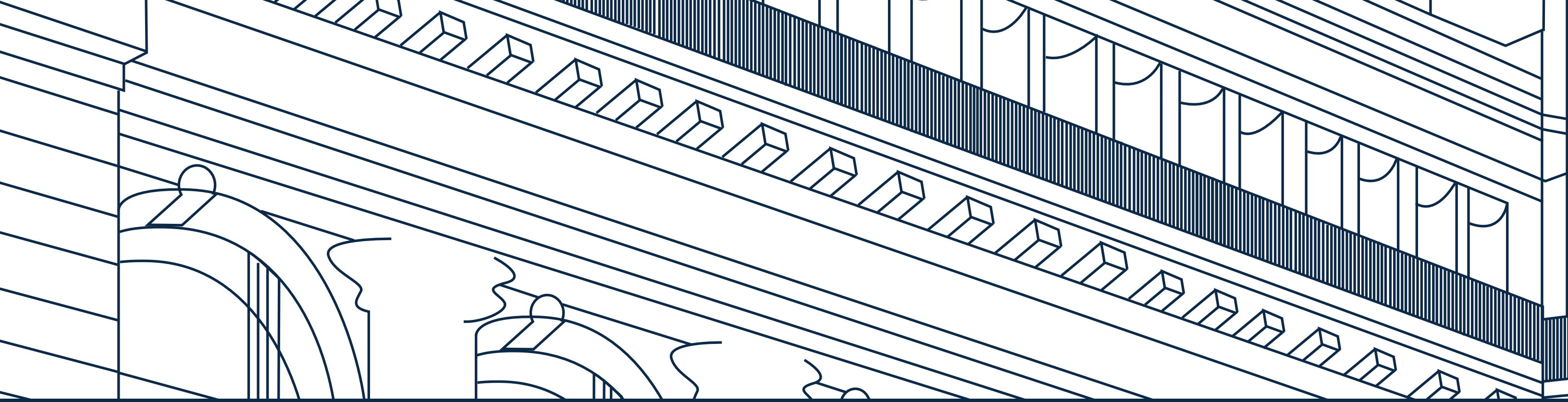

BANCO DE MÉXICO®

Minutes number 101

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on June 22, 2023

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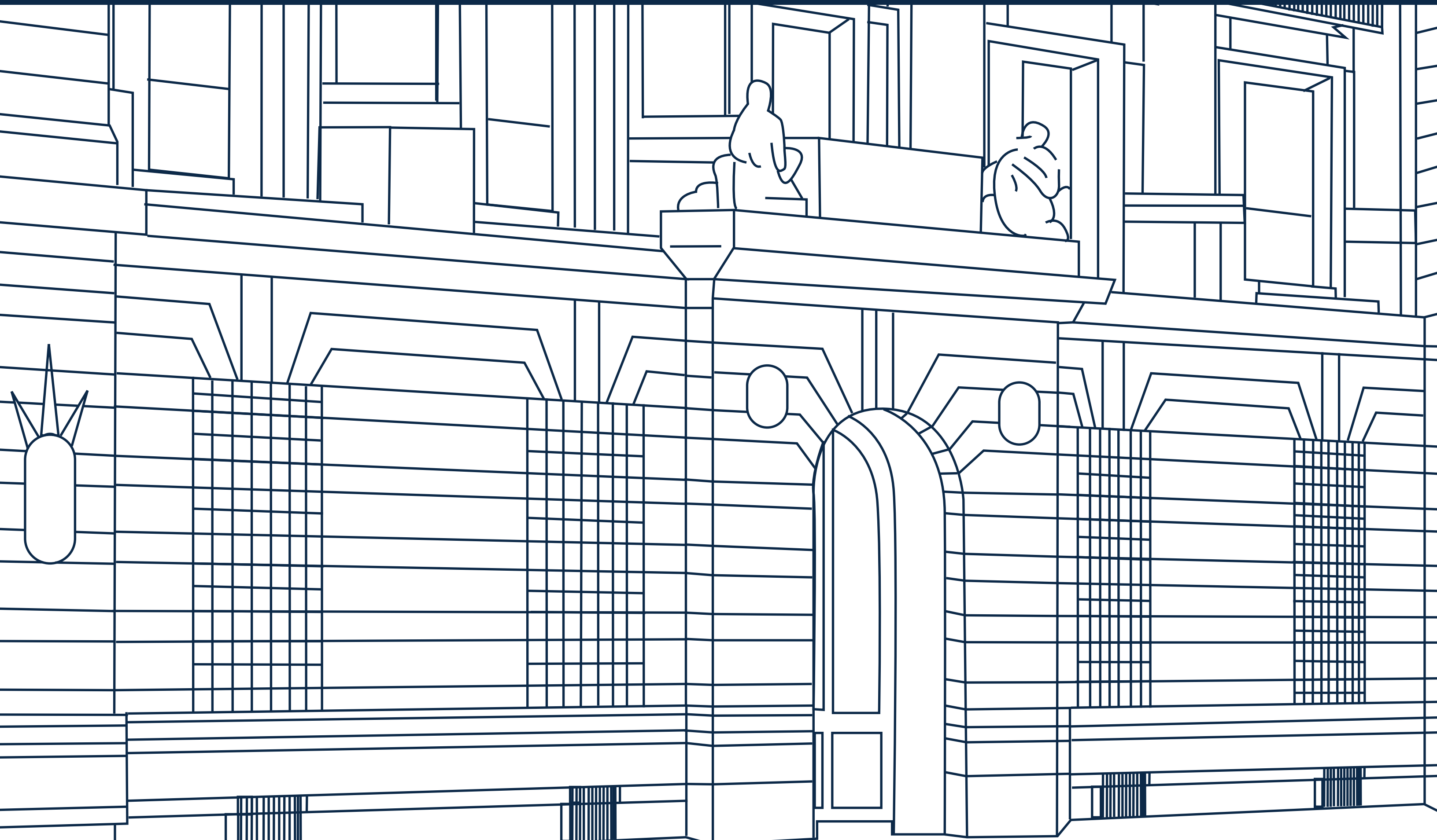

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: June 21, 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.
- Elías Villanueva, 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 global economic activity has continued to recover, albeit heterogeneously across countries. They highlighted that economic activity in the United States has continued showing resilience. They indicated that, in contrast, economic growth in China has turned out to be lower than expected. One member considered that the global economic recovery has been atypical. He/she highlighted that a rebalancing among aggregate expenditure components continues, along with a lesser global supply and demand imbalance. **Most members underlined the strength of the labor market in the United States. Some** members mentioned that this is also observed in other advanced economies. **One** member added that global economic activity and labor markets remain strong even under tight liquidity conditions and uncertainty factors.

Most members stated that world growth prospects for 2023 continue implying a deceleration, although less intense than previously anticipated. They added that a slight rebound of economic activity is expected for 2024. One member added that, in this context, a moderation of world labor markets is anticipated. **Some** members considered that a recession in some economies is likely, albeit moderate and short-lived. **One** member mentioned that the resilience of the US economy has contributed to improve growth prospects for Latin America. He/she commented that a better economic performance is also foreseen in the euro area, while lower growth is anticipated in Asia. **Another** member stated that timely indicators point to a greater expansion of services compared to manufacturing. Among the risks to global economic growth, **some** members mentioned the prevalence of an environment of geopolitical tensions and economic fragmentation. **One** member pointed out that this has encouraged the nearshoring process. In this regard, he/she mentioned that shocks associated with the pandemic and the geopolitical conflict in Ukraine, in addition to their short-term effects, could also have implications for the long term. **Another** member underlined the risk associated with tighter financial conditions.

All members pointed out that headline inflation continued decreasing in most economies. Most members attributed such decline to lower pressures on energy and food prices. Nevertheless, all members forewarned that headline inflation remains at high levels. One member added that it is still above central banks' targets. **Most members highlighted that the core component has shown a resistance to decline. One** member pointed out that, at the global level, the core component remains at levels nearly twice the central banks' targets. **Another** member estimated that it will decline very gradually. He/she pointed out that services inflation remains affected in several economies, highlighting the upward trend in the shelter component in the United States. **One** member underlined that, in some economies, core inflation even continues trending upwards. **Another** member mentioned that, during disinflationary processes, the reduction in inflation is not necessarily linear, but rather, fluctuations may occur, making it difficult to identify its trend. He/she used as an example the cases of Canada, Japan and the United States, which registered a moderate rebound in headline inflation in April, as compared to the previous month. He/she considered that longer-lasting or more intense effects of price-related shocks cannot be ruled out, which could delay the convergence of inflation to its target.

Most members highlighted that, after having left their reference rates unchanged, some advanced economy monetary authorities increased them again. One member stated that, while the global monetary tightening cycle has been somewhat similar across economies, looking ahead, a greater heterogeneity in its pace of moderation is expected. He/she pointed out that this is due to the unequal evolution of core inflation, as well as to the differences in the timing of the respective monetary policy cycles, with advanced economies having started their hiking cycles after several emerging economies. **Some** members indicated that, overall, central banks continue stating that interest rates should remain at high levels for an extended period. **Most members mentioned that, in light of the complex inflationary environment, there was an increase in the expected trajectory for reference rates of advanced economy central banks. They also noted a lower probability of interest rate cuts this year.**

Most members mentioned that, in its last meeting, the US Federal Reserve left the target range for the federal funds rate unchanged. One member stated that the chairman of that institution ruled out interest rate cuts in 2023 and mentioned instead that these cuts would only be evaluated once inflation has decreased considerably. **Most members underlined that the median of the Federal Reserve members' projections suggests that they could raise the funds rate by 50 basis points in the second half of 2023. One** member mentioned that the Federal Reserve now expects the US economy to show more resilience while it anticipates higher levels of core inflation by the end of the year.

Most members highlighted the positive performance of international financial markets. They attributed said results to greater risk appetite following the suspension of the debt ceiling in the United States as well as to the perception of lower risks in its banking sector. Some members indicated that expectations that the main central banks are nearing the end of their hiking cycle also contributed to the above. **One** member added that the probability of a systemic risk event materializing has decreased. **Most members mentioned that the lesser risk aversion was reflected in gains in the main stock market indices. One** member noted that this was more apparent in the technology sector shares. He/she underlined that interest rates increased in the main economies. **Another** member pointed out that the increase in short-term interest rates was due to the reassertion of the restrictive tone by the main central banks. **One** member noted that foreign exchange markets showed a heterogeneous behavior by region, with Latin American currencies appreciating the most. **Another** member stated that emerging economies registered inflows into equity assets and outflows from fixed-income assets. He/she added that, although risk appetite increased, the outlook for financial markets remains negative, given the environment of uncertainty and the expectation of an economic deceleration.

Economic activity in Mexico

Most members pointed out that domestic economic activity has shown resilience in a complex external environment. One member mentioned that in the first quarter of 2023 GDP surprised to the upside. **Another** member stated that available information suggests that economic activity would have expanded in April, supported by the manufacturing sector and by a certain reactivation of tertiary activities. **Most members noted that some recent indicators point to a deceleration in the second quarter. One** member added that the balance of risks to growth is more equilibrated given that some upward risks, such as the resilience of the US economy, have gained more relevance.

Some members noted that industrial production rebounded in April 2023, after having contracted during the previous month. **One** member warned that, from a medium-term perspective, it remains sluggish and does not show a change in trend since the second half of 2022. **Another** member mentioned that manufacturing recovered slightly in April and that the component of transportation equipment has already reached its pre-pandemic levels, but that other segments of industrial production decreased at the margin. **Some** members highlighted that there are signs of a loss of dynamism in manufacturing production. **One** member added that mining shows signs of deceleration. As to the services sector, **some** members underlined its growth during the first quarter of the year. However, **one** member highlighted that only 30% of its subsectors followed clearly positive dynamics during said period. **Another** member noted the dynamism shown by the segment of accommodation and food preparation services, which is about to reach its pre-pandemic level. He/she indicated that the services segments that have recovered more rapidly since the pandemic are those mostly associated with the industrial sector.

Some members underlined that domestic demand has continued increasing, although **one** member considered that it has done so at a slight pace. **Most members indicated that, by the end of the first quarter of 2023, private consumption continued expanding, mainly supported by the consumption of imported goods. One** member mentioned that the consumption of services shows sluggishness. **Another** member indicated that, in monthly terms, it grew marginally in March, although he/she emphasized that, in annual terms, it registered high growth. He/she underlined that the timely indicator of private consumption shows that it continued growing during the April-May bimester, albeit with some moderation at the margin. **One** member pointed out that leading indicators, such as indices based on Internet searches, suggest that there will be a moderation in the growth of consumption of services. **As for investment, most members underlined that it continued increasing in March, mainly driven by spending on machinery and equipment. However, they highlighted that construction remains weak. One** member attributed the latter to the decreasing trend in residential investment. **Another** member underlined that, given the opportunities provided by nearshoring, it is necessary to implement public and fiscal policies that foster a favorable environment for private investment and that public investment focuses on the provision of the infrastructure necessary to attract investment.

Regarding the external sector, most members noted that the value of manufacturing exports decreased in April, due to a fall in the automotive sector. One member explained that the above reflected a fall in the volume exported, rather than in prices. **Some** members highlighted that non-automotive exports to the United States continued increasing and remained at high levels. **One** member forewarned that, looking ahead, a moderation in external demand continues to be expected.

All members pointed out that the labor market remains strong. They highlighted that the unemployment rate is at minimum historical levels. Some members mentioned that the labor participation rate continued increasing. **One** member underlined that the number of IMSS-insured workers continued expanding. **Another** member added that the number of available job vacancies increased. He/she mentioned that this tends to be associated with positive economic activity shocks, rather than with a sectoral reallocation. **In this context, most members considered that the labor market shows signs of tightness. Some** members noted that the unemployment gap is negative, that is, that the open unemployment rate is lower than the Non-accelerating Inflation Rate of Unemployment (NAIRU). **One** member added that such gap appears to be negative, even with a metric that includes the inactive but available-for-work population. **Another** member indicated that employment is growing at a rate higher than labor participation, which in the past has coincided with a positive output gap. **Most members underlined the relatively large magnitude of wage revisions. One** member reiterated that in May the annual variations of contractual wages and of wages of IMSS-insured workers remained at high levels. **Another** member pointed out that the annualized quarterly growth rate of average wages drawn from the National Survey of Occupation and Employment (ENOE, for its acronym in Spanish) accelerated during the first quarter of the year. Finally, **one** member added that the wage bill is increasing at a rate unseen in a long time, and that some business sector participants perceive labor shortages to some extent.

Most members stated that the estimate of the output gap keeps narrowing. Some members pointed out that it is not statistically different from zero. **One** member expressed that he/she expects it to remain close to zero during 2023 and 2024. **Another** member cautioned that GDP has grown at a slower rate than employment, which raises questions regarding the impact of the shocks that have affected the economy on the country's factor productivity.

Inflation in Mexico

All members highlighted that, since the last monetary policy meeting, annual headline inflation continued decreasing, although it remains at high levels. They mentioned that, in the first fortnight of June, it registered 5.18%. One member underlined that headline inflation has decreased for more than four consecutive months. **Another** member mentioned that it continues on its convergence path. **One** member highlighted that different measures of central tendency show widespread decreases. He/she added that there is a high probability that the current price dynamics do not correspond to those of a high inflation regime.

All members underlined that the decrease in headline inflation has fundamentally responded to the evolution of the non-core component and, to a lesser degree, to the decline in core inflation. One member noted that of the 3.52 percentage points by which headline inflation decreased between August 2022 and the first fortnight of June, around 75% is attributable to the fall in the non-core component, which declined by 10.6 percentage points during that period. He/she added that the core component so far has decreased by slightly over 1.5 percentage points since its peak in November 2022. **Another** member noted that the disinflationary process will comprise two stages. The first one, in which inflation decreases but still remains at elevated levels, and the second one, in which it consolidates at levels consistent with its target. He/she pointed out that in the first stage the speed of reduction of the CPI components will be heterogeneous, and therefore some of them will likely have relatively high readings.

All members indicated that diverse inflation pressures have been easing. One member added that this has been more noticeable during the second quarter of 2023. **Another** member pointed out that most supply chains are already operating under normal conditions, that international food and commodity prices are clearly decreasing, and that inflation in the United States is declining, while producer prices in Mexico are exhibiting negative inflation rates. **Most members considered that the monetary tightening attained has contributed to the inflation's behavior. One** member added that base effects are also contributing to the above. He/she mentioned that some estimates that decompose inflation in different time frequencies show that its decline is mainly explained by short-term factors, while medium- and long-term trends remain affected. **Some** members noted that inflation is still influenced by the shocks it has been subject to.

All members stated that core inflation continued decreasing, although more gradually than headline inflation. They mentioned that, in the first fortnight of June, it registered 6.91%. One member argued that its decrease has been more noticeable in recent months, given that of the nearly 158 basis points it has fallen since its peak in November 2022, approximately 118 have been registered since April 2023. **Another** member agreed that core inflation is already trending downwards, although he/she acknowledged that there is still a long road ahead. **One** member pointed out that it remains at high levels and continues facing significant pressures.

Most members mentioned that merchandise inflation has continued decreasing. One member highlighted that it has been declining for six consecutive months, but still remains at high levels. **Another** member considered that its decline has been slow. **One** member noted that it has benefited from significant base effects. **Most members warned that food merchandise inflation continues registering double-digit annual variations. One** member highlighted that the prices of basic goods associated with food and personal care products continue registering increases of over 10%. However, **another** member mentioned that signs of mitigation of merchandise price pressures are more noticeable when seasonally adjusted and annualized monthly variations of their price index are considered. He/she noted that, based on latest readings, the three-month moving average of such variations in food merchandise prices registers 5.87%, while its annual rate registers 10.67%. He/she added that for non-food merchandise these figures are 3.48 and 5.65%, respectively. He/she pointed out that the share of weight-adjusted items from the food merchandise component with price variations larger than 10% is currently at 10.6%, after having been at 80% in 2022. He/she added that, in the case of non-food merchandise, this share is currently 7.7%, while last year it was above 40%.

Some members noted that annual services inflation remains high. **One** member underlined that most variations in services prices have not yet registered an inflection point. **Some** members noted, however, that, at the margin, this component showed signs of moderation. **One** member mentioned that it decreased slightly during the first fortnight of June, due to a marginal reduction in the inflation of services other than housing and education. He/she added that inflation of housing and education services remained relatively stable, although at levels above 3%. **Another** member noted that the dynamics of services prices improved when considering their seasonally adjusted and annualized monthly variation, which shows a three-month moving average of 3.84% compared to the annual rate of 5.23%. He/she emphasized that the share of CPI items in the services basket, which currently shows double-digit price variations, is 1.1%, while at the beginning of the year it reached levels of around 20%.

Some members noted that the high level of services inflation occurs in a context of a strong labor market, in which the demand for services has recovered. **One** member acknowledged that there is a certain effect of labor market dynamics, but he/she stated that their magnitude does not seem to be such as to explain the levels reached by services inflation. He/she considered that, in any case, this would be one of the factors that have contributed to the persistence of core inflation. He/she added that, while domestic pressures are typically associated with increases in services inflation, the behavior of the latter currently reflects other factors, such as global shocks to certain components or delayed price increases due to weak demand at the time. Therefore, he/she estimated that its evolution not necessarily responds to domestic pressures. He/she stated that, in his/her opinion, the dynamics of services inflation continue reflecting: i) the recovery of this sector in view of the mitigation of changes in consumption patterns, which has led to price increases that had been postponed due to weak demand, and, in this regard, he/she highlighted the increases in education prices; ii) that housing inflation continues being affected by last year's high inflation figures; and iii) that some items continue responding to increases in international references, such as food services. Regarding this last item, he/she mentioned that the sub-index of services excluding housing, education and tourism is 338 basis points above its historical average, of which 213 correspond to food services.

Most members mentioned that non-core inflation remained at historically low levels, reaching 0.03% during the first fortnight of June. They pointed out that the above was due to the lower annual variations of energy and agricultural and livestock products' prices. One member stated that monetary policy does not have a major impact on this component. **Another** member highlighted that domestic gas prices exhibit negative variations of a magnitude unseen in historical records.

Some members underlined that longer-term inflation expectations have remained stable. Nevertheless, **one** member mentioned that their dispersion is high and noted that the skewness coefficient of their distribution is still positive. **Another** member stated that medium- and long-term expectations remain high and do not exhibit a downward trend, which he/she considered a matter of concern. **Most members considered that short-term inflation expectations have improved somewhat, registering moderate adjustments. One** member pointed out that this behavior has not been generalized. **Some** members indicated that expectations for the next 12 months and those for the end of 2023 and 2024 decreased. **One** member underlined that expectations for the end of 2024 are above Banco de México's projections. **Some** members indicated that breakeven inflation increased since the last monetary policy decision and remains above target. **One** member estimated that the price dynamics of basic consumer goods could affect household inflation expectations.

Most members emphasized that inflation is still projected to converge to the 3% target in the fourth quarter of 2024. One member stated that these previsions consider Banco de México's monetary policy actions and that the effects of the inflationary shocks associated with the pandemic and with the military conflict in Ukraine continue dissipating. **Some** members mentioned that Banco de México's forecasts for headline inflation were revised marginally downwards for some quarters. They added that those for core inflation remained practically unchanged. **One** member pointed out that its seasonally adjusted annualized quarterly rate is expected to continue declining and fall below the upper limit of the target range in the fourth quarter of 2023.

Most members considered that uncertainty regarding the expected disinflationary process persists. They highlighted that this is a complex phenomenon. Some members estimated that, although base effects will favor the decline in core inflation during the remainder of the year, there is a significant challenge for this decline to continue towards the end of 2023 and during 2024. **One** member indicated that, although external inflationary pressures are easing, attention must now center on domestic pressures, both structural and conjunctural, especially those related to demand and the labor market. **Another** member estimated that the persistence of inflation stems from domestic pressures. He/she underlined that, based on some indicators, inflationary pressures of manufactured goods respond to demand-related pressures.

All members agreed that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member mentioned that such balance has not deteriorated. **Among upward risks to inflation, most members highlighted the persistence of core inflation at high levels. One** member rated this as the most concerning risk. **Another** member estimated that the above not only responds to the shocks associated with the pandemic and with the military conflict in Ukraine, but also appears to derive from changes in price formation, as shown by the greater frequency and magnitude of goods and services' price adjustments. **Most members indicated as an upward risk the possibility of greater cost-related pressures.** In this regard, **some** members expressed concern regarding the tightening of the labor market. **One** member argued that the accelerated wage growth is incompatible with the inflation target. He/she considered that pressures related to labor costs, reflected in different wage indicators, are already being passed on to consumers given the strength of demand. However, **another** member underlined that inflation indicators that are more sensitive to slack conditions and to wages show a downward trajectory, although they remain at high levels. **One** member mentioned that the evolution of the labor market should be consistent with the equilibrium of the economy and with price stability. He/she added that, so far, readings of this market that could imply adverse effects on inflation are heterogeneous and nonconclusive. **All members agreed that the dynamics of the labor market should continue to be monitored. One** member argued that measures of economic slack will gain even more relevance in the coming months. Meanwhile, **another** member mentioned as an upward risk a possible abrupt correction in market expectations for the Federal Reserve's future actions, with its corresponding impact on the exchange rate and price stability. **Most members mentioned the risk of a greater-than-expected increase in non-core inflation in the following months. One** member warned that, even with the foreseen increase in non-core inflation, the central bank forecasts would imply that, during the planning horizon, non-core inflation would be below its average of the last 13 years, and thus there is a risk that this indicator registers higher-than-anticipated levels. **Some** members mentioned higher prices of agricultural and livestock products, caused by climate-related factors, as an example of risks that could lead to an increase in non-core inflation. Among risks to the downside, **one** member mentioned the possibility of a greater-than-anticipated slowdown in global economic activity, mainly in the United States, and also in Mexico, which would lead to lower domestic inflationary pressures.

Macrofinancial environment

All members highlighted the appreciation of the Mexican peso since the previous monetary policy meeting. Most members noted that the peso-dollar exchange rate reached its lowest level since December 2015 and that trading conditions in the foreign exchange market have been favorable. They considered that this behavior is due to the country's sound macroeconomic fundamentals and the wide volatility-adjusted interest rate spread between Mexico and the United States. One member added that the yield in domestic currency implied on foreign exchange forwards being above the reference rate reflects that the Mexican peso is attractive to investors. **Some** members considered that remittance inflows and better investment prospects in view of the nearshoring process have also contributed to the favorable behavior of the national currency. **One** member added the weakening of the US dollar in recent months and uncertainty regarding the beginning of a rate-cutting cycle by the US Federal Reserve.

Most members highlighted that, since the previous monetary policy decision, short-term government bond yields decreased, while medium- and long-term ones registered limited adjustments. One member added that the inversion of the yield curve prevailed. **Another** member underlined that the performance of domestic financial markets was in line with global markets, registering gains in the main stock market index and reductions in risk premia. However, **one** member noted that the stock market registered a negative performance at the margin.

Some members underlined that there has been a recovery in the percentage of Mexican Federal Treasury Certificates (Cetes, for their acronym in Spanish) held by foreign investors. **One** member stated that non-resident holdings of bonds decreased since the last decision as a result, in part, of an increase in the cost of foreign exchange hedging and of profit taking from positions given the appreciation of the Mexican peso during this year. He/she indicated that pension and mutual funds have been the main buyers of government bonds this year. He/she noted that the increase in employer's contributions has increased the resources managed by the Specialized Investment Companies for Retirement Funds (Siefores, for their acronym in Spanish) and, in turn, the demand for different assets, including government debt and corporate securities.

Most members mentioned that the pass-through of increases in the reference rate to commercial bank deposit rates has contributed to incentivize Mexican households to save through term deposits. Some members indicated that commercial banks' performing credit to private firms and households has continued to expand, especially for consumer credit. **One** member noted that delinquency rates remain relatively low and stable, although a marginal increase in those of credit cards has been observed. Regarding the financial cycle, he/she added that the financial conditions index for Mexico has trended upwards so far this year, and therefore financial conditions remain tight, although at stable levels. **Another** member pointed out that credit to large issuing firms decelerated in a difficult environment for issuing securities in foreign markets. He/she pointed out that this stands in contrast with the expansion of domestic financing to private firms.

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 considered that caution is required at the current stage of disinflation. He/she acknowledged that since the last monetary policy meeting, the disinflation process continued moving forward. However, he/she judged that the outlook remains complicated. In this context, he/she argued in favor of keeping the reference rate unchanged at 11.25%. He/she underlined that disinflationary processes are complex. He/she pointed out that there is always uncertainty about the pace at which shocks may dissipate and that some inflation components may exhibit volatility. He/she highlighted that the reference rate should be maintained at its current level for a period that is long enough to ensure that inflation declines in a sustained manner and that the upward bias of the balance of risks for inflation moderates. He/she stated that it is still too early to consider the possibility of interest rate cuts. He/she noted that the monetary policy stance attained needs more time to continue operating. He/she pointed out that it will be essential to continue analyzing the observed and forecasted behavior of inflation and its components, as well as of all its determinants. Among these, he/she highlighted inflation expectations, cost-related pressures, domestic economic activity, labor and financial market dynamics, as well as external factors such as world inflation, global economic activity, and international monetary policy. He/she highlighted that it is necessary to closely monitor a wide range of economic and financial variables. He/she argued that during this inflationary period, monetary policy has contributed to the anchoring of inflation expectations, mainly long-term ones. He/she mentioned that, despite the magnitude of the shocks, they have remained relatively stable, which has been essential for the disinflation process to begin. He/she added that monetary policy has contributed to the resilient behavior of the Mexican peso. He/she stated that this has eased inflationary pressures by moderating the costs of imported inputs used by the productive sector. He/she noted that it has also contributed to moderate the rate of expansion of external demand faced by the export manufacturing sector, which shows high levels of capacity utilization. He/she added that monetary tightening has fostered a process of intertemporal substitution of household spending. Finally, he/she reiterated that Banco de México remains firmly committed to its primary mandate of price stability. He/she stated that this is to the benefit of the country's population, particularly those with lower incomes.

Another member considered that, in view of the prevailing inflationary pressures, it is essential to preserve the level of monetary restriction attained in order to promote the decline of inflation in line with the central bank's projections and mitigate inflationary risks. He/she thus considered it appropriate to maintain the reference rate at its current level of 11.25%. He/she stated that the high uncertainty environment regarding the inflationary process compels Banco de México to act with caution and favor a flexible monetary policy stance subject to incoming data. He/she noted that subsequent monetary policy decisions will depend on incoming data, particularly on headline and core inflation consolidating their downward trend as expected, and on domestic pressures not generating persistence. He/she added that the central bank must clearly state that it is prepared to respond to the circumstances. He/she pointed out that it cannot be ruled out that the level of monetary restriction attained should be maintained for longer than anticipated or that a greater or lesser tightening may be required. He/she stated that, in any case, a restrictive stance should be maintained throughout the planning horizon. He/she mentioned that the monetary policy statement should highlight that the favorable evolution of inflation has mainly responded to external factors, while domestic pressures have persisted and may hinder the convergence of inflation to its target within the forecast horizon. Finally, he/she warned that the accumulated lag in physical investment and lower productivity, both worsened by the pandemic, may have lowered the country's potential growth, which constitutes a risk factor for inflation that, in his/her opinion, will have significant implications for monetary policy conduction in the short and medium terms. He/she warned that if the country's potential growth has fallen and in the absence of a restrictive monetary policy, the economy could be on its path towards an equilibrium of low growth and high levels of inflation. Looking ahead, the possibility of lower potential growth could make it difficult to observe high growth rates without inflationary pressures being generated.

One member considered it necessary to maintain the reference rate at its current level for an extended period in order to achieve convergence of inflation to its target. He/she recalled that this was communicated since the previous meeting, in which it was transmitted that, according to the information available, the terminal rate had already been attained. He/she considered that, in an environment of lower external pressures, monetary restriction is having an effect. He/she pointed out that a necessary but not sufficient condition to overcome this inflationary episode was that global pressures would begin to ease. He/she stated that now domestic pressures must be contained by maintaining a restrictive monetary stance. He/she mentioned that efforts should focus on further reducing core inflation. He/she stated that the relative monetary policy stance allows for some room for maneuver to focus exclusively on the inflationary outlook, even if the US Federal Reserve were to raise its reference rate on several occasions. He/she mentioned that, since the last reference rate increase in March, the ex-ante real interest rate has risen by 20 basis points due to the fall in 12-month inflation expectations, which is equivalent to almost an additional increase in the reference rate if expectations had not declined. However, he/she pointed out that the monetary stance must be prevented from becoming too restrictive given the expected decline in inflation expectations. He/she highlighted that the expectations channel will be crucial in the upcoming months, together with the materialization of larger effects on the monetary aggregates and other transmission channels. He/she underlined that it is important to continue guiding markets on the temporality of forward guidance and the nature of any possible adjustment in the reference rate. He/she warned that it is too early to believe that the interest rate cuts which are anticipated by market indicators for the end of 2023 will materialize. He/she stated that the term "extended period" should remain undefined until there is greater certainty about an improvement in the inflationary outlook. He/she pointed out that, instead, it will be important to maintain caution when discussing the desirable timing to initiate a normalization cycle and underlined that the environment is still complex and fragile. He/she highlighted that Banco de México will remain committed to its primary mandate through a firm stance until the inflation target is attained.

Another member pointed out that, although inflation keeps improving, most of its decline is attributed to the non-core component and to important base effects that are unlikely to operate indefinitely. He/she noted that, although the reference rate has not been adjusted, the ex-ante real interest rate has been increasing. He/she estimated that this is expected to continue occurring, although to a limited extent, given that inflation expectations tend to decline slowly. He/she considered that the effectiveness of the monetary policy stance will depend on the functioning of the transmission channels, which, in his/her opinion are operating in the required direction, particularly with regards to the exchange rate channel. He/she added that, as in other monetary cycles, the tightening of financing conditions and the rise in funding costs have not increased in the same proportion as the reference rate, and therefore the magnitude and lag with which they will influence the behavior of domestic demand still need to be evaluated. He/she argued that monetary restriction will require a prolonged period to be properly transmitted, since the lags with which different channels operate are ample and differ from each other. He/she stated that such restriction must ensure: i) the consolidation of an orderly and sustained trend of headline and core inflation to a level of 3%; ii) a neutral balance of risks for the forecast, and iii) inflation expectations adjusting to their historical averages. He/she considered that, in view of the complex inflationary scenario, these conditions are not yet resolved, and therefore it is necessary to maintain a flexible and data-dependent approach. He/she expressed the need for communication to provide clear signals in a timely manner and to avoid inconsistencies that could damage the central bank's credibility. He/she warned that the reference rate foreseen by fixed-income markets for the end of 2023 and 2024 is below the level required to guarantee the convergence of inflation to its target over the forecast horizon. He/she pointed out that, at this moment, anticipating changes in the monetary cycle would be premature. He/she indicated that, in contrast, providing clear communication on the commitment to the constitutional mandate of price stability can contribute to an adequate formation of expectations and reduce some of the lags with which the transmission mechanisms operate.

One member considered that the monetary tightening attained has contributed to the disinflation process. He/she argued that given the persistence of core inflation and a balance of risks biased to the upside, maintaining the reference rate at its current level allows to continue evaluating the degree of absorption of the monetary policy stance in the economy. He/she added that although the transmission channels are operating and their effect will be more noticeable in the coming quarters, the atypical nature of the shocks and their implications on inflationary dynamics strengthen the need for an extended pause. He/she reiterated that, although domestic pressures tend to be associated with increases in services inflation, the latter is still affected by the described shocks and is not necessarily explained by domestic pressures. He/she added that if such pressures were present, these would already be addressed with the monetary restriction achieved. He/she stated that the significant adjustment to the inflation forecast at the beginning of the year in part responded to the anticipation of greater pressures on services, including those stemming from the greater dynamism of the labor market. He/she asserted that the firm and timely action implemented at that policy meeting also sought to address such dynamics, although he/she also highlighted the need to monitor its evolution. On the other hand, he/she considered it prudent to refrain from taking actions that could diminish the effectiveness of the accumulated adjustment or of communication as a policy tool that would relax the monetary stance prematurely. For this reason, he/she stated that currently it is not appropriate to discuss the possibility of interest rate cuts. He/she estimated that, although better readings in inflation expectations are anticipated, which is important to observe under the inflation targeting regime, the referred pause will allow said expectations to continue evolving favorably and contribute to improve the price formation process. He/she added that, among a wide range of factors, it is also relevant to consider the evolution of the balance of risks, the development of inflation with respect to the forecast, and the progression of the forecast itself. Finally, he/she stated that it is essential to continue using communication as an active tool to strengthen the monetary policy stance. He/she highlighted that, in his/her opinion, it is still prudent to communicate that the pause will continue for a sufficiently long period to consolidate the convergence of inflation and foster 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.

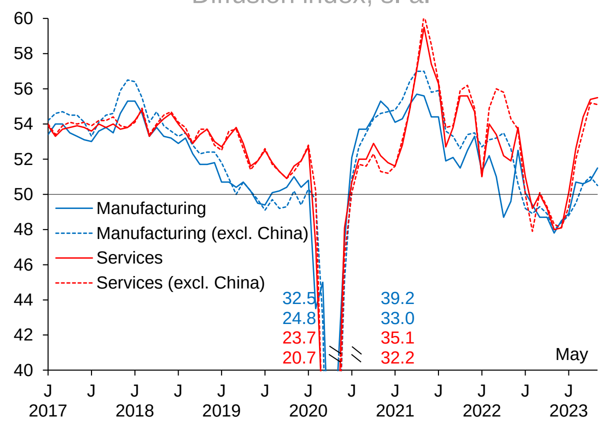
A.1. External conditions

A.1.1. World economic activity

Available indicators suggest that during the second quarter of 2023 global economic activity continued expanding. Global growth continued being driven by the fading of disruptions in supply chains and by lower pressures in energy prices. The pace of expansion of economic activity is expected to have accelerated slightly in advanced economies and to have decelerated in emerging economies. Purchasing Managers' Indices point to a greater expansion of services than that of the manufacturing sector (Chart 1). Among risks to global economic activity, the following stand out: the persistence of inflationary pressures, the intensification of geopolitical tensions, tighter financial conditions in some advanced economies and, to a lesser extent, challenges to financial stability in general.

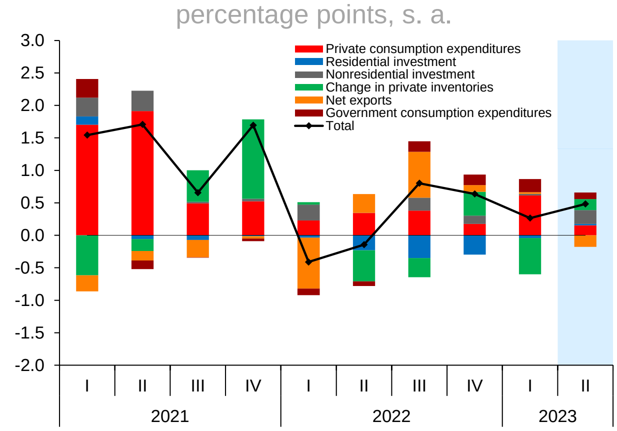
In the United States, Gross Domestic Product (GDP) is expected to have continued expanding during the second quarter of 2023, after having grown at a seasonally adjusted quarterly rate of 0.3% in the first quarter of 2023 (Chart 2).[1] Available indicators suggest that growth in the second quarter was supported by private consumption and that nonresidential investment would continue showing resilience, despite tighter lending conditions. Public spending and the change in inventories are also expected to have contributed positively to GDP growth during that period. This would be tempered by a negative contribution from net exports.

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



s.a./ Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points is considered an overall increase compared to the previous month and below 50 points an overall decrease.
Note: Figures in the chart correspond to the minimum level of the 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.
Note: The shaded area refers to the Federal Reserve Bank of Atlanta's GDPNow forecasts.
Source: BEA and Federal Reserve Bank of Atlanta.

US industrial production contracted at a monthly rate of 0.2% in May, after having grown 0.5% in April. The decline in industrial activity in May reflected lower electricity and gas generation, due to warmer-than-usual weather conditions and a fall in mining production. This was partially offset by a 0.1% growth in manufacturing production. The latter was

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 1.3% in the first quarter of 2023.

the result, to a greater extent, of the expansion of consumer durables, with aerospace and transportation goods standing out. Purchasing Managers' Indices point to a moderate expansion of the manufacturing sector during the second quarter of the year.

The US labor market continued showing signs of tightness. The non-farm payroll accelerated its pace of job creation in May, increasing by 339 thousand new jobs, figure higher than expected by the analysts' consensus. After declining during the first quarter, vacancy and layoff rates increased at the beginning of the second quarter and remained at levels that suggest a still tight labor market. Initial claims for unemployment insurance continued at low levels. Although it rose to 3.7% in May, the unemployment rate remains at low levels.

In the euro area, a slight rebound of economic activity is expected during the second quarter of 2023, after having accumulated two consecutive quarters of contractions, falling 0.1% at a seasonally adjusted quarterly rate in each of the two previous quarters.[2] During the second quarter, economic activity is expected to have benefited from lower energy prices, lesser disruptions in supply chains, tax incentives, and the resilience of the services sector. In contrast, manufacturing activity would have been affected by weak external demand and tight financial conditions. The unemployment rate in the euro area declined from 6.6% in March to 6.5% in April.

Economic activity in major emerging economies is foreseen to have registered a heterogeneous behavior during the second quarter of 2023. In Emerging Asia, most economies continued expanding, although at a slower pace than in the previous quarter. In the case of China, several indicators suggest that during the second quarter the recovery would be lower than anticipated. In Emerging Europe, most economies are expected to recover during the second quarter. In Latin America, economic activity is anticipated to contract or decelerate in most economies.

Since Mexico's previous monetary policy decision, international commodity prices have had a mixed performance. Oil prices were subject to episodes of volatility throughout the period, ending at levels similar to those registered in mid-May. Among the factors that contributed to the downward pressure on prices, the following stood out: a lower impact of the production cuts announced by the members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+); the lower-than-anticipated recovery of economic activity in China; the uncertainty surrounding the agreement to suspend the debt ceiling in the United States which, if it had not subsequently been achieved, could have implied a lower demand for oil; and the high levels of US crude oil production. Meanwhile, prices were subject to upward pressures, due to, among other factors, a higher demand in the United States, the announcement of Saudi Arabia's production cut, and the agreement to suspend the US debt ceiling in early June. Natural gas reference prices in Europe declined in May due to high inventory levels, although in June they reversed this trend in light of a warmer-than-usual weather. In the United States, natural gas prices exhibited volatility. Prices were driven upwards by supply issues related to the fires in Canada, the expectation of increased demand for air conditioning in view of warmer weather forecasts, and reduced wind power generation capacity. Meanwhile, prices were subject to downward pressures due to record production levels and signs of weak global demand. Grain prices trended downwards in May due to the renewal of the Black Sea security corridor agreement and expectations of weak demand for cereals. However, prices rebounded in June due to supply shocks associated with climate-related factors in China and the United States. Industrial metal prices overall declined in mid-May due to weaker-than-anticipated figures from China and signs of recession in some advanced economies. However, this trend reversed in June due to better economic performance expectations in the United States.

A.1.2. Monetary policy and international financial markets

Headline inflation declined in most of the major economies, both advanced and emerging, although it remains at elevated levels. The reduction in inflation was largely associated with lower pressures on energy prices. The core component has shown resistance to decline. In some cases, inflation increased in its most recent readings.

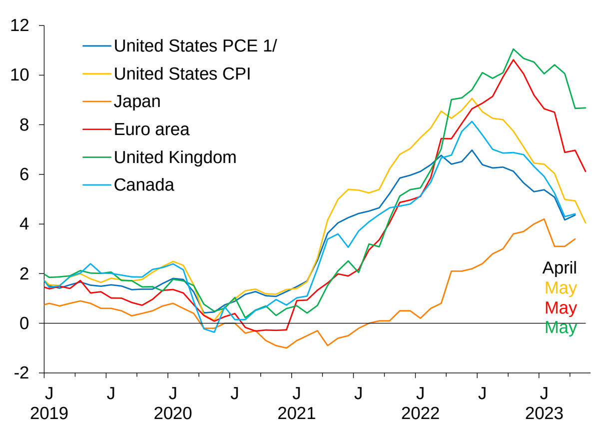
In a large number of advanced economies, headline inflation declined, although in some cases, the most

[2] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was -0.4% in the fourth quarter of 2022.

recent figure increased (Chart 3). Nevertheless, headline inflation remained at high levels and above their respective central banks' targets. The core component showed resistance to decline. In the particular case of the United States, headline inflation as measured by the consumer price index in annual terms decreased from 4.9% in April to 4.0% in May, as a result of a significant fall in energy inflation, a decrease in food inflation, and a moderate decline in annual core inflation. The annual variation of this last component went from 5.5% to 5.3% during the same period, mainly as a result of a decline in services inflation. The monthly variation of the core component showed greater persistence by increasing marginally from 0.41 to 0.44% in May, while headline inflation fell from 0.4% in April to 0.1% in May. Annual headline inflation as measured by the personal consumption expenditure index (PCE) rose from 4.2% in March to 4.4% in April, remaining above the 2% inflation target. Annual core inflation rose from 4.6% to 4.7% during the same period.

Analysts' short-term inflation forecasts for most of the main advanced economies foresee a moderation in headline inflation in 2023 relative to the levels registered in 2022. However, they reflect that average inflation in 2023 would remain above their central banks' targets. Longer-term inflation expectations for these economies drawn from financial instruments, remained relatively stable with respect to the levels registered in mid-May.

Chart 3
Selected Advanced Economies: Headline Inflation
Annual percentage change

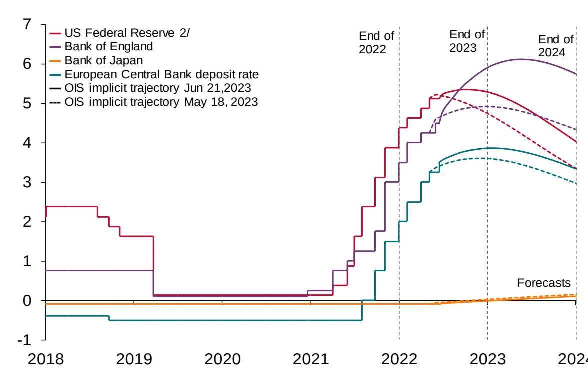


1/ The personal consumption expenditure deflator is used.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, The UK Office for National Statistics and Statistics Canada.

In most of the major emerging economies, annual headline inflation declined. However, it remained above most central banks' targets, except for a few countries, such as China, Thailand, Indonesia, India, Russia and Brazil, where inflation lay within the variability range considered by each central bank or below its point target. In most emerging economies, core inflation stabilized or slightly decreased.

In this environment, since Mexico's previous monetary policy decision, most central banks of the major advanced economies continued tightening their monetary policy stances. In particular, the European Central Bank and the central banks of New Zealand and Australia continued raising their reference rates. The Bank of Canada resumed the hike in its interest rate by increasing it by 25 basis points (bps) in June, after leaving it unchanged in its March and April decisions. In this regard, it stated that the decision to increase it reflected its view that monetary policy was not sufficiently restrictive to bring inflation back to its target on a sustained basis. Other central banks left their interest rates unchanged, including the US Federal Reserve and the central banks of Japan and Korea. Regarding their asset purchase programs, most central banks in this group of economies continued to gradually reduce their securities' holdings. Expectations on reference rates drawn from financial instruments for most of the major advanced economies increased during the period. Based on the latest available information on interest rates implicit in interest rate swap curves (OIS), no interest rate cuts are expected for the rest of the year in any 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 (5.00% - 5.25%) is used.
Source: Banco de México with data from Bloomberg.

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

i) After having increased the target range for the federal funds rate on 10 consecutive occasions, the US Federal Reserve left it unchanged at its June meeting, at 5.00-5.25%. It pointed out that keeping the target range stable at this meeting allows the Federal Open Market Committee (FOMC) to evaluate additional information and its implications for monetary policy. It stated that in order to determine what additional policy tightening might be appropriate, the Committee will consider the cumulative tightening of monetary policy, the lags with which it affects economic activity and inflation, and economic and financial developments. It also continued reducing the size of its balance sheet. During a press conference, the chairman of the Federal Reserve mentioned that almost all FOMC members expect that it will be appropriate to raise interest rates further this year and that none of them forecast an interest rate cut in 2023. He pointed out that tighter lending conditions are likely to affect economic activity, employment and inflation, although the extent of these effects remains uncertain. He reiterated that they will maintain a stance dependent on incoming data. Regarding adjustments to FOMC forecasts between March and June, median growth was revised upwards from 0.4 to 1.0% for the end of 2023, downwards from 1.2 to 1.1% for 2024, and from 1.9 to 1.8% for 2025. Meanwhile, headline inflation forecasts anticipate that it will be 3.2% at the end of 2023, 2.5% in 2024, and 2.1% in 2025. As for core inflation, the median was modified upwards from 3.6 to 3.9% for the end of 2023, remained unchanged at 2.6% for the end of 2024, and increased from 2.1 to 2.2% for the end of 2025. As for the federal funds rate, the Committee revised upwards its expectation for the end of 2023 from 5.1 to 5.6%, for the end of 2024 from 4.3 to 4.6%, and for the end of 2025 from 3.1 to 3.4%. The above contrasts with expectations drawn from financial instruments, which, based on the latest available information, anticipate that the highest interest rate level will be around 5.35% and that this will be observed in the fourth quarter of 2023, to subsequently decrease to levels of 5.0% by the first quarter of 2024 and 4.0% by the end of that same year.

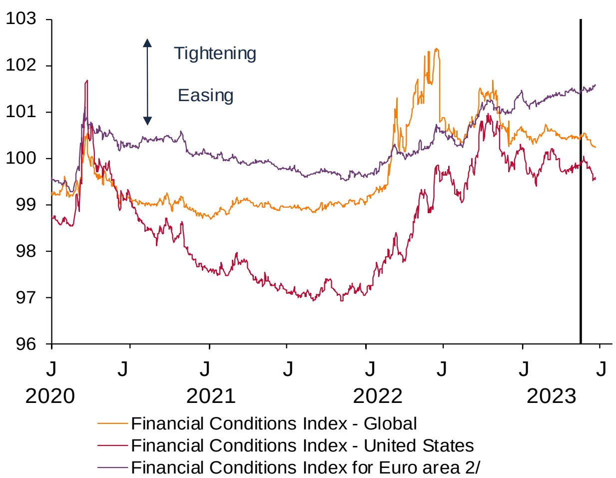
ii) The European Central Bank (ECB) maintained the pace of its reference rate hikes by announcing an increase of 25 bps in June. Its refinancing, key lending and key deposit rates stood at 4.00, 4.25 and 3.50%, respectively. It stated that previous interest rate hikes are strongly being passed through to financial conditions and are gradually impacting the entire economy. It reiterated that through future decisions, monetary policy rates will be set at levels sufficiently restrictive to achieve a timely return of inflation to the 2% medium-term target and will remain at those levels for as long as necessary. It stated that the Governing Council will continue to follow a data-dependent approach in determining the appropriate level and duration of monetary restriction. During a press conference, the president of that institution indicated that the hiking cycle has not yet ended and that it is very likely that the Council will continue raising interest rates in July. She added that the Council has not discussed or begun to think about a pause in interest rate hikes. Regarding its securities' holdings, she stated that the Council will suspend reinvestments under the Asset Purchase Program (APP) as of July 2023.

Since Mexico’s previous monetary policy decision, most central banks of the major emerging economies kept their interest rates unchanged. Some suggested that they would maintain them at their current levels for some time at least until inflation starts to decline steadily, that the hiking cycle has not necessarily come to an end, or that future adjustments will depend on the evolution of indicators. In the particular case of Chile, the central bank pointed out that, if the current economic trend continues, it will begin to lower its reference rate in the short term. Brazil's central bank removed from its statement the comment that it would not hesitate to resume monetary tightening if the disinflation process does not evolve as expected. China announced a cut of 10 bps in several of its reference interest rates, due to concerns regarding the pace of its economic recovery. Other central banks continued raising their reference rates.

In the context described above, international financial markets showed greater stability and there was an increase in global risk appetite stemming from lesser concerns regarding the stability of banking systems in some advanced economies and the agreement regarding the suspension of the debt ceiling in the United States. Since Mexico's previous monetary policy decision, global financial conditions eased slightly (Chart 5). Stock markets in the major advanced and emerging economies registered a mixed performance, although with an upward bias. In foreign exchange markets, the US dollar strengthened slightly against major advanced economies' currencies in the second half of May, although this trend reversed in recent weeks. Emerging economies' currencies registered a mixed behavior. Interest rates on short-term and, to a lesser extent, long-term government bonds in most of the main advanced economies rose (Chart 6). In emerging economies, long-term interest rates in most countries were below the level registered in Mexico's previous monetary policy decision, although increases were observed in some countries, particularly in Asia (Chart 7).

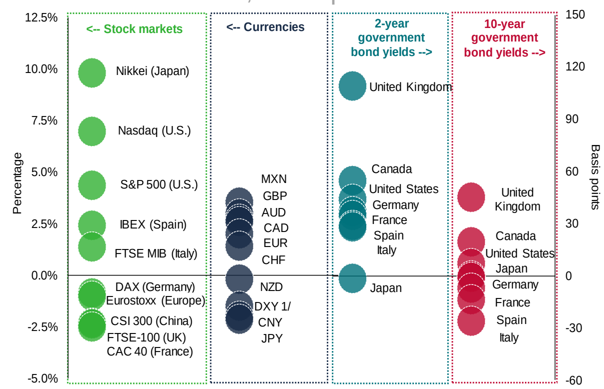
In this context, since Mexico’s previous monetary policy decision, cumulative net inflows to emerging economies were registered. Flows behaved differently across asset classes, with cumulative net inflows to equity assets and moderate outflows from fixed-income assets.

Chart 5
Financial Conditions Indices[1/]
Units



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

Chart 6
Change in Selected Financial Indicators from May 18 to June 21, 2023
Percent; basis points



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

Chart 7
Selected Emerging Economies: Financial Assets Performance as of May 12, 2023
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	2.87%	-0.19%	-6	-1	-15
	Brazil	2.00%	9.49%	-62	-60	-42
	Chile	-1.21%	2.56%	-34	-24	-21
	Colombia	8.58%	1.28%	-73	-52	-62
	Peru	0.86%	4.87%	-40	-8	-19
Emerging Europe	Russia	-8.08%	9.19%	-126	-119	N.A.
	Poland	1.95%	6.57%	21	34	-26
	Turkey	-20.67%	14.18%	-427	98	-27
	Czech Rep.	-0.03%	-3.51%	5	-4	0
	Hungary	-0.10%	8.77%	-61	-52	-15
Asia	China	-2.41%	0.03%	-10	-3	-13
	Malaysia	-3.01%	-2.41%	13	9	-16
	India	0.28%	2.19%	7	4	-8
	Philippines	-0.16%	-1.06%	0	6	-14
	Thailand	-1.97%	-0.13%	18	12	-2
	Indonesia	-1.25%	-0.14%	-18	-11	-12
Africa	South Africa	5.97%	0.26%	-16	-19	-61

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.

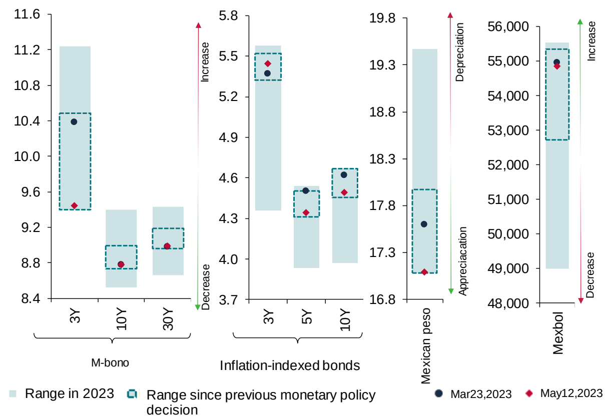
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described above, since Mexico's last monetary policy decision, the Mexican peso appreciated against the US dollar. Short-term interest rates decreased while medium- and long-term ones registered limited adjustments (Chart 8).

This was accompanied by a decline in volatility across all asset classes.

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



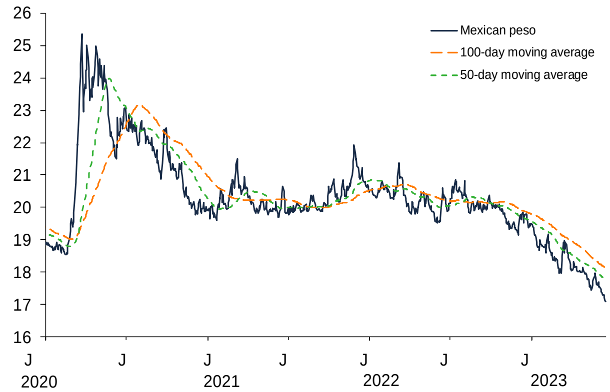
Source: Prepared by Banco de México.

The Mexican currency traded in a range of 0.97 pesos, between 17.02 and 17.99 pesos per US dollar since the previous monetary policy decision. During the period it appreciated 2.87%, reaching its lowest level since December 2015 (Chart 9). The above occurred in a context in which trading conditions, both realized and prospective, improved.

Interest rates on government securities decreased in the short-term nodes and slightly increased in the medium- and long-term nodes (Chart 10). The yield curve of real rate instruments exhibited generalized decreases of up to 23 bps. In this context, breakeven inflation implicit in spreads between nominal and real interest rates of market instruments increased slightly for most terms (Chart 11). These movements took place in an environment in which trading conditions, despite improving, still have not reached pre-pandemic levels.

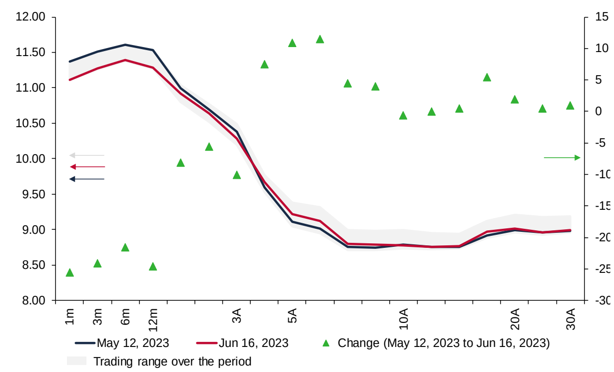
Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swaps curve does not incorporate any adjustment for the June decision (Chart 12). Most analysts surveyed by Citibanamex anticipate that the reference rate will remain unchanged in the June decision and that by the end of 2023 it will be at a level of 11.00%.

Chart 9
Mexican Peso Exchange Rate
MXN/USD



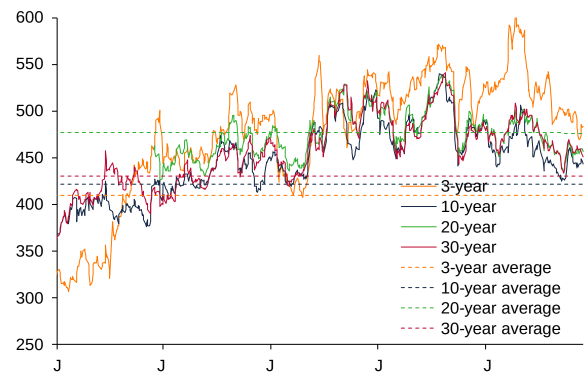
Source: Prepared by Banco de México.

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



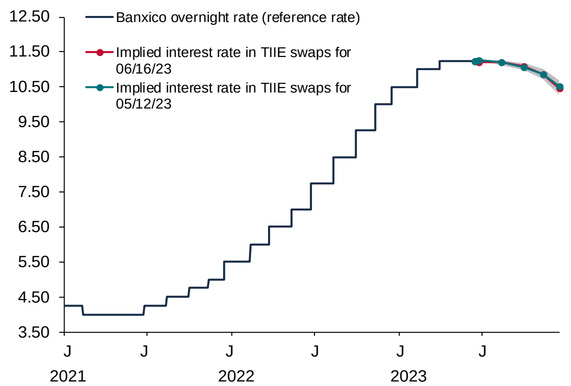
Source: PIP.

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



Source: PIP.

Chart 12
Interbank Funding Rate Implied in TIIE Swaps
Percent

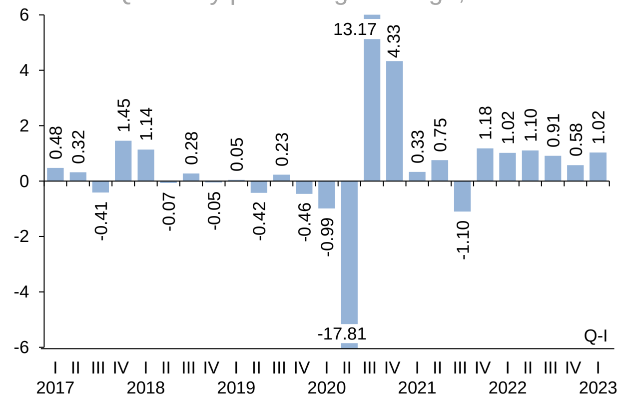


Nota: Shaded areas represent the range since the last monetary policy decision.
Source: Prepared by Banco de México with Bloomberg data.

A.2.2. Economic activity in Mexico

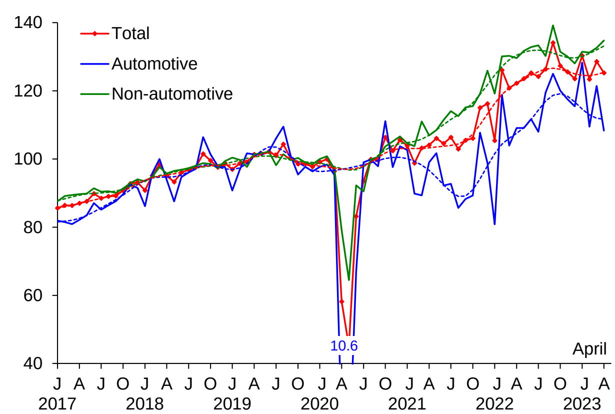
Mexico's economic activity has remained resilient despite the prevailing complex external environment. During the first quarter of the year, GDP increased its rate of expansion (Chart 13). At the end of the first quarter of 2023, private consumption continued trending upwards. This indicator rose in March mainly as a result of the performance of goods, since services showed a lack of dynamism. Gross fixed investment continued increasing. Investment in machinery and equipment continued exhibiting dynamism, while investment spending on construction continued showing weakness, after the reactivation displayed at the end of 2022. At the beginning of the second quarter, the value of manufacturing exports contracted at a monthly rate, reflecting a fall in automotive exports, given that the rest of manufacturing exports increased (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.
Source: Mexico's System on National Accounts (SCNM, for its Spanish acronym), INEGI.

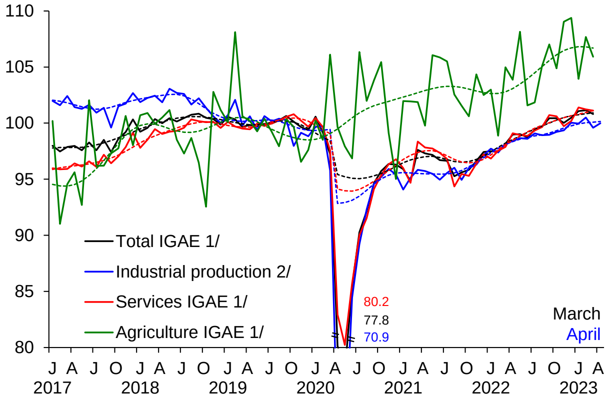
Chart 14
Total Manufacturing Exports
Indices 2019 = 100, s. a.



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

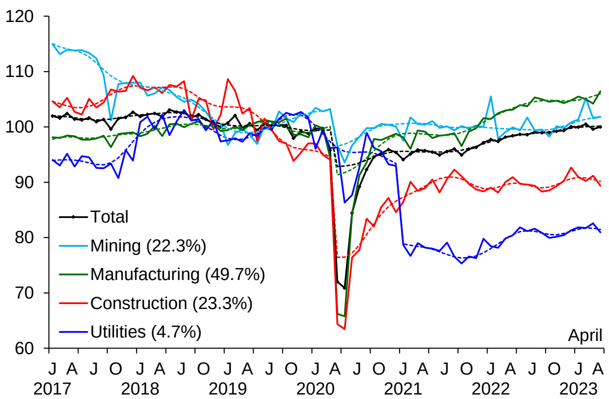
On the production side, in March 2023, services contracted for the second consecutive month (Chart 15). This was the result of a weak performance by most of its sectors. Industrial activity reactivated slightly in April, driven by manufacturing, which expanded significantly (Chart 16). Mining increased slightly. In contrast, construction and electricity generation contracted at the margin.

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

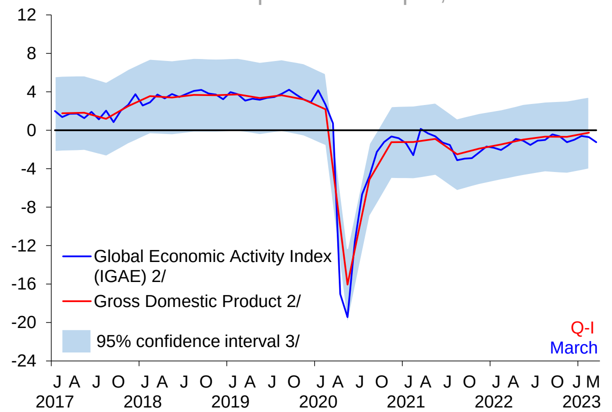
Chart 16
Industrial Activity [1/]
Indices 2019 = 100, s. a.



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.

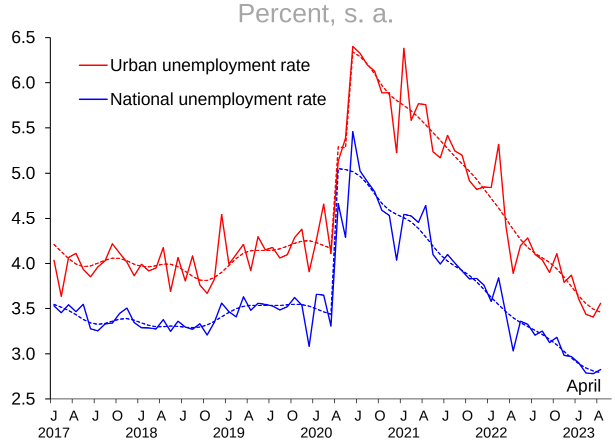
Regarding the cyclical position of the economy, in light of the growth of economic activity during the first quarter of 2023, the negative output gap point estimate continued closing (Chart 17). During the first quarter of the year, the national and urban unemployment rates remained at particularly low levels (Chart 18). Seasonally adjusted figures for May show that the creation of IMSS-insured jobs maintained its dynamism. Finally, in April 2023, unit labor costs in the manufacturing sector partly reversed the increases of February and March, although they remained slightly above the 2022 average level (Chart 19).

Chart 17
Output Gap Estimates [1/]
Percent of potential output, s. a.



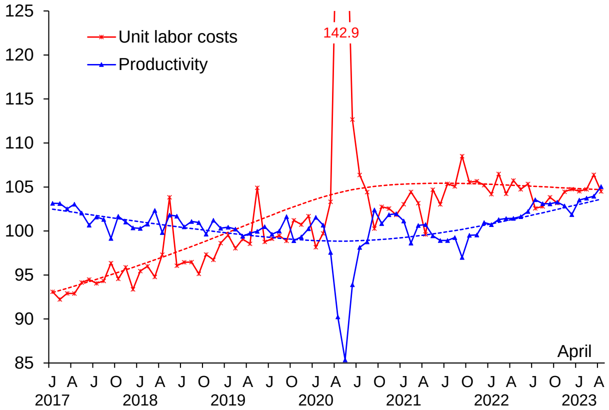
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.74.
2/ GDP figures up to Q1-2023 and IGAE implicit up to March 2023, consistent with said timely figure.
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.



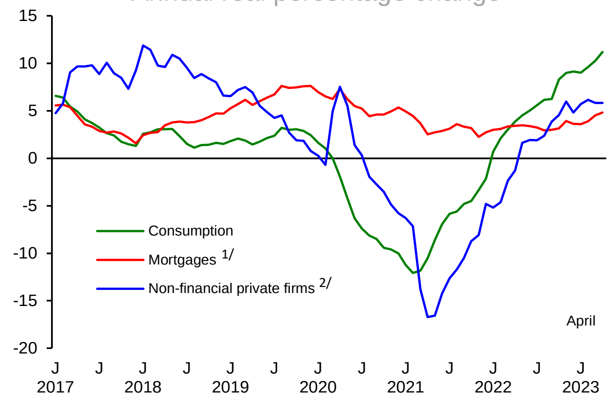
a.e. / Seasonally adjusted and trend series. The former is represented by a solid line and the latter by a dotted line. The range of the chart was narrowed to make it easier to read.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly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

In April 2023, domestic financing to non-financial private firms registered a positive real annual variation for the tenth consecutive month. The bank lending component continued increasing, although its annual growth rate has stabilized (Chart 20). This occurred in a context in which demand of non-financial private firms for loans continued recovering. Lending standards were more restrictive for large companies and thus remained tight. These conditions have tended to ease for smaller private firms since the second half of 2021.

As for lending to households, in April 2023 commercial bank housing portfolio increased its rate of expansion. Performing loans to consumption grew at a faster rate and continued to be the segment with the highest growth, as a result of the dynamism of credit cards and payroll loans.

In April 2023, bank lending interest rates increased consistent with changes in the reference rate. Thus, they reached levels above those observed at the end of 2019. Corporate credit intermediation margins remained, in general, at levels below those of February 2020, although in April they increased for large non-issuing private firms. Although interest rates on mortgages increased from July 2022 to January of this year and then remained practically unchanged, their levels continued to be relatively low. Between June 2021 and June 2022, credit card interest rates adjusted only slightly to changes in the reference rate. During the second half of 2022, these rates increased markedly, although they have remained significantly unchanged in the first two months of 2023 for which information is available. Interest rates for payroll loans have remained relatively stable since August 2021.

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



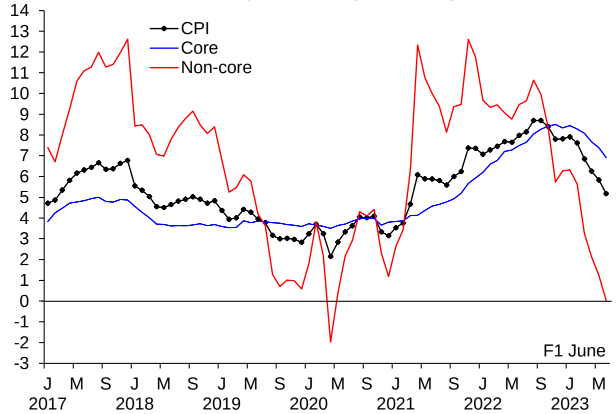
1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

As for portfolio quality, in April 2023 corporate and mortgage delinquency rates remained stable with respect to those observed in the previous month and at low levels. Finally, consumer portfolio delinquency rates did not change significantly for the second consecutive month and remain below pre-pandemic levels.

A.2.3. Development of inflation and inflation outlook

Between April and the first fortnight of June 2023, annual headline inflation decreased from 6.25 to 5.18% (Chart 21 and Table 1). This result was due to the decline in both non-core and core inflation.

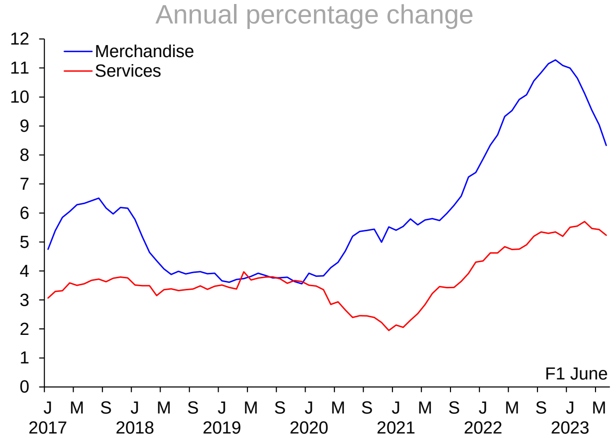
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

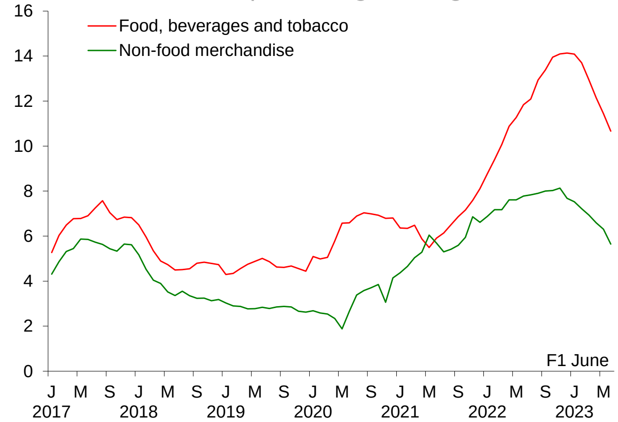
Annual core inflation declined from 7.67 to 6.91% between April and the first fortnight of June 2023. Within its components, annual merchandise inflation continued to decrease from 9.54 to 8.33% between the referred dates (Chart 22). This performance reflected the reduction from 12.14 to 10.67% in the annual variation of food merchandise prices and from 6.59 to 5.65% in non-food merchandise prices (Chart 23). Annual services inflation decreased from 5.46 to 5.23% during the same period. The annual variation of prices of services other than education and housing, while remaining at high levels, declined from 7.10 to 6.63%, with the decrease of food preparation services from 11.23 to 10.35% standing out.

Chart 22
Merchandise and Services Core Price Subindex
Annual percentage change



Source: INEGI.

Chart 23
Merchandise Core Price Subindex
Annual percentage change

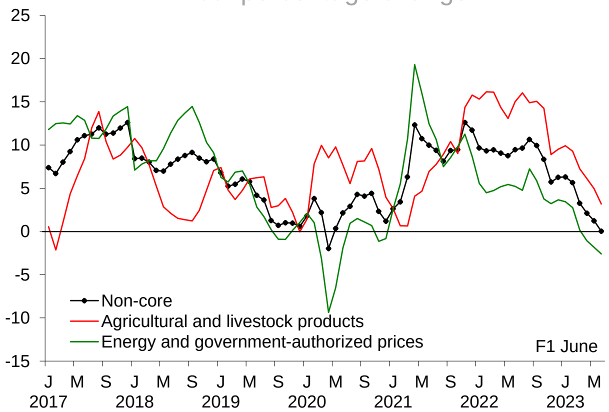


Source: INEGI.

Annual non-core inflation continued registering atypically low levels. Between April and the first fortnight of June 2023, it declined from 2.12 to 0.03% (Chart 24 and Table 1). This result was influenced by the decrease from 6.13 to 3.19% in the annual inflation of agricultural and livestock products, associated in turn with the reduction from 8.01 to 2.81% in livestock products. The lower levels of non-core inflation were also due to the decrease from -4.21% to -6.52% in the annual variation of energy prices, with the decline from 2.43 to 1.53% in the price of gasoline and from -26.38 to -30.84% in that of LP gas standing out.

Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between April and May 2023 the median for headline inflation at the end of 2023 decreased from 5.05 to 5.02%, while that for the core component moved from 5.36 to 5.40%. The median for headline inflation expectations for the end of 2024 declined from 4.10 to 4.07%, while that for the core component increased from 4.10 to 4.17%. The medians of headline and core inflation expectations for the next four years remained at 3.80%. The median of headline inflation expectations for longer terms (5 to 8 years) increased from 3.55 to 3.60%, while that for the core component was adjusted from 3.55 to 3.56%. Finally, compensation for inflation and inflationary risk rose since the previous monetary policy decision. Within it, expectations implied by market instruments remained stable, while the inflation risk premium decreased between April and May, although it increased slightly in June.

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



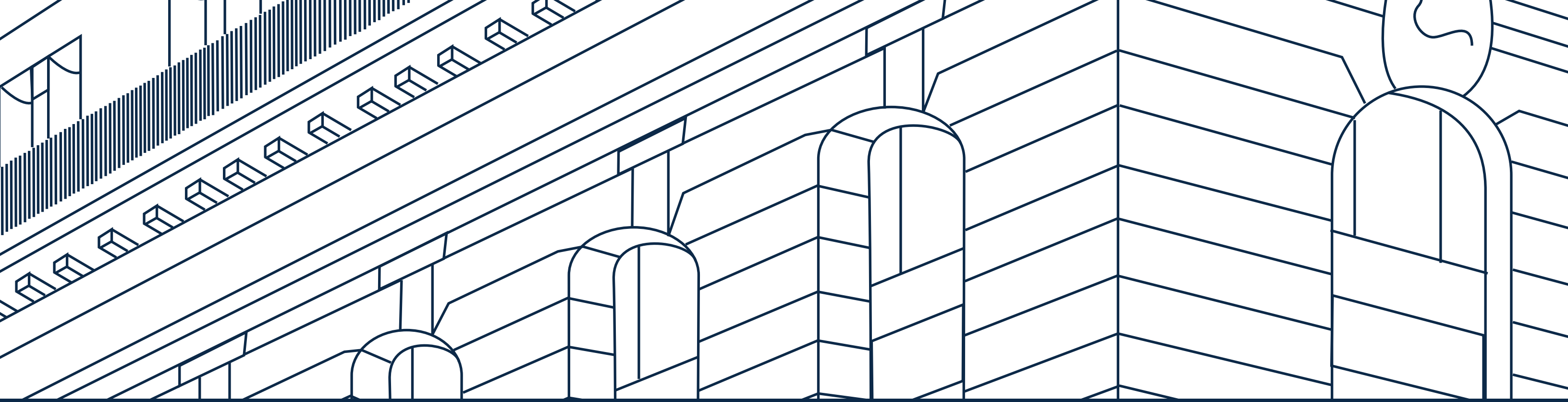
Source: INEGI.

Inflation is still projected to converge to the 3% target in the fourth quarter of 2024. These projections are 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) a better functioning of production and distribution chains; 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	April 2023	May 2023	1st fortnight June 2023
CPI	**6.25**	**5.84**	**5.18**
Core	**7.67**	**7.39**	**6.91**
Merchandise	**9.54**	**9.04**	**8.33**
Food, beverages and tobacco	12.14	11.44	10.67
Non-food merchandise	6.59	6.30	5.65
Services	**5.46**	**5.43**	**5.23**
Housing	3.67	3.67	3.66
Education (tuitions)	4.88	4.88	4.83
Other services	7.10	7.01	6.63
Non-core	**2.12**	**1.24**	**0.03**
Agricultural and livestock products	**6.13**	**4.95**	**3.19**
Fruits and vegetables	3.73	3.73	3.67
Livestock products	8.01	5.91	2.81
Energy and government-authorized prices	**-1.08**	**-1.83**	**-2.60**
Energy products	-4.21	-5.48	-6.52
Government-authorized prices	6.78	6.99	6.87

Source: INEGI.



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