lag with which monetary policy operates. He/she noted that these lags are considerable and may not be stable throughout the entire horizon. He/she highlighted that the greater resilience of the economy may suggest a more gradual transmission of monetary policy onto domestic demand which contributes to a slower decline in the core component. He/she noted that the latter could be explained, among other factors, by the normalization of consumption patterns and the growth of tertiary activities, which tend to be less sensitive to interest rates than other sectors. He/she mentioned that the better performance of the economy has also contributed to ease tighter credit conditions and to maintain the prices of various assets at high levels, which has caused credit channels and asset prices to operate slowly. He/she pointed out that, despite this, monetary policy has tightened further through both the increase in the ex-ante real interest rate and the behavior of the real exchange rate. He/she indicated that the level of restriction attained is contributing to the anchoring of inflation expectations and to the disinflationary process. However, he/she argued that monetary restriction will still require an extended period to be adequately transmitted and to guarantee: the consolidation of an orderly and sustained trajectory of inflation to the 3% target, a neutral balance of risks around the inflation forecast, and an adjustment of inflation expectations towards their historical averages. Considering all of the above, he/she deemed that the reference rate should be maintained at its current level. He/she warned that expectations implicit in the fixed income market anticipate a cycle of cuts in the reference rate for 2024 similar to that of an economic crisis scenario, which is not consistent with the expected behavior of economic activity. He/she expressed that, in this environment of high uncertainty, communication must underline that the stance will continue to be flexible and data-dependent in order to comply with the constitutional mandate.

One member considered that the solid stance adopted by Banco de México has contributed to the disinflationary process. However, he/she noted that, despite better inflation readings and its more favorable outlook, there are elements that make it convenient to continue with a cautious approach and maintain the reference rate at its current level for an extended period. He/she argued that since there is a stance consistent with inflation's convergence and monetary policy operates with lags, the effects of this monetary tightening should be allowed to continue having an incidence on the economy, which appears to be operating at its potential. He/she considered that the persistence of core inflation as well as the fact that the balance of risks remains biased to the upside, in an environment of high uncertainty, are an important challenge, and thus new shocks cannot be ruled out. Likewise, he/she stated that, although they have remained anchored, inflation expectations are still affected, and during this pause period, improvements in their readings will continue to be observed. He/she highlighted that this period will also allow us to analyze the effects of the shocks associated with the global inflationary episode on how the economy operates, not only in the short term, but also its possible impact in the long term. He/she also stated that the level of restriction attained is sufficiently robust in light of possible adjustments in the stance relative to other economies. He/she indicated that Banco de México's timely and decisive actions have allowed it to implement a more gradual tightening cycle than in other emerging economies, but in a more timely manner than in advanced economies. In this regard, he/she stated that the pace of normalization of monetary cycles is foreseen to be heterogeneous. Regarding forward guidance, he/she highlighted that it has allowed to transmit Banco de México's vision of the inflationary outlook effectively. He/she added that, without being too explicit, it has contributed to strengthen the monetary policy stance. He/she delved into the fact that, in view of the prevailing uncertain and complex environment, a moderate and effective use of forward guidance should be pursued, in order for it to consolidate as a vehicle to facilitate the understanding of monetary policy actions looking ahead. He/she was of the opinion that it must be communicated that currently it is not prudent to discuss the possibility of cuts in the reference rate and that it must stay at its current level for an extended period, which will give time to see substantial improvements in the inflationary outlook, while fostering an orderly adjustment of the economy and markets.

3. MONETARY POLICY DECISION

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

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

4. VOTING

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

ANNEX

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

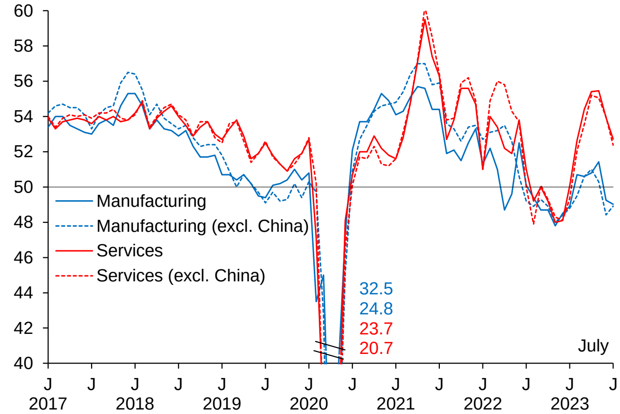
A.1. External conditions

A.1.1. World economic activity

Available indicators suggest that during the second quarter of 2023 global economic activity expanded at a more moderate pace than in the previous quarter, although slightly faster than anticipated at the beginning of the quarter. Global economic activity is expected to have performed heterogeneously across economies and sectors. In advanced economies, it would have been similar to that of the previous quarter, and in several of the main emerging economies, it would have decelerated, with the case of China standing out. Purchasing Managers' Indices point to a continued expansion of services and a weakness in global manufacturing activity at the beginning of the third quarter (Chart 1). Among global risks, the following stand out: the persistence of inflationary pressures, the intensification of geopolitical tensions, tighter financial conditions, and to a lesser extent, challenges to financial stability.

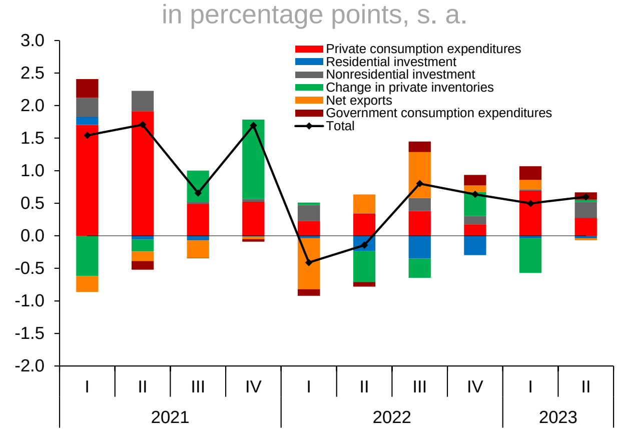
In the United States, Gross Domestic Product (GDP) grew at a seasonally adjusted quarterly rate of 0.6% during the second quarter, after having increased 0.5% in the first quarter of the year. The expansion during the second quarter was driven by private consumption, business investment, government spending, and inventory accumulation (Chart 2).[1] The positive contributions of the above factors were slightly offset by the negative impact of net exports and residential investment.

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



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

Chart 2
US Real GDP and Components
Quarterly percentage rate and contribution in percentage points, s. a.



s. a./ Seasonally adjusted figures.
Source: BEA.

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 2.4% in the second quarter and 2.0% in the first quarter of 2023.

US industrial production contracted at a seasonally adjusted monthly rate of 0.5% in June, after having decreased 0.5% in May. The decline in June reflected a decline in all of its components, with a 2.6% fall in electricity and gas generation standing out. Manufacturing activity decreased 0.3%, mainly as a result of a fall in non-durable goods and, to a lesser extent, in that of durables. Non-residential construction spending continued expanding during the second quarter, particularly in the technology sector. Purchasing Managers' Indices point to some sluggishness in the manufacturing sector at the beginning of the third quarter.

The US labor market remained tight even though some indicators have shown signs of moderation. The non-farm payroll continued expanding, albeit at a more moderate pace, going from a job creation of 281 thousand new positions in May to 186 thousand new positions on average per month in June and July. The vacancy rate remained at levels that suggest that the labor market remains tight. Initial claims for unemployment insurance continued at low levels. The unemployment rate remained low, moving from 3.7% in May to 3.5% in July.

In the euro area, economic activity expanded moderately in the second quarter of 2023. GDP grew at a seasonally adjusted quarterly rate of 0.3%, after having stagnated in the previous quarter.[2] Economic activity, however, continued showing signs of weakness in light of a sluggish domestic demand. Moreover, the region's manufacturing activity continued losing dynamism due to the moderation of global demand and the tightening of financial conditions. The services sector showed resilience, although it has lost some dynamism. The unemployment rate remained unchanged in June at 6.4%.

The main emerging economies are expected to have registered heterogeneous GDP growth during the second quarter of 2023. Emerging Asia grew at a slower pace in most of its economies. In the case of China, the pace of growth of economic activity moderated in the second quarter of 2023. In Emerging Europe, most economies are expected to report a moderate expansion compared to the previous quarter. In Latin America, economic activity may have contracted in several countries.

International commodity prices registered a mixed performance since Mexico's previous monetary policy decision. Oil prices trended upwards starting in July, as a result of the announcements of the extension of oil production cuts in Saudi Arabia and some other members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+), as well as the reduction of commercial crude inventories in the United States, among other factors. In Europe, natural gas reference prices exhibited volatility throughout the period, although in early August they were below the level registered at the time of Mexico's previous monetary policy decision. In the United States, they increased in response to warmer-than-anticipated weather conditions, a decrease in wind energy production in June, and a reduction in inventories. Grain prices were highly volatile during the period. Although the non-ratification of the agreement known as the Black Sea Grain Initiative drove prices significantly higher, they were subject to downward pressures subsequently due to improved rainfall forecasts as well as larger-than-expected harvests of corn in the United States and of wheat in Argentina. As a result, at the beginning of August, said prices were below the levels registered at the beginning of the period since the last monetary policy decision. Finally, industrial metal prices trended upwards during most of the period. This was mainly associated with a decline in metal production in Europe. However, at the beginning of August, prices were subject to downward pressures, in a context of concerns regarding demand from China and the accumulation of inventories in that country.

A.1.2. Monetary policy and international financial markets

Headline inflation continued decreasing in most major economies, although it remains at elevated levels and above central banks' targets in most cases. Lower energy price pressures contributed to the reduction, with this item’s inflation even reaching negative levels in several economies as a result, in part, of a base effect. The fall in inflation also reflected, to a lesser extent, lower food inflation. Core inflation continued showing a resistance to decline. The normalization of global supply chains has contributed to the decline in core inflation.

In most of the major advanced economies, headline inflation declined (Chart 3). Core inflation also

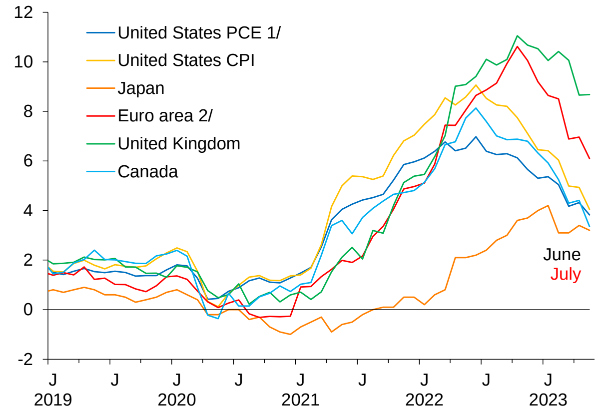
[2] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 1.1% in the second quarter and 0.1% in the first quarter of 2023.

declined, although in several cases to a lesser extent than headline inflation. The most recent headline and core inflation readings in several major advanced economies were below the levels expected by analysts. In the United States, headline inflation measured by the personal consumption expenditure deflator fell from an annual rate of 3.8% in May to 3.0% in June, remaining at levels above the 2% inflation target. This reflected a decline in food and core inflation. The fall in the annual variation of the latter was smaller, from 4.6 to 4.1% during the same period, as a result of a decline in inflation of both goods and services. Headline inflation measured by the consumer price index fell in annual terms from 4.0% in May to 3.0% in June. During the same period, annual core inflation also fell, from 5.3 to 4.8%.

Analysts' short-term inflation forecasts have remained relatively stable for most major advanced economies, although increases have been observed in some cases. However, they continue forecasting a moderation of headline inflation in 2023 from the levels registered in 2022, although inflation would remain at levels above their central banks' targets. Longer-term inflation expectations for these economies derived from financial instruments remained relatively stable with respect to the levels registered at the end of June.

In most of the major emerging economies, annual headline inflation also declined. It remains above their central banks' targets in most cases. In cases such as Brazil, South Africa, India, Thailand, Indonesia and China, inflation is within the variability range considered by each central bank or below their point targets. In the case of China, annual headline inflation remained at low levels, decreasing from 0.2% in May to 0.0% in June, and to -0.3% in July. Core inflation decreased gradually in most of the major emerging economies.

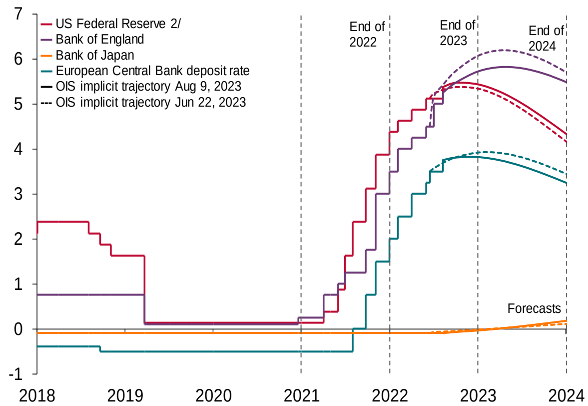
Chart 3
Selected Advanced Economies: Headline Inflation
Annual percentage change



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

In this environment, since Mexico's previous monetary policy decision, the central banks of the main advanced and emerging economies have made adjustments to their monetary policy reference rates in a heterogeneous manner, depending on the evolution of inflation and other economic indicators that, in turn, have shown differences among countries. Central banks of the major advanced economies increased their reference rates, underlining that future rate adjustments would be dependent on incoming data. In particular, in July, the US Federal Reserve increased its interest rate again, after leaving it unchanged in June. The central banks of Norway and the United Kingdom accelerated the pace of hikes in their June decision. However, in its most recent decision, the Bank of England returned to its previous pace of hikes. The central banks of Sweden and Switzerland decreased their pace of adjustments, while the Bank of Canada and the European Central Bank maintained them. The central banks of Australia and New Zealand left their interest rates unchanged in their most recent decisions, after having raised them on previous occasions. The central banks of Korea and Japan continued leaving them unchanged. However, the Bank of Japan announced modifications in the conduct of its yield curve control in the long-term segment. The latter, in order to improve the sustainability of its monetary easing, helping to improve functionality and reduce volatility in financial markets.[3] As for their asset purchase programs, most central banks in this group of economies continued to gradually reduce their securities' holdings. Regarding expectations on reference rates for most major advanced economies, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) are expected to remain at elevated levels for the rest of 2023 for most of these economies (Chart 4).

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



1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the US, the average interest rate of the target range of the federal funds rate (5.25%- 5.50%) is used.
Source: Banco de México with data from Bloomberg.

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

i) After having left the target range for the federal funds rate unchanged in its June decision, the US Federal Reserve increased it by 25 basis points (bps) at its July meeting, at 5.25-5.50%. It also continued reducing the size of its balance sheet. It reiterated that it will continue evaluating new information and that, in determining the degree of additional tightening that may be appropriate, it will consider the cumulative tightening of monetary policy, the lags with which it affects economic activity, inflation, and economic and financial developments. It highlighted that tighter credit conditions are likely to affect economic activity, employment and inflation, although it added that the extent of these effects remains uncertain. During a press conference, the chairman of that institution indicated that the Committee estimates that monetary policy is at a restrictive level and expects it to remain that way for some time until there is confidence that inflation is declining in a sustained manner. In this regard, he mentioned that at its next meeting they could announce either a pause or an increase in the reference rate. He also stated that no interest rate cuts are expected this year and that a data-dependent stance will be maintained. Based on the latest available information, expectations drawn from financial instruments anticipate that the highest interest rate level will be observed during the third quarter of 2023, when it will reach around 5.5%, and then subsequently decrease to levels of 5.3% by the end of the first quarter of 2024 and to 4.3% by the end of that same year.

ii) The European Central Bank (ECB) maintained the pace of its reference rate hikes by announcing an increase of 25 bps in July. Its refinancing, key lending and key deposit rates stood at 4.25, 4.50 and 3.75%, respectively. It also stated that subsequent decisions by the Governing Council will ensure that the ECB's monetary policy rates are set at sufficiently restrictive levels for as long as necessary to achieve a timely return of inflation to its medium-term objective of 2%. The Council also decided to set the remuneration of minimum reserves at 0% as of September 20, which they hope will improve the efficiency of their monetary policy by reducing the total amount of interest to be paid on reserves. During a press conference, the president of that institution indicated that the economic data will determine whether at its next meeting in September an increase in reference rates or a pause in their adjustments will take place. Regarding its securities' holdings, the ECB suspended reinvestments under the Asset Purchase Program (APP) as of July 2023.

Since Mexico's last monetary policy decision, in the main emerging economies most central banks left their interest rates unchanged. Several of them suggested that future adjustments will depend on the evolution of economic indicators. The central banks of Brazil and Chile announced interest rate cuts. Meanwhile, those of Russia and Turkey raised their

[3] The Bank of Japan stated that it will continue to allow 10-year Japanese government bond (JGB) yields to fluctuate in a range of around +/-0.5 percentage points from the target level, while conducting yield curve control with greater flexibility, considering the upper and lower limits of the range as references, rather than rigid limits, in its market operations. The Bank raised the interest rate at which it will offer to purchase 10-year JGBs every business day through fixed-rate purchase transactions from 0.5 to 1.0%, unless no bids are likely to be submitted.

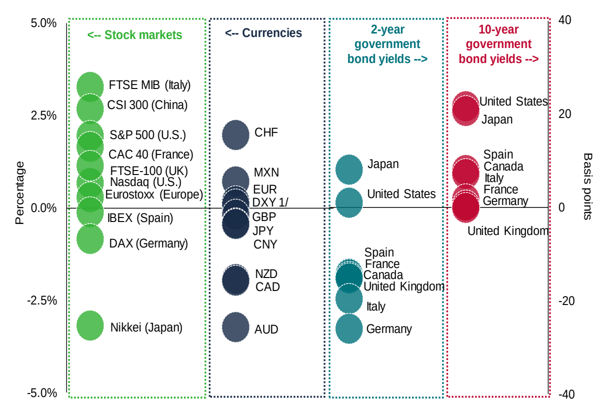
interest rates again after having left them unchanged in previous decisions.

International financial markets showed, in general, greater stability during most of the period. However, starting in August, an increase in volatility was observed due to, among other factors, concerns regarding the fiscal position in the United States. The latter was associated with the US government's announcement to increase sovereign debt issuance and with a downgrade of its debt rating by one of the main rating agencies. In this environment, since Mexico's last monetary policy decision, global financial conditions registered moderate changes (Chart 5). Stock markets registered mixed results across countries. In foreign exchange markets, the US dollar strengthened slightly against major advanced economies' currencies in the first weeks of the reporting period, although it reversed this trend in the first half of July. More recently, it has strengthened again, appreciating in early August from its level at the beginning of the reference period. The currencies of emerging economies performed positively against the dollar during most of the period, which recently reversed marginally in light of the increased risk aversion associated with the aforementioned factors. The greater risk aversion also contributed to the increase in government bond interest rates in most of the major advanced economies (Chart 6). Similarly, in most emerging economies, an increase in long-term interest rates was observed (Chart 7). Since Mexico's previous monetary policy decision, cumulative net capital inflows to emerging economies have been registered. However, flows exhibited a differentiated behavior among asset classes, with cumulative net inflows to equity assets and moderate outflows from fixed-income assets during most of the period.

Chart 5
Financial Conditions Indices1/
Units

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

Chart 6
Change in Selected Financial Indicators from June 22 to August 9, 2023
Percent; basis point



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

Chart 7
Selected Emerging Economies: Financial Assets Performance as of June 16, 2023
Percent, basis points

Region	Country	Currencies	Equity markets	Interest rates 2Y	Interest rates 10Y	CDS
Latin America	Mexico	0.19%	-1.55%	-5	24	-1
	Brazil	-1.30%	0.63%	-86	-38	-10
	Chile	-7.22%	9.63%	-135	33	-11
	Colombia	2.32%	-0.31%	-23	-29	-31
	Peru	-1.60%	4.73%	3	-19	-7
Emerging Europe	Russia	-14.76%	10.41%	-29	-42	N.A.
	Poland	1.47%	5.34%	-51	-50	-5
	Turkey	-14.24%	35.16%	200	211	-85
	Czech Rep.	-1.24%	3.19%	-1	-20	-2
	Hungary	-3.49%	7.84%	-18	38	-8
Asia	China	-0.83%	0.45%	-6	-2	-3
	Malaysia	1.19%	4.08%	3	14	-10
	India	-0.99%	3.69%	11	15	-2
	Philippines	-0.30%	-0.88%	38	47	-9
	Thailand	-0.50%	-1.86%	12	2	-6
	Indonesia	-1.67%	2.30%	26	5	-5
Africa	South Africa	-2.07%	-2.00%	-48	-23	-18

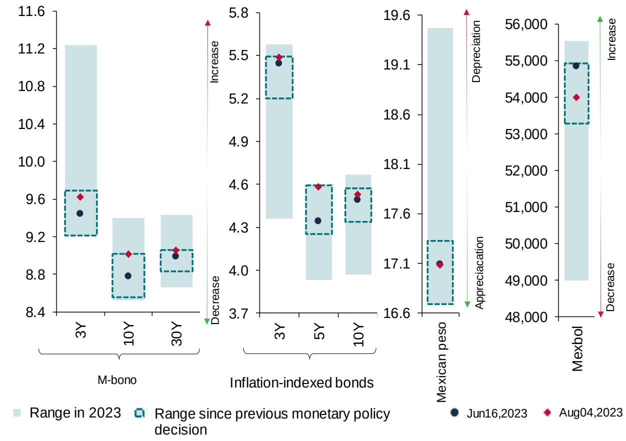
Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year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

A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described above, the Mexican peso maintained an appreciation trend against the US dollar observed since Mexico's last monetary policy decision, despite the temporary interruption registered at the beginning of August due to the downgrading of the US credit rating and the announcement of debt issuance by the US government. Long-term interest rates were adjusted slightly upwards (Chart 8). This was accompanied by a moderate increase in volatility, mainly in the foreign exchange market.

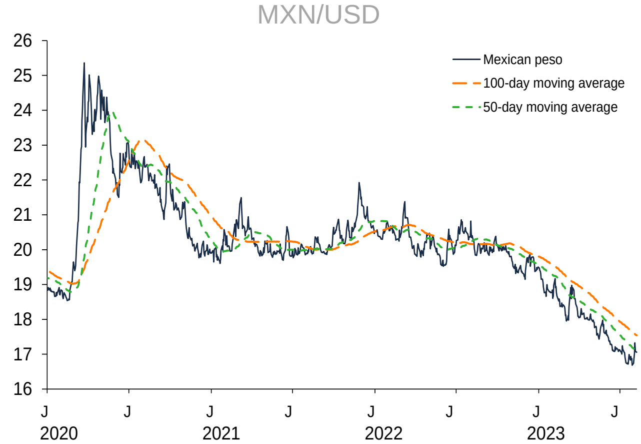
Chart 8
Mexican Markets' Performance
Percent, MXN/USD and index



Source: Prepared by Banco de México.

The Mexican currency traded in a range of 0.80 pesos, between 16.62 and 17.42 pesos per US dollar since the previous monetary policy decision. During the period, it appreciated marginally by 0.20%, and reached its lowest level since December 2015 (Chart 9).

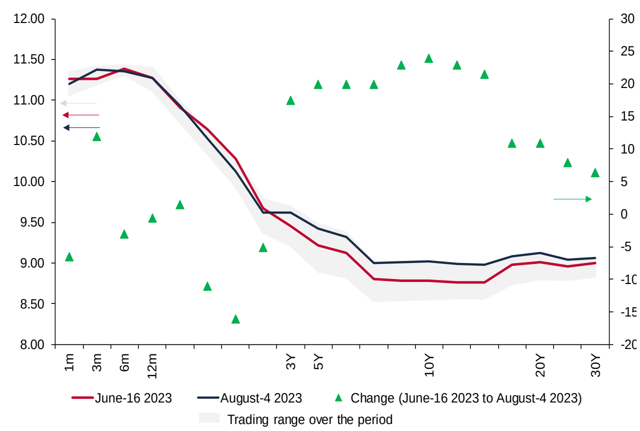
Chart 9
Mexican Peso Exchange Rate
MXN/USD



Source: Prepared by Banco de México.

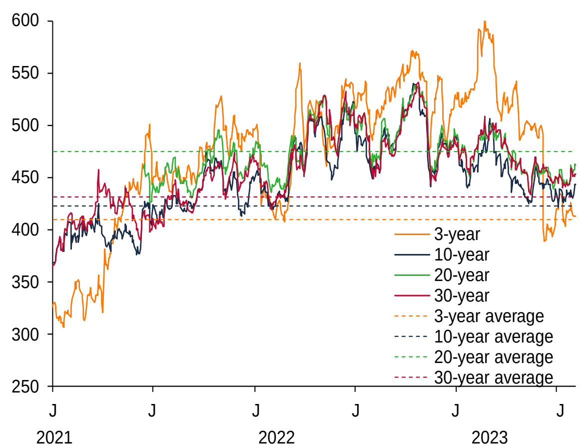
Interest rates on government securities registered mixed results, with some increases in medium- and longer-term nodes and limited decreases in short-term ones (Chart 10). The yield curve of real rate instruments exhibited generalized increases of up to 22 bps. In this context, breakeven inflation implicit in spreads between nominal and real interest rates of market instruments increased moderately for most terms (Chart 11). These movements took place in an environment in which trading conditions remained relatively stable, compared to other periods of uncertainty.

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



Source: PIP.

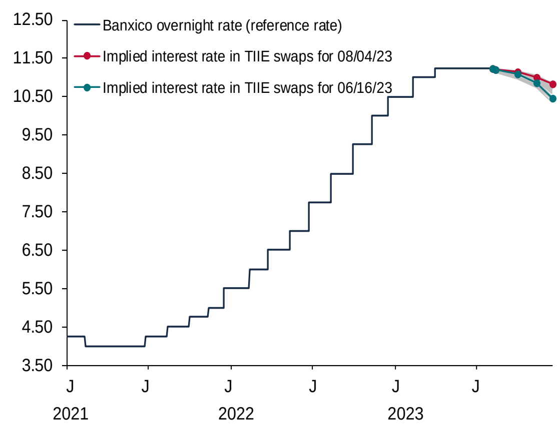
Chart 11
Breakeven Inflation and Inflation Risk Implied in Government Securities' Yields
Basis points



Source: PIP.

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swaps curve does not incorporate any adjustment for the August decision, anticipating a 25-bp cut between November and December 2023 (Chart 12). Most analysts surveyed by Citibanamex anticipate that the reference rate will remain unchanged in the August decision. The median of these analysts expects a reference rate of 11.00% for the end of 2023.

Chart 12
Interbank Funding Rate Implied in TIIE Swaps
Percent



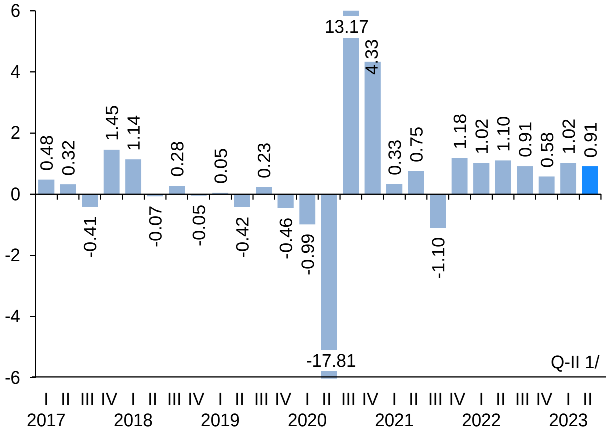
Note: Shaded areas represent the range since the last monetary policy decision.
Source: Prepared by Banco de México with Bloomberg data.

A.2.2. Economic activity in Mexico

According to Mexico's GDP flash estimate published by INEGI, during the second quarter of the year the country's economic activity increased its rate of expansion at a pace similar to that of the previous quarter (Chart 13). Thus, it has displayed resilience and growth at a greater-than-expected pace.

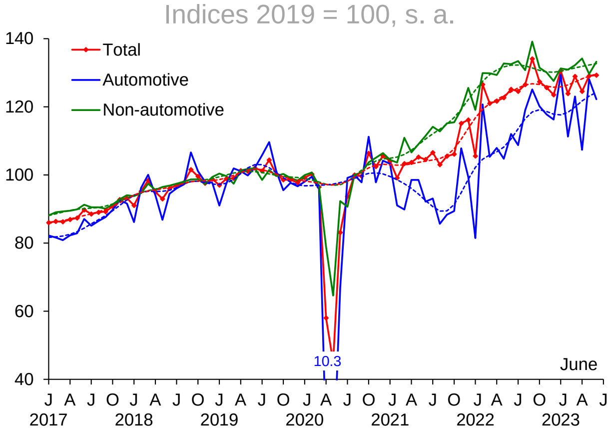
During April-May 2023, private consumption decelerated due to a contraction in the consumption of domestic goods and to a lower dynamism in the consumption of services. Consumption of imported goods continued trending markedly upwards. Gross fixed investment increased significantly. This can be attributed to the outstanding performance of both non-residential construction and investment in imported machinery and equipment. As for external demand, between April and June, the value of manufacturing exports contracted slightly with respect to the first quarter, reflecting a fall in automotive exports and certain sluggishness in the rest of manufacturing exports (Chart 14).

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



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

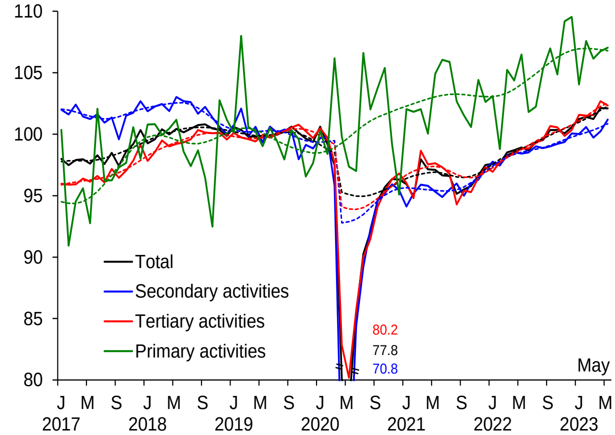
Chart 14
Manufacturing Exports
Indices 2019 = 100, s. a.



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

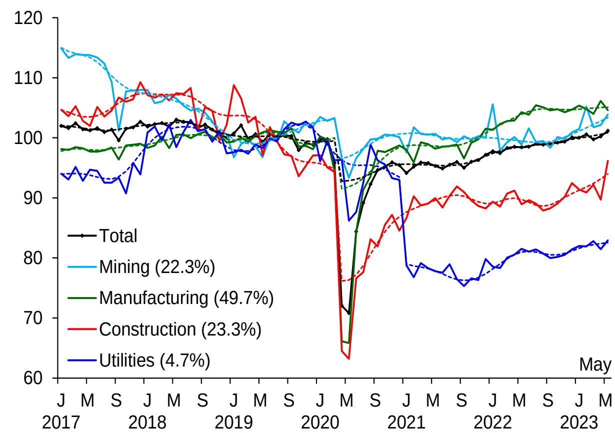
On the production side, during the bimester April-May 2023, services continued to expand (Chart 15) as a result of growth in most of its sectors. Industrial activity increased, mainly due to a significant rebound in construction in April (Chart 16). Manufacturing exhibited weakness. Regarding its components, manufacturing excluding transportation equipment continued trending downwards. In contrast, manufacturing of transportation equipment continued showing dynamism.

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



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

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

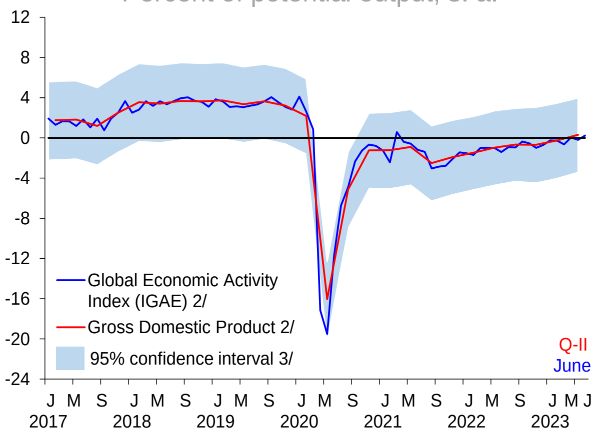


s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2013.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the cyclical position of the economy, as a result of the growth of economic activity during the second quarter of 2023, the point estimate for the negative output gap was close to zero during said period (Chart 17). The labor market remained strong. At the end of the second quarter, the national and urban unemployment rates decreased at the margin, reaching new historical lows (Chart 18). Seasonally adjusted figures show that the creation of IMSS-insured jobs continued trending upwards in July, although with some deceleration. Finally, in May 2023, unit labor costs in the manufacturing sector increased at the margin, remaining above the average level of 2022 (Chart 19).

Chart 17
Output Gap Estimates [1/]

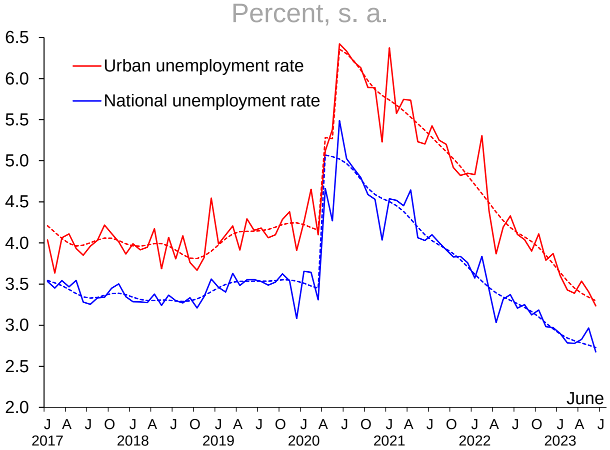
Percent of potential output, s. a.



s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.74
2/ GDP flash estimate up to Q2-2023 and IGAE implicit up to June 2023, consistent with said timely figure.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and Urban Unemployment Rates

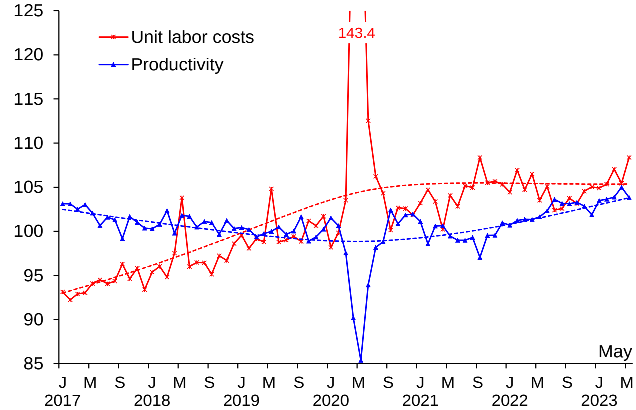
Percent, s. a.



s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from ENOE, ETOE (from April to June 2020), and ENOE new edition (ENOE[N]) from July to date.

Chart 19
Productivity and Unit Labor Costs in the Manufacturing Sector [1/]

Indices 2019 = 100, s. a.

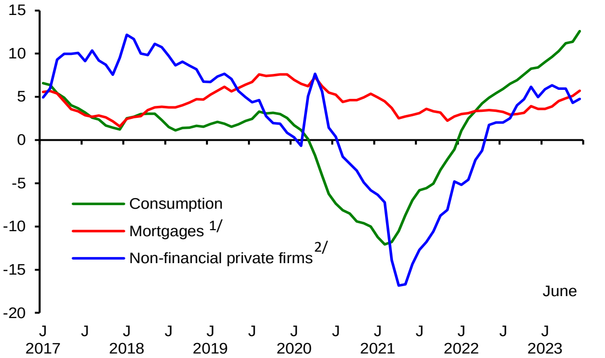


s. a. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line. The range of the chart was narrowed to make it easier to read.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly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

In June 2023, domestic financing to non-financial private firms continued to expand, registering a positive real annual variation for four consecutive quarters. Debt issuance in the domestic market increased during the quarter, thus continuing the recovery observed since the second half of 2022. The bank lending component continued increasing, although its annual growth rate has stabilized in recent months (Chart 20). This occurred in a context in which the demand of firms for loans continued increasing, particularly among larger firms. In contrast, lending standards did not change significantly during the quarter and thus remained relatively tight.

As for lending to households, in June 2023 commercial bank housing portfolio continued increasing its rate of expansion. Performing loans to consumption grew at a faster rate and continued to be the segment with the highest dynamism. In this regard, the survey conducted on banks showed a sustained increase in the demand for consumer credit, especially in the credit card segment.

Chart 20
Performing Credit from Commercial Banks to the Non-financial Private Sector
Annual percentage change



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

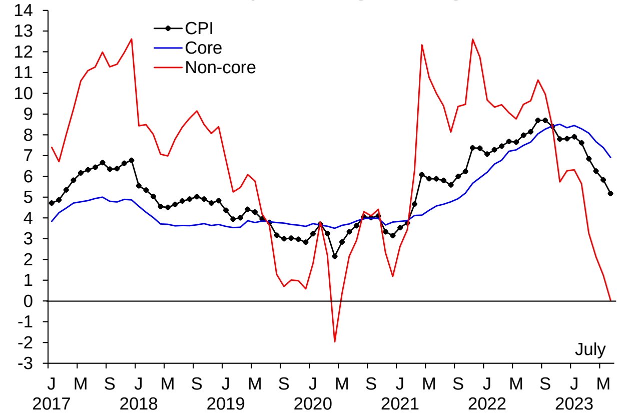
In June 2023, bank lending interest rates remained relatively stable and thus remained at high levels. Corporate credit intermediation margins remained, overall, below those observed prior to the pandemic. However, in June they increased for smaller firms. Interest rates on mortgages remained relatively low. As for consumer credit, credit card interest rates have been increasing. Finally, interest rates for payroll loans have remained relatively stable since August 2021.

As for portfolio quality, in June 2023 corporate and mortgage delinquency rates remained stable with respect to those observed in the previous month and thus continued at low levels. Finally, consumer portfolio delinquency rates increased, although they remain below pre-pandemic levels.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation decreased from 5.06 to 4.79% between June and July 2023. This performance was due to the reduction in both core and non-core inflation (Chart 21 and Table 1).

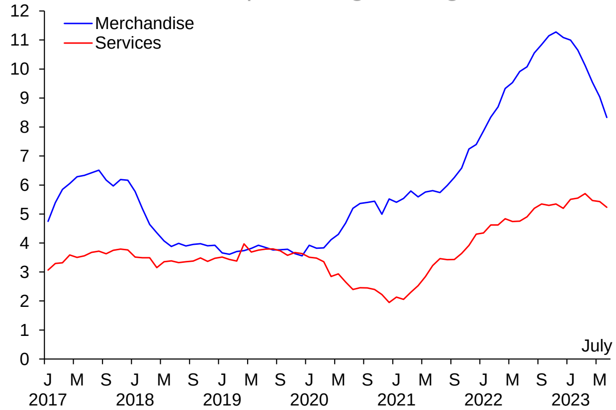
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

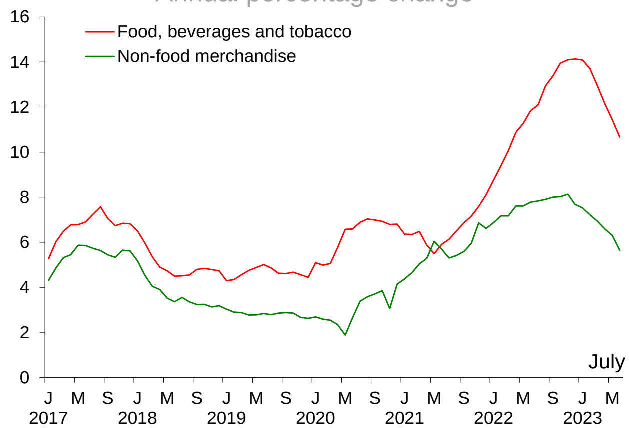
Between June and July 2023, annual core inflation declined from 6.89 to 6.64%. As for its components, annual merchandise inflation continued decreasing, from 8.26 to 7.82% during the same months (Chart 22). Food merchandise inflation remained at high levels, although it decreased from 10.49 to 9.79% during the referred period, while that of non-food merchandises declined slightly from 5.70 to 5.54% between the referred months (Chart 23). Annual services inflation decreased marginally from 5.25 to 5.24% between June and July. The annual variation of prices of services other than education and housing declined from 6.66 to 6.61% during the same period, a behavior mainly associated with a reduction in the annual variation of food preparation prices. The annual inflation of education services increased from 4.85 to 4.92%, while that of housing remained at 3.66%.

Chart 22
Merchandise and Services Core Price Subindex
Annual percentage change



Source: INEGI.

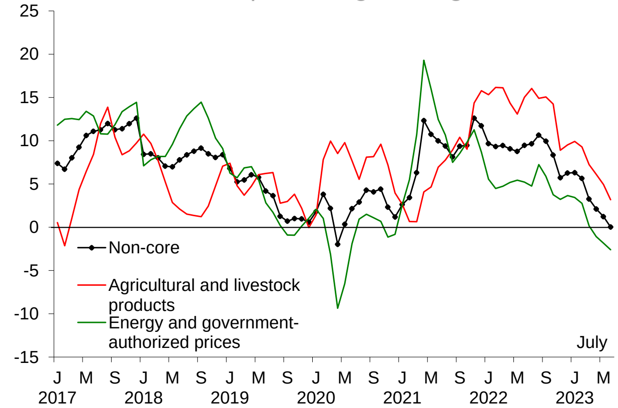
Chart 23
Merchandise Core Price Subindex
Annual percentage change



Source: INEGI.

Annual non-core inflation declined from -0.36 to -0.67% between June and July 2023 (Chart 24 and Table 1). This result was influenced by the decrease from -6.95 to -7.82% in the annual inflation of energy, which is associated in turn with the reduction from -32.05 to -34.87% in the annual variation of LP gas prices. The annual inflation of agricultural and livestock products increased from 2.89 to 3.16% during the same period.

Chart 24
Non-core Price Sub-index
Annual percentage change



Source: INEGI.

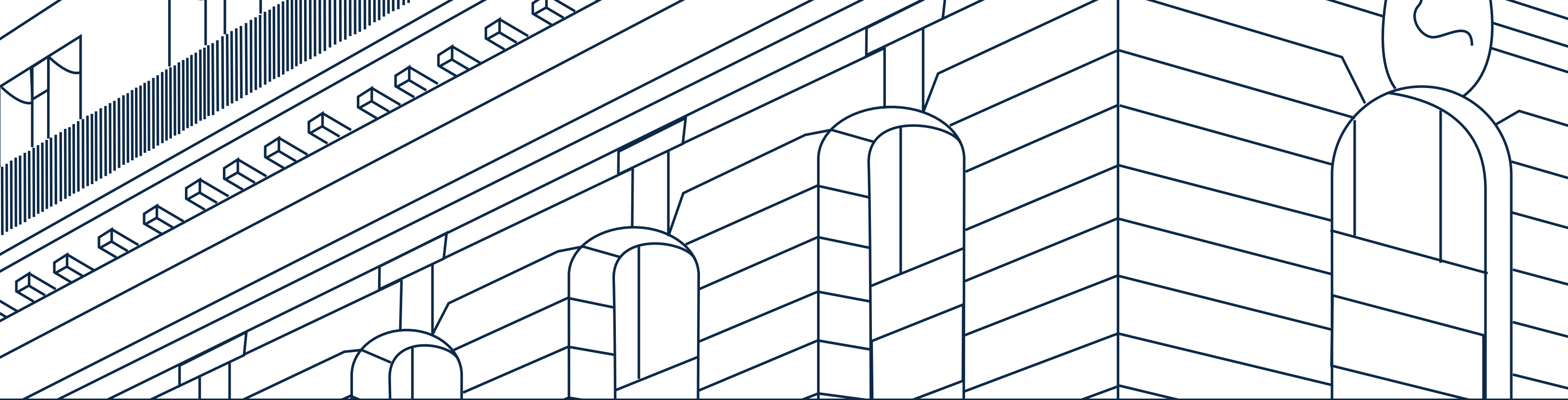
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between May and July 2023 the median for headline inflation at the end of 2023 decreased from 5.02 to 4.60%, while that for the core component shifted from 5.40 to 5.20%. The median for headline inflation expectations for the end of 2024 declined from 4.07 to 4.03%, while that for the core component from 4.17 to 4.13%. The medians of headline and core inflation expectations for the next four years remained at 3.80%. The median of headline inflation expectations for the long term (5 to 8 years) remained at 3.60%, while that for the core component adjusted from 3.56 to 3.60%. Finally, compensation for inflation and inflationary risk decreased since the previous monetary policy decision. Regarding its components, expectations implied by market instruments remained stable, while the inflation risk premium declined between May and July.

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

Table 1
Consumer Price Index and Components
Annual percentage change

Item	May 2023	June 2023	July 2023
CPI	**5.84**	**5.06**	**4.79**
Core	**7.39**	**6.89**	**6.64**
Merchandise	**9.04**	**8.26**	**7.82**
Food, beverages and tobacco	11.44	10.49	9.79
Non-food merchandise	6.30	5.70	5.54
Services	**5.43**	**5.25**	**5.24**
Housing	3.67	3.66	3.66
Education (tuitions)	4.88	4.85	4.92
Other services	7.01	6.66	6.61
Non-core	**1.24**	**-0.36**	**-0.67**
Agricultural and livestock products	**4.95**	**2.89**	**3.16**
Fruits and vegetables	3.73	3.98	7.14
Livestock products	5.91	2.05	0.00
Energy and government-authorized prices	**-1.83**	**-3.08**	**-3.90**
Energy products	-5.48	-6.95	-7.82
Government-authorized prices	6.99	6.26	5.51

Source:INEGI.



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