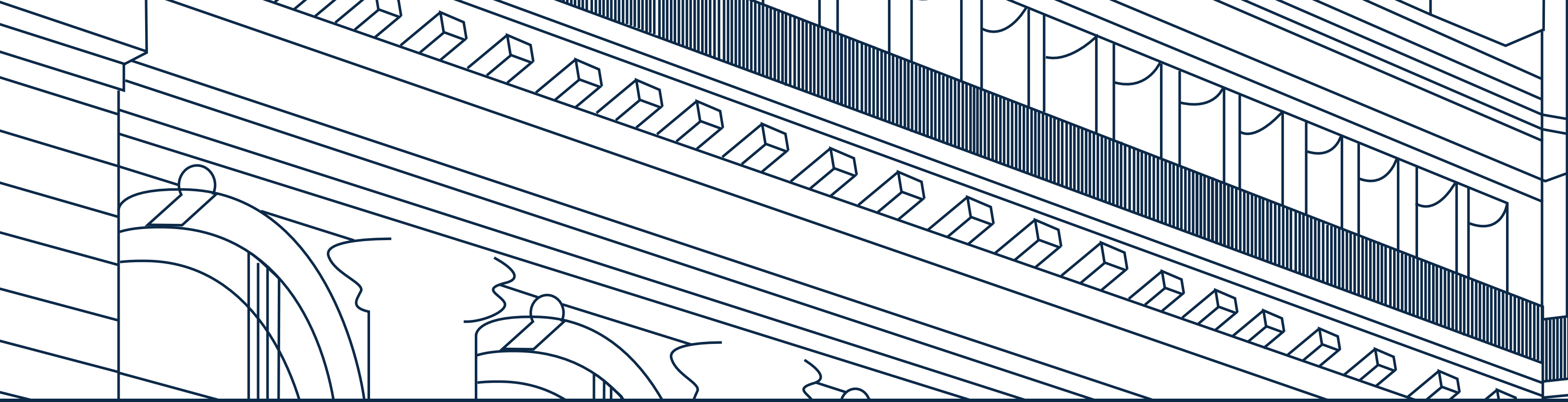

BANCO DE MÉXICO®

Minutes number 105

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on December 14, 2023

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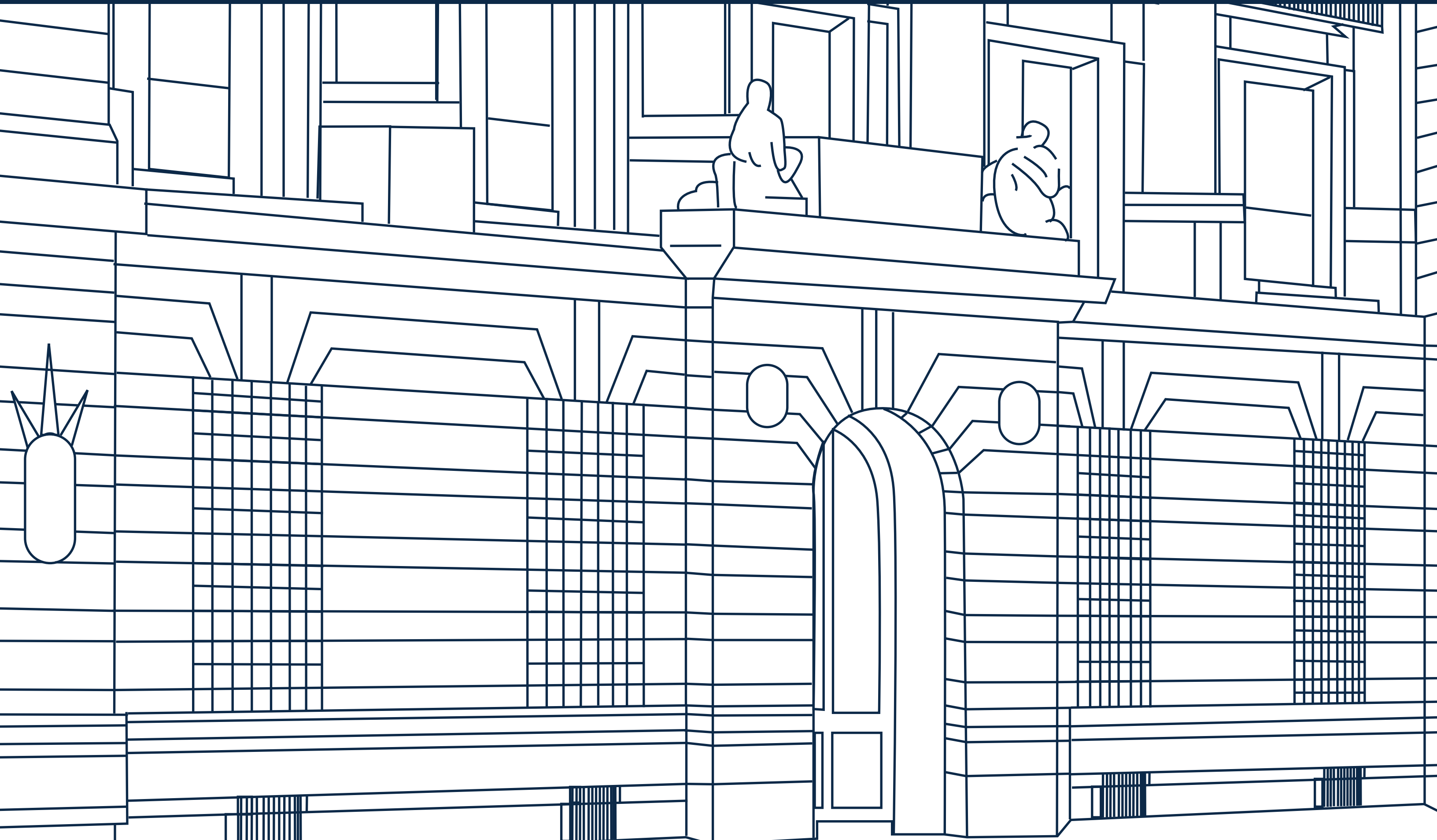

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: December 13, 2023.

1.3. Participants:

- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- 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 stated that world economic activity continued expanding during the third quarter of 2023. Some members highlighted that it surprised to the upside. **One** member noted that growth was higher than that registered in the second quarter. **Some** members underlined that economic dynamism continued despite the tightening of global financial conditions. However, **one** member indicated that economic activity in the euro area remained weak, while in China, industrial production stagnated and fixed investment continued declining.

The majority highlighted that available information suggests that the pace of expansion of world economic activity would have slowed down during the fourth quarter of 2023. One member added that a deceleration is foreseen for 2024. **Some** members underlined the anticipated economic moderation in the euro area for that year. Furthermore, **one** member mentioned that in China economic growth is expected to remain below the average observed from 2013 to 2019 and that, therefore, authorities have announced new stimulus measures, while greater heterogeneity prevails in the rest of the emerging economies. Meanwhile, **another** member argued that in the United States manufacturing continues showing a lack of dynamism. He/she added that some important companies revised their sales projections for 2024 downwards in their corporate reports, given the recent trend in consumption. **Some** members noted that, despite the expected slowdown, growth prospects for the United States have been continuously revised upwards. Regarding the balance of risks to global economic activity, **one** member considered that it remains biased to the downside. He/she noted that some factors have become more relevant, such as the uncertainty about the impact of tighter credit conditions, the reduction in households' excess savings in the United States, and the effect of higher interest rates on businesses and households when they face the need to refinance. He/she also noted the problems in China's real estate sector.

Most members highlighted that labor markets in several countries remain tight. One member considered that the US labor market continues being strong despite the tightening of monetary conditions. **However, most members mentioned that these markets have shown signs of some easing. One** member described that, in the United States, during the second half of 2023, the non-farm payroll registered monthly increases close to their pre-pandemic average, vacancies continued trending downwards, and labor force participation rates moderated somewhat. **Another** member stated that job creation figures in that country had been surprising to the downside, although the most recent non-farm payroll report did so to the upside.

Most members pointed out that the disinflationary process continued advancing at the global level. They mentioned that headline inflation kept declining in most economies, although it remains above their central banks' targets. One member highlighted that in the United States inflation even surprised to the downside in more recent readings. **Another** member argued that the decline in global inflation has been due to the fading of supply shocks associated with the pandemic, to the lower pressures on energy, food and goods prices, as well as to central banks' restrictive policy stances.

Most members noted that core inflation decreased globally, although more gradually than headline inflation. They attributed the latter to the persistence of services inflation. One member stated that, looking ahead, uncertainty prevails about the pace of convergence of inflation to the central banks' targets, which is expected to occur between the end of 2024 and the first half of 2025. **Another** member pointed out that there were slight reductions in inflation expectations implicit in short- and long-term financial instruments, as well as in consumer expectations, although they remain above the monetary authorities' targets.

As for commodity prices, **some** members stated that, in general, they decreased significantly in 2023. However, they highlighted the increase in the international prices of sugar. **The majority pointed out that, since the last monetary policy decision, international crude oil reference prices continued trending downwards.** However, **one** member warned that, given the global demand and production cuts, this trend could reverse.

Most members mentioned that the central banks of the major advanced economies left their reference rates unchanged. They added that these are expected to have reached the end of their upward cycles or be nearing them. One member noted that analysts and market participants no longer anticipate additional increases in the Federal Reserve's federal funds rate. **Another** member stated that the European Central Bank and the Bank of England are expected to keep their interest rates unchanged in their December decisions and to begin their cutting cycles in June 2024. **Some** members added that the expectation of the first policy rate cut was brought forward in these economies. **Some** members pointed out that lower reference rates are now expected for 2024 and 2025, as compared to those previously anticipated. **One** member highlighted that fewer concerns about the geopolitical conflict in the Middle East, the downward trend in inflation in most economies, the moderation in the labor market, and lower fiscal pressures in the United States, have contributed to the perception in financial markets that the message of high interest rates lasting longer in the major advanced economies is less likely to hold. **Some** members indicated that, looking forward, the central banks will maintain a data-dependent approach.

Most members mentioned that in its last meeting the US Federal Reserve left the target range for the federal funds rate unchanged. They indicated that such institution reiterated that it will proceed in a careful manner and maintain a data-dependent approach. **One** member highlighted that, both in the monetary policy statement and at the press conference, it was stated that the monetary restriction will remain at its current level for some time. He/she added that the Fed's most recent forecasts show that there could be between two and four 25 basis-point cuts next year. **Another** member pointed out that these forecasts consider that at the end of 2024 and 2025 the federal funds rate will be 50 and 30 basis points below what was suggested in previous projections. He/she added that inflation forecasts were also revised slightly downwards. He/she highlighted that these modifications take place in a context in which Federal Open Market Committee (FOMC) members have placed greater emphasis on the effects of high interest rates on households and firms, which have started to postpone their investment plans due to high financing costs. **Most members stated that markets expect the first cut in the second quarter of 2024. Some** members indicated that expectations implied by market instruments for the end of 2024 point to a greater decline in the federal funds rate than the Federal Reserve's projections.

Most members agreed that several factors contributed to the recent developments in international financial markets. In particular, they mentioned the expectation that the central banks of the major economies will begin lowering the reference rate sooner than previously anticipated. In this regard, **one** member considered that this was influenced by the moderation in the dynamics of the US labor market. **Another** member added the slowdown in the rate of expansion of economies worldwide. **Most members stated that this was also due to decreased concerns about the possibility of an escalation of geopolitical conflicts, and less uncertainty regarding the US fiscal environment. Most members argued that markets have recently exhibited greater risk appetite. In this context, they highlighted that interest rates on government securities declined globally, the US dollar registered a generalized depreciation, and valuations of major stock markets rebounded. One** member considered that all of the above was reflected in an easing of global financial conditions. **Another** member underlined the positive performance of financial markets in Latin America and Emerging Europe. However, he/she pointed out that capital outflows were registered in both fixed-income and equity markets. **In this regard, the majority highlighted the volatile behavior of international financial markets. One** member noted that this has been due to the fact that, in an uncertain environment, they have been highly sensitive to economic data. **Another** member stated that, looking ahead, bouts of volatility cannot be ruled out given the data-dependent approach of some central banks.

Economic activity in Mexico

All members mentioned that Mexico's economic activity has continued showing dynamism. Most members stated that GDP growth in the third quarter of 2023 was driven by the three sectors of economic activity. One member highlighted that it registered a seasonally adjusted quarterly growth rate of 1.1%, expanding for eight consecutive quarters. **Another** member added that this implied an acceleration with respect to the first two quarters. **One** member highlighted that growth was higher than anticipated. **Another** member noted that, during the year, the observed pace of expansion of economic activity has surpassed on several occasions the forecasts by different organizations. He/she mentioned that Banco de México's growth forecasts for 2023 have been continuously revised upwards. He/she stated that, looking ahead, more recent projections suggest that economic growth will remain robust in 2024, thus consolidating one of the longest expansions in recent years. **One** member pointed out that it cannot be ruled out that, looking forward, Mexico's economy turns out to be more resilient than expected. In this regard, **another** member noted that it is becoming increasingly feasible that the nearshoring process will continue. He/she added that, furthermore, the slowdown in the US economy could be less profound than expected. However, **one** member stated that such slowdown could be greater than anticipated. Therefore, he/she considered that risks to economic activity are perceived as balanced.

On the production side, most members noted that industrial activity continued trending upwards, driven by the dynamism of the construction sector. Some members mentioned that manufacturing continues showing sluggishness. **One** member pointed out that this mirrors the weakness exhibited by the same sector in the United States. **Another** member indicated that manufacturing, excluding transportation equipment, has contributed only to a small extent to growth due to weakness in most of its subsectors. **Most members highlighted the dynamism of services and their contribution to the expansion of economic activity.** However, **some** members considered that its subsectors performed heterogeneously.

As for domestic demand, all members pointed out that investment has exhibited significant dynamism. Most members mentioned the high levels of non-residential construction, although **one** member added that it declined marginally in September. **Some** members explained that these high levels are largely attributed to the performance of public investment. **One** member stated that private investment has also contributed to the above, given the positive expectations on nearshoring. **Most members highlighted that growth of the machinery and equipment component has also contributed to the strength of investment. As for private consumption, all members argued that it continued expanding. Some** members underlined its sound performance. **Some** members pointed out the positive behavior of consumption of imported goods. **One** member noted the performance of consumption of services. **Some** members emphasized that the strong dynamism of the labor market has supported consumption. **As for external demand, most members pointed out that it has been resilient, mainly supported by the rebound in automotive exports.** However, **some** members highlighted that non-automotive exports remain weak.

Most members indicated that the point estimate for the output gap widened in positive territory. One member stated that it remains on an upward trend. **Another** member pointed out that the economy is projected to continue growing above its potential rate. However, **one** member underlined that the output gap estimate is not statistically different from zero. He/she added that it is expected to approach zero during the forecast horizon.

All members considered that the labor market remains strong. Most members highlighted that unemployment rates remain at historically low levels. Some members stated that employment registers high levels of growth. **One** member mentioned that the unemployment gap is in negative territory. **Another** member expressed that the labor participation rate is at levels similar to those observed prior to the pandemic. Nevertheless, **some** members stated that certain timely indicators drawn from surveys conducted by Banco de México suggest a possible moderation in the labor market's dynamism. In this regard, they described that these indicators point to shorter time-to-hire periods, less difficulty in hiring workers, and a decline in the number of vacancies. **One** member added that the growth of formal employment has slowed.

Most members highlighted that wages continue increasing at high rates. Some members underlined that the average base salary of IMSS-insured workers has increased by more than 6% in real terms in the last three months. **One** member added that the real wage bill of this group of workers is growing at a rate close to 10%. **Another** member stated that the annual variation of workers' average nominal wage calculated by the National Occupation and Employment Survey (ENOE, for its acronym in Spanish) shows a clear upward trend for both formal and informal wages. He/she added that the minimum wage will increase by 20% in 2024. **One** member indicated that wage dynamism has remained high throughout the year and that the increased fraction bound by the minimum wage has led to an increasingly large pass-through on to the average wage. He/she added that, although these increases are not yet proportional, and for a long period there was enough space to make these adjustments, it will be important to monitor that wage increases are consistent with price stability.

Inflation in Mexico

Most members considered that inflation has decreased significantly throughout the year. Some members pointed out that progress in disinflation is illustrated by comparing current inflation levels with those registered in 2022 and early 2023. **One** member indicated that annual headline inflation has declined by approximately 250 basis points since March 2023 and currently stands significantly below its peak of 8.70% observed in August 2022. **Another** member stated that in September 2022 headline inflation was 570 basis points above target, whereas now it is 132 basis points above it. He/she asserted that during this episode headline inflation has declined faster than in other periods. He/she noted that in 2009 and 2017 headline inflation decreased at an average monthly rate of 25 and 16 basis points, respectively, while in the current episode it has done so at a rate of 35 basis points per month. **Some** members underlined the improvement in various metrics such as the decrease in the proportion of CPI items with high variations, the increase in the proportion of those with variations under 3%, and the decline in the trimmed mean indicator. **One** member added the trend of seasonally adjusted monthly inflation and the evolution of the inflation rates observed across different Mexican cities. **Another** member added the reduction in the frequency of price revisions. **Most members estimated that inflation pressures have eased considerably during the year.**

Most members pointed out that after reaching 4.26% in October, headline inflation increased slightly to 4.32% in November. They mentioned that this upward adjustment was due to the rise in the non-core component, as core inflation continued decreasing. One member asserted that in recent months core inflation has had a larger contribution to the disinflation process. **Some** members recalled that disinflation processes are complex. **One** member stated that the recent rebound does not imply that the disinflationary process has come to a halt. He/she argued that the non-linear behavior of the disinflationary process is a result of a heterogeneous timing in the decline of the different components of inflation.

Most members pointed out that core inflation registered 5.30% in November. One member underlined that this reading is the lowest since October 2021. **Another** member noted that annual core inflation has declined in every month of the year. **Some** members highlighted that this component has dropped 321 basis points since November of last year when it reached 8.51%. **Some** members indicated that most of this decrease occurred since March 2023, when the reference rate reached its current level. **One** member pointed out that core inflation has fallen by 299 basis points since that month. He/she added that it has fallen at a rate of 27 basis points per month during this inflationary episode, compared to 16 and 15 basis points during the episodes of 2009 and 2017, respectively. **Another** member stated that the annualized seasonally adjusted monthly inflation of the core component, which had been declining, registered an inflection point during the second half of 2023.

Regarding the components of core inflation, most members noted that merchandise inflation continued decreasing, registering 5.33% in November. One member highlighted that the favorable performance of this indicator has been due to both the appreciation of the exchange rate, which has eased pressures on the prices of imported goods, and the moderation of international prices of several intermediate goods. However, **some** members pointed out some deterioration in the dynamics of food merchandise prices at the margin, highlighting the increase in sugar prices. **One** member indicated that the seasonally adjusted monthly variations of food merchandise prices have been increasing so far in the fourth quarter, after having fallen to levels below 4%. **Another** member added that annual food merchandise inflation remained at high levels, registering 6.78% in November.

Most members agreed that annual services inflation still does not show a clear downward inflection point and indicated that in November it registered 5.28%. One member noted that trend indicators of this component, which accounts for one-third of headline inflation, continue showing no signs of improvement. He/she stated that monthly variations of services prices have remained at high levels. **Some** members asserted that the higher relative demand for services after the lockdown appears to be enabling this sector's businesses to pass onto consumers the accumulated costs as a result of the shocks associated with the pandemic and the military conflict. **One** member stated that the above resulted in an important distortion of the relative price of merchandise relative to services, which lies well above its long-term equilibrium, and therefore it is natural to continue observing adjustments in relative prices, which does not necessarily imply the emergence of new sources of inflationary pressures.

Most members pointed out that non-core inflation registered 1.43% in November. One member expressed that this component declined during the first seven months of the year, although it has exhibited an upward trend in the last four months. **Some** members considered that this component has started to revert towards its historical average. However, **one** member noted that the November reading still remains at low levels.

Regarding inflation expectations, **one** member considered that their distribution continues showing improvement for all terms. He/she stated that expectations for the next 12 months kept decreasing and accumulated a 107 basis-point drop since headline inflation reached its peak. However, **another** member mentioned that longer-term inflation expectations remain at levels above target. He/she pointed out that they are above their historical average registered prior to 2020. He/she added that expectations drawn from surveys and those implicit in market instruments remain above the central bank's projections. He/she warned that they are not decreasing at a pace required to reach the target by the second quarter of 2025. **One** member noted that, even though the monetary policy stance has allowed analysts' expectations to remain anchored, their distribution still lies to the right of that prevailing prior to the pandemic. He/she indicated that expectations drawn from market instruments continue exhibiting few signs of improvement. He/she also pointed out that business sector expectations are still at high levels. He/she underlined that breakeven inflation for different terms remains elevated.

Most members highlighted that the central bank's forecasts for headline inflation were revised upwards for some quarters. Some members mentioned that forecasts for core inflation were also adjusted upwards. **Most members indicated that current forecasts consider a more gradual decline in food merchandise inflation and in services inflation. One** member stated that, in the revised forecasts for headline inflation, the higher pressures on services and food merchandise prices are partially offset by the lower variations foreseen in energy prices.

The majority mentioned that the new forecasts do not imply a change in the inflation trend and that the outlook of a continuing disinflationary process is maintained. They added that inflation is still expected to converge to the target in the second quarter of 2025. One member asserted that this forecast considers the monetary policy actions implemented and the fading of shocks' effects. **Another** member estimated that the easing of the shocks will be reflected in a more noticeable decline in services inflation. **One** member expressed that the disinflationary process is undergoing a phase in which progress will be slower. He/she added that non-core inflation is expected to continue trending upwards during the first six months of 2024.

Most members stated that the inflation outlook continues posing challenges. They considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member warned that it cannot be ruled out that inflation may take longer to converge to the target. However, **some** members pointed out that, despite the risks, the current inflationary outlook has improved as compared to that prevailing in late 2022 and in early 2023.

Among upward risks to inflation, most members highlighted the persistence of core inflation at high levels. Some members warned about the possibility of a greater-than-expected resilience of the Mexican economy. **One** member mentioned that the output and unemployment gaps, along with other slack indicators, suggest the presence of demand-related inflationary pressures. He/she considered that said pressures are reflected in the high levels of services inflation. In addition, he/she underlined the risk of annual merchandise inflation halting its downward adjustment. He/she added that the exhaustion of the comparison base effect poses a challenge for the process of convergence to the inflation target. He/she expressed that core inflation's downward trend may be interrupted in December and January. **Another** member warned that a prolonged deviation of inflation from its historical average could affect the formation of prices, wages, and expectations, making price dynamics more vulnerable to emerging shocks, even if they were moderate. He/she indicated that this would represent a challenge to the pace of convergence, especially if such shocks altered the dynamics of the non-core component beyond what was anticipated. He/she pointed out that the foreseen trajectory will depend on the favorable evolution of the non-core component, the duration of the shocks' effects, and on the absence of new pressures on inflation.

Most members warned about the possibility of greater cost-related pressures. Some members noted that such pressures could arise from the evolution of the exchange rate. **One** member added that they could result from changes in the international references of various inputs. **Another** member mentioned that there is high uncertainty regarding commodity prices. **Some** members indicated the possibility of pressures arising from wage adjustments. **One** member added to the above some idiosyncratic factors, such as those associated with insecurity, water scarcity, and climate-related phenomena.

Some members identified the procyclical fiscal policy as a risk to the inflation outlook. In this regard, **some** members expressed the possibility that the fiscal stance may entail a higher aggregate demand. **One** member mentioned that, although the outlook for sovereign credit ratings remains stable, the trajectory of the public debt-to-GDP ratio, which is relevant for credit ratings, is sensitive to macroeconomic assumptions. He/she argued that a lower-than-expected growth or an exchange rate depreciation could negatively impact the public debt-to-GDP ratio and, consequently, credit ratings. He/she added that the greater dependency on federal government support without a plan to ensure Pemex's feasibility poses a risk to the sustainability of public finances. He/she underlined that the electoral process in the United States could lead to episodes of foreign exchange rate volatility similar to those observed between 2016 and 2017. He/she added that, in addition to the above, this time said event will occur simultaneously with Mexico's general elections. Regarding risks to the downside, **another** member mentioned the possibility of a greater-than-anticipated slowdown of the world economy, particularly in the United States.

Macrofinancial environment

The majority indicated that, in line with the developments in international financial markets, domestic financial assets performed favorably. They mentioned that trading conditions in the foreign exchange market improved. They added that the Mexican peso appreciated slightly. One member highlighted that in recent weeks it traded again at levels below 17.50 pesos per dollar. **Some** members underlined that so far in 2023 the Mexican peso has accumulated an appreciation of almost 11%. **One** member stated that said appreciation stands out among emerging economies' currencies. **Some** members specified that sound macroeconomic fundamentals are among the factors that have contributed to support the national currency. **One** member added to the above the higher risk appetite among investors and the solid monetary policy stance. **Another** member underlined the wide volatility-adjusted spread between external and domestic interest rates, the optimism regarding nearshoring, and the generalized depreciation of the US dollar. **One** member mentioned that the Mexican peso is highly sensitive to external factors that could increase its volatility. However, he/she stated that throughout the year the national currency has exhibited flexibility and resilience.

Most members noted that, since the last monetary policy decision, government bond yields decreased, mainly those for medium and long terms. One member highlighted inflows from non-resident investors to various government securities. **Another** member underlined that sovereign risk premia decreased, behaving similarly to other emerging economies. **One** member noted that, during the same period, the stock market performed favorably, exhibiting gains of over 6%. **Another** member mentioned that it has accumulated a 12% increase in 2023. He/she added that TIIE swaps decreased in all of their nodes. **Some** members argued that, in this regard, both markets and analysts incorporate a cut in the reference rate in the first quarter of 2024, as well as a 200 basis-point reduction for the entire 2024.

Regarding total financing in the economy, **one** member noted that it continued growing in real terms. **Some** members highlighted the expansion of the domestic component. **One** member underlined the growth of credit to firms and consumer credit. He/she pointed out that, in contrast, external financing weakened. He/she stated that, based on October figures, the financial conditions index for Mexico has slightly tightened and remains in restrictive territory. He/she added that delinquency rates are at low and stable levels, although those corresponding to consumption and corporate loans have recently registered a marginal increase.

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 acknowledged the progress of the disinflationary process in Mexico. Nevertheless, it estimated that the outlook is still challenging. Based on the above, and taking into consideration the monetary policy stance already attained and the persistence of the shocks that the Mexican economy is facing, with the presence of all its members, the Board decided unanimously to maintain the target for the overnight interbank interest rate at 11.25%. With this decision, the monetary policy stance remains in the trajectory required for inflation to converge to its 3% target within the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. It considers that, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, the reference rate must be maintained at its current level for some time. The latter, taking into account that although the outlook remains complicated, progress on disinflation has been made. 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 argued that, in light of ongoing pressures on the core component, especially on food merchandise and services' prices, and considering the revised inflation forecasts, the reference rate should be maintained at 11.25% in this monetary policy meeting. He/she deemed it prudent to emphasize in the monetary policy statement the need for the reference rate to remain at its current level for some time in order for inflation to converge to the target. He/she underlined that, while the nominal rate has remained unchanged since March 2023, in view of the decline in one-year inflation expectations, the ex-ante real interest rate continued increasing as required by the complex inflationary environment, and its whole distribution lies clearly in restrictive territory. He/she added that, during the same period, the disinflation process continued making significant progress. He/she pointed out that since march headline inflation declined by about 250 basis points, and core inflation by 280 points. He/she specified that the latest inflation readings illustrate considerable progress in disinflation, and that the current situation is less adverse than that faced in 2022 and in the early months of 2023. However, he/she acknowledged that the inflationary environment continues posing challenges. He/she pointed out that headline inflation is still above the 3% target, and that the balance of risks for its foreseen trajectory remains biased to the upside. In this context, he/she mentioned that, during the meetings of the first quarter of 2024, caution must be exercised when evaluating the possibility of lowering the reference rate. He/she indicated that a cautious approach implies that, when macroeconomic conditions allow, downward adjustments should be gradual, and decisions be such that the monetary policy stance remains solid to achieve the convergence of inflation to the target. He/she stated that the prevailing level of monetary restriction will be weighed against further decreases in inflation, its levels at that time, its outlook, as well as that of its determinants. He/she explained that all of this will imply monitoring a wide range of variables, and that decisions made at the time will be data-dependent. He/she reiterated that, in compliance with the primary mandate of Banco de México, monetary policy's priority is to reduce inflation levels and consolidate an environment of low and stable inflation to the benefit of Mexico's population.

Another member expressed that there are still risk factors that could hinder the foreseen trajectory of inflation towards the 3% target, which could complicate the conduction of monetary policy next year. He/she highlighted the possibility that the resilience of economic activity continues through the horizon of monetary policy planning, the cyclical position of the economy in positive and increasing territory, that the labor market remains tight and does not show signs of easing, the persistence of core inflation, inflation expectations that are not declining to the required levels, and the procyclical fiscal policy. He/she added that new episodes of peso depreciation could occur and affect inflation, in case of adjustments in expectations regarding the Federal Reserve's actions. He/she also mentioned the high uncertainty regarding commodity prices, especially energy-related ones, as a result of a potential escalation or continuation of geopolitical conflicts. In view of the environment of high uncertainty and the risks mentioned above, he/she considered it essential to maintain the level of monetary restriction attained. Thus, he/she indicated that in this meeting the reference rate should be maintained at 11.25%. He/she argued that, in his/her opinion, monetary policy communication should maintain a cautious tone and emphasize that the balance of risks for the trajectory foreseen for inflation remains biased to the upside. Likewise, he/she considered that, given this environment, the reference rate will likely need to remain at its current level longer than expected by markets. As a result of the above, he/she emphasized that a data-dependent approach should continue to be followed, allowing flexibility in future decisions and avoiding any sign of complacency, as the outlook can change rapidly due to both external and domestic factors. He/she concluded that the Mexican economy has a high exposure to both external and domestic risks, and the materialization of these risks would further deteriorate the already complex inflation outlook and affect monetary policy implementation. Under these conditions, he/she expressed that now more than ever a message of prudence and caution must be conveyed.

One member argued that, despite the strong monetary restriction implemented for over a year, economic activity remains robust, bank lending is growing in real terms, and risks to inflation remain biased to the upside. Thus, the inflationary problem continues. He/she mentioned that the economy's cyclical position requires a restrictive policy stance. He/she argued that certain idiosyncratic factors hinder the transmission of the restrictive policy stance, such as the lack of synchronization between fiscal and monetary policies. He/she also mentioned structural factors such as low levels of financial depth, low credit penetration, high levels of informality, and lack of competition in both the financial system and other sectors. He/she stated that the latter allows an environment of high margins by firms. Given the above, he/she considered that the reference rate should be maintained at 11.25% in this monetary policy meeting. He/she deemed it necessary to maintain the forward guidance unchanged in this occasion in order to communicate that the reference rate will be left at that level for some time. He/she added that monetary policy must still remain restrictive for an extended period. He/she highlighted that caution and prudence should be maintained in 2024 so as to avoid a premature easing. He/she pointed out that the real ex-ante interest rate has had a tightening cycle like no other since the adoption of the inflation targeting regime. He/she stated that, since November 2021, it has increased by 671 basis points, 84 of which have occurred since March 2023 when the reference rate was set at its current level. He/she warned that such rate should not exceed the range of 7-7.5%, which he/she deemed appropriate to ensure inflation convergence. Given the risk of an excessively restrictive policy stance that could impact economic activity or financial stability, he/she noted that a fine-tuning adjustment to the reference rate should be considered for the end of the first quarter or during the second quarter of 2024. He/she stated that, in order to evaluate monetary policy adjustments at the margin, it is imperative that upward risks do not materialize, that the pressures onto core inflation abate, that inflation adheres to the projected trajectory through the ongoing disinflation process, and that twelve-month inflation expectations continue declining, getting close to the target range. He/she mentioned that it should be clarified that a fine-tuning adjustment does not imply the beginning of a cycle of consecutive reference rate cuts, as the absorption of inflationary shocks, the decline in inflation, and the improvement of expectations are not continuous, constant, and homogeneous processes. He/she added that these fine-tuning adjustments would need to be implemented in a spaced, gradual, and cautious manner, which will represent the main communication challenge.

Another member argued that the disinflation process advanced significantly in 2023, associated with the fading of the shocks. He/she underlined the normalization of global supply chains and the decline in commodity prices. He/she explained that this, along with the monetary policy stance adopted, led to a better balance between supply and demand in various sectors. He/she indicated that, based on the international experience, when an economy is subject to shocks of great magnitude, inflation tends to decline significantly once the impact of such disturbances dissipates. However, he/she warned that inflation moderates its pace of deceleration once the original effects of the shocks that caused the price increases fade away. In this regard, he/she stated that disinflation will be characterized by being slower, just as the latest forecasts show, and that convergence to the target still requires a tight and cautious monetary policy stance given the upward biased distribution of risks. He/she highlighted that during 2023 it was necessary to consolidate a markedly restrictive policy stance in order to anchor inflation expectations and prevent disruptions in price formation in the economy. He/she noted that the expectations channel and the exchange rate channel played a key role in allowing inflation to decline rapidly and efficiently. Nevertheless, he/she underlined that during 2024 the channels most associated with demand will likely need to play a more relevant role. He/she pointed out that the experience suggests that these channels are particularly sensitive to the duration of tight monetary conditions, since the lags with which they operate are considerably long. He/she considered that, looking ahead, the challenge will be to calibrate both the magnitude of the restriction and its duration. He/she added that the communication strategy should allow for sufficient flexibility in each policy meeting, as the materialization of risks under a rigid forward guidance approach could lead to a time inconsistency. He/she reiterated that, in view of a complex inflationary outlook, and considering the uncertainty associated with inflection points, a data-dependent approach should be maintained, incorporating all available information and keeping various options on the table. He/she underlined that the monetary policy stance should be assessed according to the circumstances and prudently, in order to comply with the constitutional mandate and to ensure an orderly adjustment of the economy and of financial markets.

One member considered that there are conditions to begin discussing the possibility of reference rate cuts in the next policy meetings. He/she highlighted the need to take into account the progress in the disinflationary process. He/she reiterated the significant reduction in both headline and core inflation from their peak levels. He/she added that, since March, when the reference rate reached its current level, the decline of the core component has been more evident, and remarked that during this period a passive tightening of 84 basis points has been accumulated. He/she underlined that, given the current policy stance, inflation is expected to continue trending downwards. Second, he/she pointed out that, even with reference rate cuts, the monetary policy stance will remain sufficiently solid to continue supporting the convergence of inflation. He/she noted that, although the recent inflationary episode has been atypical, the current level of the reference rate is above any historical reference, taking into account the current level of inflation. He/she specified that the current level of the reference rate is higher than the average observed during periods in which headline inflation has been between 4 and 4.5%, of 5.95% for the nominal rate, and of 2.06% for the real one. He/she pointed out that when core inflation was between 5 and 5.5%, the nominal and real rates averaged 7.28 and 2.93%, respectively. Third, he/she added that the recent dynamics of services prices responds to a necessary adjustment, after merchandise prices deviated from their long-term equilibrium relative to services prices due to the shocks faced. He/she mentioned that the absolute monetary policy stance attained is sufficiently robust to address possible changes in the relative stance. He/she also considered that some inflation determinants have improved compared to what was observed at the end of last year. He/she highlighted that the challenge ahead is to adjust the degree of monetary restriction in a non-linear disinflationary context. He/she argued that future policy meetings should assign greater weight to the already observed and expected behavior of the inflationary outlook in its entirety, including the evolution of its determinants and its balance of risks, and not rely exclusively on specific data. He/she added that it will be necessary to take into account that inflation, while remaining above target, has declined considerably. Finally, he/she estimated it pertinent to communicate that the reference rate will remain at its current level for some time and that, given the expected evolution of the overall outlook and the prevailing uncertainty, adjustments would be gradual and not necessarily continuous.

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 acknowledged the progress of the disinflationary process in Mexico. Nevertheless, it estimated that the outlook is still challenging. Based on the above, and taking into consideration the monetary policy stance already attained and the persistence of the shocks that the Mexican economy is facing, with the presence of all its members, the Board decided unanimously to maintain the target for the overnight interbank interest rate at 11.25%. With this decision, the monetary policy stance remains in the trajectory required for inflation to converge to its 3% target within the forecast horizon.

The Board will thoroughly monitor inflationary pressures as well as all factors that have an incidence on the foreseen path for inflation and its expectations. It considers that, in order to achieve an orderly and sustained convergence of headline inflation to the 3% target, the reference rate must be maintained at its current level for some time. The latter, taking into account that although the outlook remains complicated, progress on disinflation has been made. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

4. VOTING

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

ANNEX

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

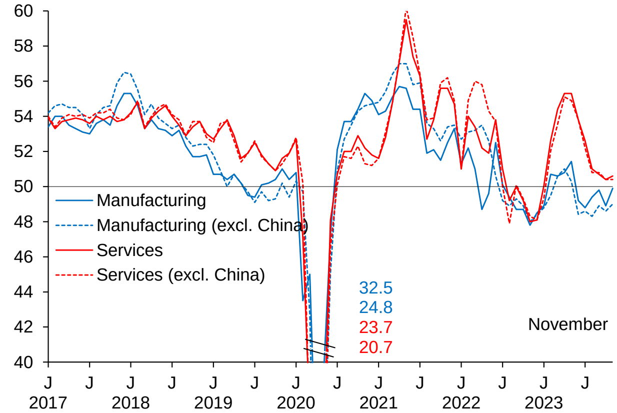
A.1. External conditions

A.1.1. World economic activity

During the third quarter of 2023, global economic activity expanded at a greater rate than in the previous quarter. However, available information suggests a slowdown during the fourth quarter of the year. Although in general both advanced and emerging economies are expected to exhibit less dynamism than in the third quarter, performance is foreseen to be heterogeneous among countries. Purchasing Managers' Indices continued pointing to a deceleration in services, mainly in advanced economies, as well as to a persistent sluggishness in manufacturing activity at the global level (Chart 1). Among global risks, the following stand out: persistence of inflationary pressures, intensification of geopolitical tensions, tighter financial conditions, and, to a lesser extent, challenges to financial stability.

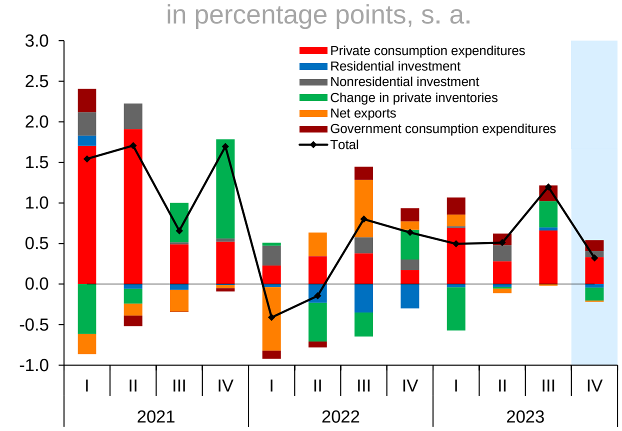
In the United States, available indicators for the fourth quarter suggest that Gross Domestic Product (GDP) would moderate its rate of expansion (Chart 2), after having grown at a seasonally adjusted quarterly rate of 1.3% in the third quarter of the year.[1] During the fourth quarter of 2023, economic activity would be mainly driven by private consumption, non-residential investment, and government spending. This would be partially offset by negative contributions from residential investment, net exports, and the accumulation of inventories.

Chart 1
Global: Purchasing Managers' Index: production component
Diffusion index, s. a.1/



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

Chart 2
US: real GDP and components
Quarterly percentage rate and contribution in percentage points, s. a.



s. a. / Seasonally adjusted figures.
Note: The shaded area refers to Atlanta Federal Reserve's GDPNow forecasts as of December 7.
Source: Bureau of Economic Activity (BEA).

In October, US industrial production decreased at a seasonally adjusted monthly rate of 0.6%, after having remained stagnant in the previous two months. Manufacturing activity also declined 0.7%. This drop was largely due to a 10% contraction in vehicle production that was associated with strikes in the automotive sector, which ended in late October.

[1] Expressed as a seasonally adjusted annualized quarterly rate, the change in US GDP was 5.2% in the third quarter of 2023.

Looking ahead, Purchasing Managers' Indices suggest that activity in the services sector will be moderate and manufacturing production will remain somewhat sluggish.

The US labor market remained tight. However, some indicators have shown signs of easing. The non-farm payroll expanded at a more moderate pace, going from a monthly average creation of 221 thousand new jobs during the third quarter to an average of 175 thousand new jobs in October and November. The number of new vacancies fell from 9.3 million in September to 8.7 million in October. Initial claims for unemployment insurance remained at low levels, with 202 thousand new claims in the week that ended on December 9. Wage indicators showed a moderation. In particular, average hourly wages registered an annual variation rate of 4.4% in October, lower than the average rate of 4.6% observed in the third quarter. The unemployment rate decreased from 3.9% in October to 3.7% in November.

In the euro area, economic activity is expected to have remained weak in the fourth quarter of 2023, after GDP contracted at a seasonally adjusted quarterly rate of 0.1% in the previous quarter.[2] The weak expected performance would be attributed to the tightening of financial conditions, which is increasingly affecting investment and consumer spending. Additionally, industrial and manufacturing activities remain weak, while the services sector has lost dynamism. In October, the unemployment rate remained unchanged at 6.5%.

Most major emerging economies are expected to expand in the fourth quarter of 2023. However, growth rates are anticipated to vary among countries. The Chinese economy is foreseen to continue expanding during said period, although at a slower pace than in the previous quarter. In October, retail sales and industrial production in that country surprised to the upside, while fixed investment remained weak. This economy continues facing significant risks associated with problems in its real estate sector. The Chinese authorities have recently implemented new fiscal and monetary measures to boost its economy.

International prices of most commodities have declined since Mexico's last monetary policy decision. First, oil reference prices decreased in light of the mitigation of the initial impact of the Israeli-Palestinian conflict, production increases in the United States, plans for increased oil extraction in Angola and Nigeria, and a lower-than-expected growth in global oil demand in the fourth quarter of 2023. The latter was observed despite the fact that some members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+) agreed to voluntary cut production levels for the first quarter of 2024, which led to transitory upward pressures at the end of November. Similarly, natural gas prices decreased due to increases in production and exports in the United States, as well as forecasts of a lower demand due to the expectation of warm temperatures in that country, as well as to the end of the gas sector strike in Australia. Additionally, wheat and corn prices fell during the second half of November due to higher-than-expected production levels in the United States. However, wheat prices rose significantly at the beginning of December due to large purchases by China. Soybean prices increased in mid-November due to adverse weather conditions in Brazil’s productive regions, and then declined due to forecasts of better weather conditions for this crop. Finally, in the second half of November, metal prices rose due to the Chinese government's announcements of its intention to stimulate the construction sector, as well as to miners' strikes in Peru, and environmental protests against the mining sector in Panama that limited the supply of some metals.

A.1.2. Monetary policy and international financial markets

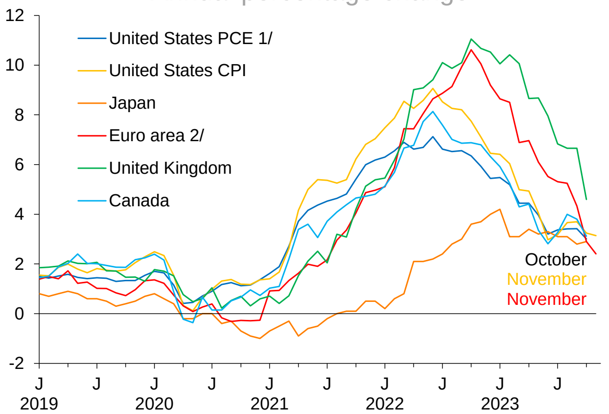
Annual headline inflation declined in a large number of major advanced and emerging economies. However, it remains above central banks' targets in most countries. Meanwhile, core inflation continued decreasing.

In most advanced economies, headline and core inflation declined in their most recent readings (Chart 3). However, the latter component has declined gradually, reflecting, to a large extent, a certain persistence in pressures on services prices. In the United States, annual headline inflation measured by the consumer price index fell from 3.2% in October to 3.1% in November. This was due to lower pressures on energy and food prices. The annual

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

variation of the core component remained practically unchanged at 4.0% during the same period. The country's headline inflation measured by the consumer expenditure deflator also decreased in annual terms, from 3.4% in September to 3.0% in October. Annual core inflation declined from 3.7 to 3.5% during the same period.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



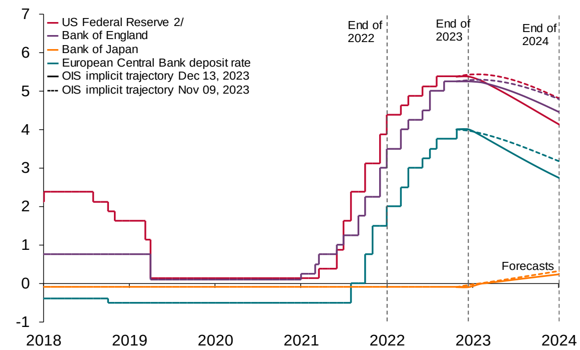
1/ The personal consumption expenditures price index is used.
2/ Preliminary figures as of November.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

Analysts' short-term inflation forecasts for most major advanced economies remained relatively stable and continued anticipating a moderation in headline inflation in 2024. However, it would remain above the targets set by their central banks. Longer-term inflation expectations drawn from financial instruments decreased slightly with respect to the levels registered at the beginning of November.

In a large number of emerging economies, annual headline inflation declined as a result of lower pressures on energy and food prices and on the core component. However, it remains above the targets of their respective central banks. In some cases, such as Brazil, South Africa, India and Indonesia, headline inflation was within each central bank's variability interval, while in China and Thailand, annual headline inflation registered negative levels. In most major emerging economies, core inflation declined.

In this environment, since Mexico's last monetary policy decision, most central banks of the main advanced and emerging economies have left their reference rates unchanged. Regarding future adjustments, several central banks indicated that their actions will depend on the evolution of relevant data and the inflation outlook. In some countries, central banks reported that they are prepared to make additional adjustments, if necessary, with the aim of bringing inflation back to their targets. In line with the above, most central banks of the major advanced economies maintained the gradual reduction of their securities' holdings. As for market expectations for the reference rate in the main advanced economies, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) are expected to remain at their current levels for the remainder of 2023 and the beginning of 2024, and then start decreasing in the second quarter of next year (Chart 4).

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



1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the U.S., the average interest rate of the target range of the federal funds rate (5.00%- 5.25%) is used.
Source: Banco de México with data from Bloomberg.

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

i) At its December meeting, the US Federal Reserve left the target range for the federal funds rate unchanged at 5.25-5.50% for the third consecutive decision. Additionally, it continued reducing the size of its balance sheet. It reiterated that it will continue evaluating incoming information and that, in order to determine the degree of additional tightening that might be appropriate, it will take into account the cumulative tightening of monetary policy, the lags with which it affects economic activity and inflation, as well as economic and financial developments. During the press conference, the chairman of that institution mentioned that the Federal

Open Market Committee (FOMC) began to discuss when it would be appropriate to start reducing the restrictive stance of monetary policy. However, he also stated that the Committee does not rule out the possibility of an additional increase in the reference rate. Regarding adjustments to the Committee's forecasts, between September and December, the median of the annual growth rate was revised upwards from 2.1 to 2.6% for the fourth quarter of 2023, while it was revised downwards from 1.5 to 1.4% for the fourth quarter of 2024, and was left unchanged at 1.8% for the fourth quarter of 2025. Headline inflation forecasts fell from 3.3 to 2.8% for the end of 2023, from 2.5 to 2.4% for the end of 2024, and from 2.2 to 2.1% for the same period of 2025. The Committee lowered its expectation for the federal funds rate for the end of 2023 from 5.6 to 5.4%. The expected level of the federal funds rate fell from 5.1 to 4.6% for the end of 2024 and from 3.9 to 3.6% for the end of 2025. Expectations drawn from financial instruments anticipate an interest rate of 5.1% for the end of the first quarter of 2024, which would subsequently decrease to levels close to 4.1% by the end of that year and to 3.2% by the end of 2025.

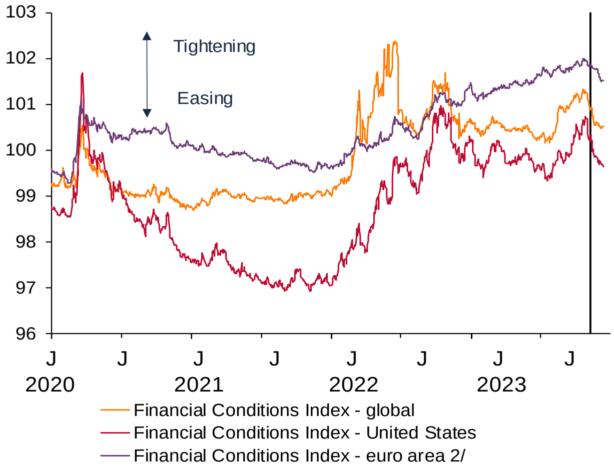
ii) At its December meeting, the European Central Bank (ECB) left its reference rates unchanged for the second consecutive decision. Thus, its refinancing, key lending and key deposit rates remained at 4.50, 4.75 and 4.00%, respectively. In this regard, its Governing Council reiterated that it considers that interest rates are at levels that, if maintained for a sufficiently long period, will contribute substantially to the timely return of inflation to its target. It indicated again that it will continue using a data-dependent approach to determine the appropriate duration and level of monetary tightening. Regarding its Pandemic Emergency Purchase Program (PEPP), the Governing Council decided to expedite the normalization of its balance sheet, seeking to fully suspend reinvestments of maturing securities purchased under the PEPP by the end of 2024.[3]

Since Mexico's last monetary policy decision, most central banks of the major emerging economies left their reference rates unchanged. In China, although its monetary policy reference rates remained unchanged, the central bank implemented alternative easing measures, such as injecting liquidity through its medium-term credit line. Considering the specific economic circumstances of each country, some central banks announced cuts to their reference rates, including those of Brazil, Peru and Hungary. In contrast, Turkey's central bank continued increasing its reference rate.

Since Mexico's last monetary policy decision, international financial markets showed, in general, more favorable conditions, in both advanced and emerging economies (Chart 5). This behavior reflected the expectation of a lesser tightening of monetary and financial conditions in light of figures that pointed to some rebalancing of slack conditions in the US labor market and of favorable inflation data. Thus, sovereign debt interest rates declined in most advanced economies (Chart 6). Stock markets in both advanced and emerging economies registered gains overall. In foreign exchange markets, the US dollar depreciated. Meanwhile, the currencies of most emerging economies appreciated against the US dollar (Chart 7). Lastly, during the reported period, emerging economies registered moderate capital outflows. However, flows showed a differentiated behavior among asset classes, with slight net inflows of equity assets and outflows of fixed-income assets during most of the period.

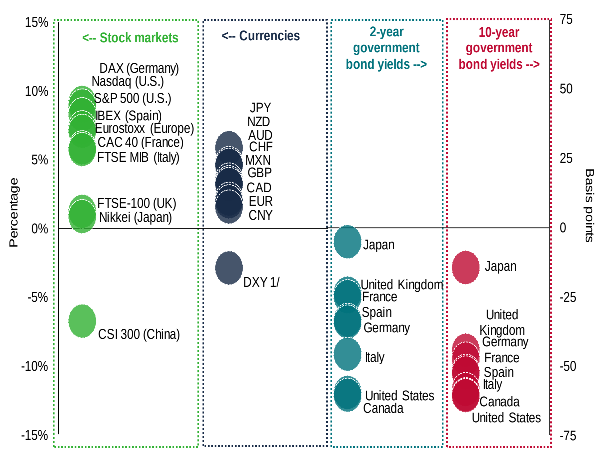
[3] During the first half of 2024, the Governing Council will reinvest in full the principal payments from maturing securities purchased under the PEPP. During the second half of the year, it intends to reduce the PEPP portfolio by 7.5 million euros per month on average, before interrupting reinvestments at the end of 2024.

Chart 5
Financial Conditions Index[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 November 9 to December 13, 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 November 3, 2023
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	0.48%	6.22%	-52	-56	-6
	Brazil	-0.39%	6.95%	-59	-55	-13
	Chile	0.52%	6.23%	-94	-109	-9
	Colombia	-0.35%	4.23%	-54	-38	-17
	Peru	-0.20%	2.66%	-34	-38	-7
Emerging Europe	Russia	1.39%	-4.20%	18	-14	N.A.
	Poland	2.91%	6.55%	2	-14	-1
	Turkey	-2.02%	3.63%	-16	-220	-33
	Czech Rep.	0.39%	1.96%	24	-34	-1
	Hungary	-0.25%	1.91%	-85	-62	-13
Asia	China	1.54%	-2.02%	5	2	-11
	Malaysia	1.33%	-0.55%	-12	-23	-13
	India	-0.12%	8.49%	-6	-4	-17
	Philippines	1.43%	4.10%	-61	-69	-10
	Thailand	1.06%	-2.73%	-15	-34	-17
	Indonesia	1.39%	5.46%	-23	-27	-11
Africa	South Africa	-3.35%	1.66%	-14	-25	-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 1, 2022.
Source: Bloomberg.

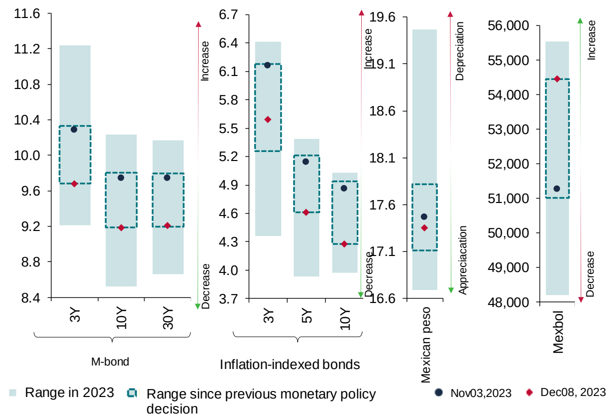
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

In the international context described, the Mexican peso appreciated slightly against the US dollar since Mexico's last monetary policy decision. Interest rates on government securities decreased, especially those for medium and long terms, in line with developments in international financial markets (Chart 8).

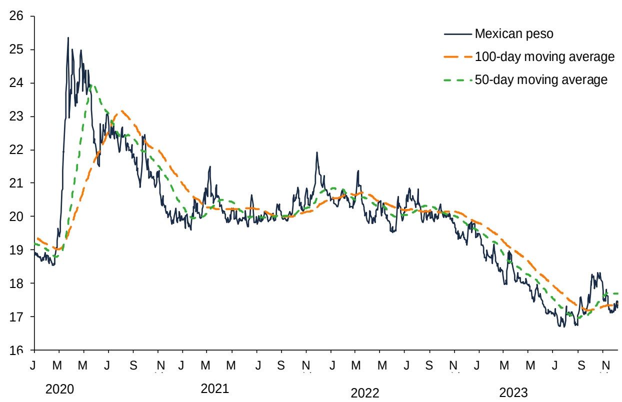
The Mexican peso traded in a range of 91 cents, between 17.03 and 17.94 pesos per US dollar since the last monetary policy decision. During the period, the currency appreciated 0.48% (Chart 9). This adjustment occurred in an environment where trading conditions slightly improved.

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



Source: Prepared by Banco de México.

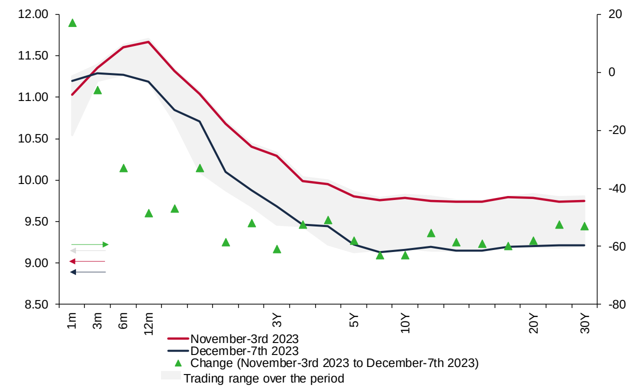
Chart 9
Mexican peso exchange rate
MXN/USD



Source: Prepared by Banco de México.

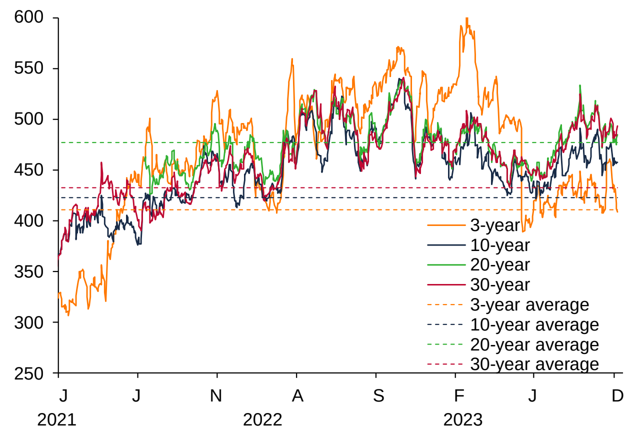
Interest rates on government securities registered positive dynamics, with decreases of up to 63 basis points along the entire curve (Chart 10). The yields of real rate instruments decreased significantly, primarily in the short term. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments exhibited mixed movements (Chart 11) that occurred in an environment in which trading conditions slightly deteriorated.

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



Source: PIP.

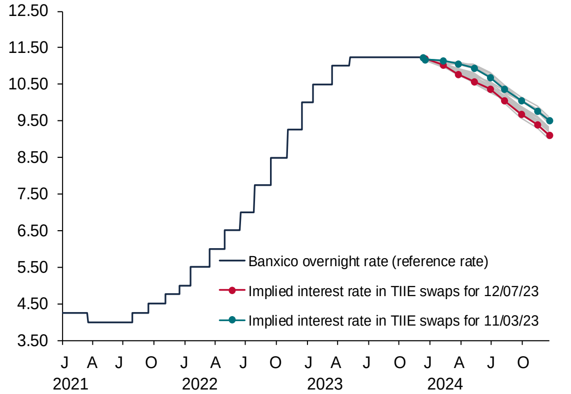
Chart 11
Breakeven inflation and inflation risk implied in government securities' yields
Basis points



Source: PIP.

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve does not incorporate any adjustment for the December decision and estimates the first cut of 25 basis points between February and March 2024 (Chart 12). Most analysts surveyed by Citibanamex anticipate that the reference rate will remain unchanged in the December decision and that the next adjustment will occur in March 2024.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent



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

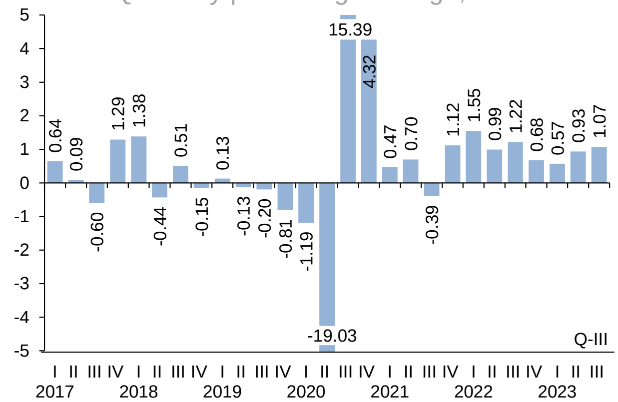
A.2.2. Economic activity in Mexico

During the third quarter of 2023, economic activity in Mexico continued experiencing robust growth as it registered a quarterly growth 1.07% (Chart 13).

Regarding the evolution of domestic demand, private consumption continued trending upwards at the end of the third quarter. Regarding its components, consumption of imported goods kept exhibiting high dynamism and consumption of domestic goods and services accelerated at the margin. Gross fixed investment decreased as a result of a contraction in non-residential construction, although the latter remained at high levels. Meanwhile, the machinery and equipment component rebounded. As for external demand, during the July-October period, the value of manufacturing exports increased with respect to the second quarter, due to the greater volume of automotive shipments, while the rest of manufacturing contracted (Chart 14).

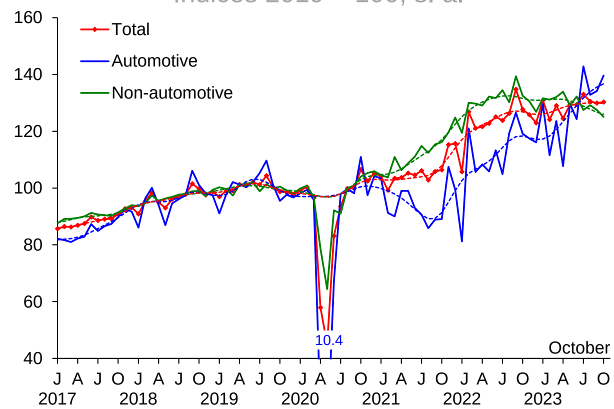
On the production side, in September, services grew at a faster rate, albeit with a differentiated behavior among sectors. In October, industrial production continued trending upwards (Chart 15). This was attributed to the good performance of construction, which reversed the decline registered in the previous month (Chart 16). Despite having decreased at the margin, production of the transportation equipment sector continued high levels. The rest of manufacturing remained weak, reflecting the unfavorable performance of the majority of its subsectors.

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



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

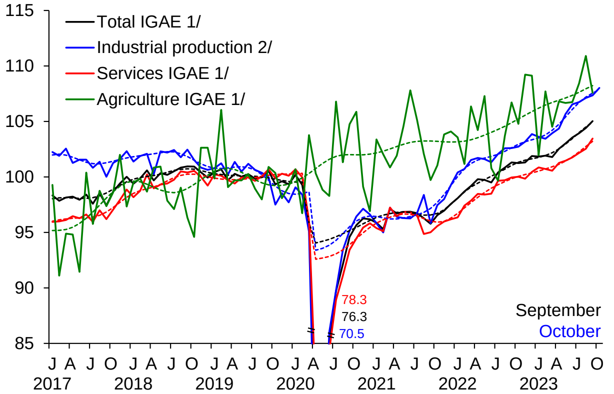
Chart 14
Manufacturing exports
Indices 2019 = 100, s. a.



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. The National System of Statistical and Geographical Information (SNIEG, for its Spanish acronym). Information of national interest.

Chart 15
Global Indicator of Economic Activity

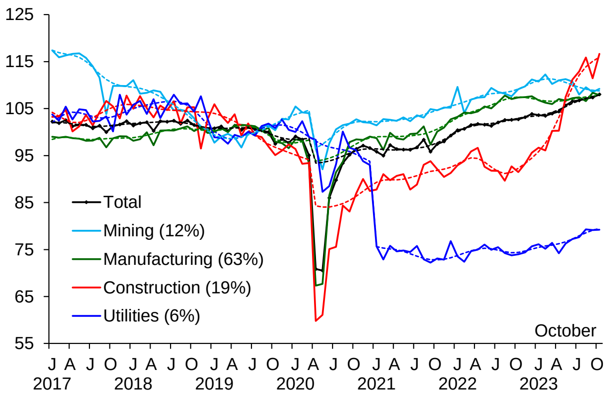
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
1/ Figures as of September 2023.
2/ Figures as of October 2023 from the Monthly Indicator of Industrial Activity.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 16
Industrial activity1/

Indices 2019 = 100, s. a.

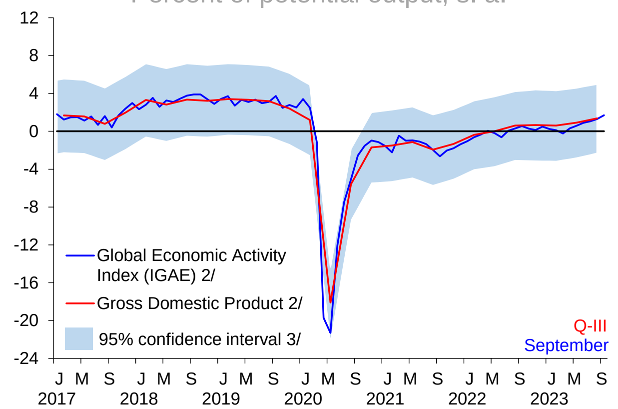


s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding the cyclical position of the economy, the point estimate of the output gap widened in positive territory during the third quarter, without being statistically different from zero (Chart 17). The labor market continued showing strength. In October, both national and urban unemployment rates decreased at the margin and both reached their respective historic lows with seasonally adjusted figures (Chart 18). In November, the number of newly created IMSS-insured jobs continued increasing, although with seasonally adjusted data it has decelerated in recent months. Finally, in September unit labor costs in the manufacturing sector decreased at the margin, although they remained at high levels (Chart 19).

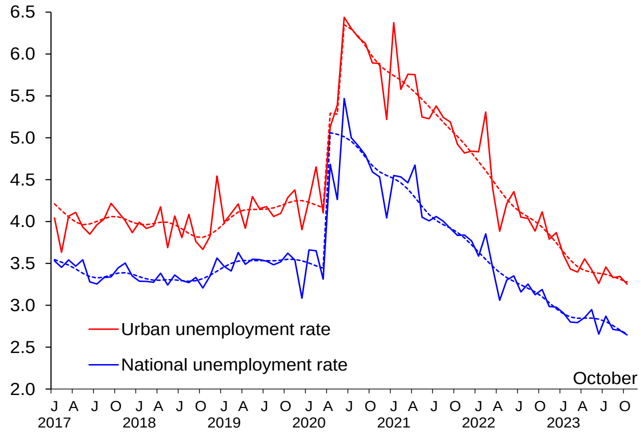
Chart 17
Output gap estimates1/

Percent of potential output, s. a.



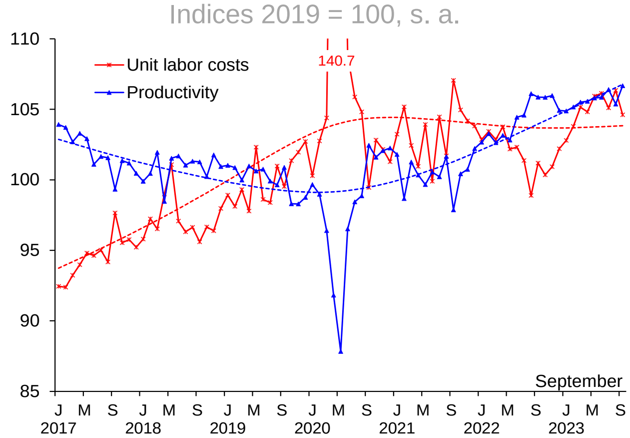
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ GDP flash estimate up to Q3 2023 and IGAE up to September 2023.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and urban unemployment rates
Percent, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from ENOE, ETOE (from April to June 2020), and ENOE new edition ($ENOE^N$) from July 2020 to December 2022.

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



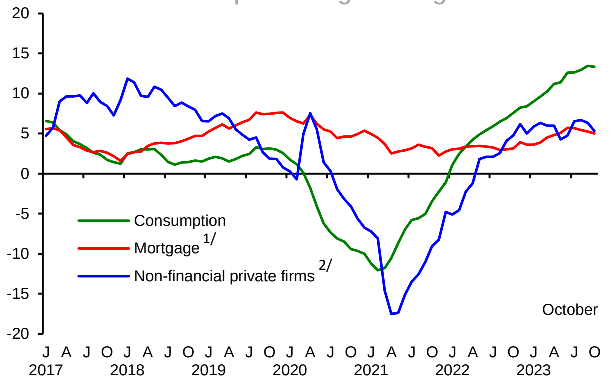
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly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

In October 2023, domestic financing to the private sector continued showing dynamism. Within it, bank lending to firms kept expanding (Chart 20). As for lending to households, the bank housing portfolio continued increasing. Meanwhile, commercial bank consumer credit continued exhibiting high growth rates, registering the highest rates of change since the first half of 2013. The dynamism of commercial bank credit to the private sector continued to be driven mainly by an increased demand for financing from firms and households, in line with the continuous expansion of economic activity and the strength of the labor market.

As for the cost of financing, interest rates on bank lending to firms remained stable and at high levels in October 2023. Corporate credit intermediation margins continued to be generally lower than those observed prior to the pandemic. Interest rates on mortgages did not register significant changes with respect to previous months. They continued being at levels similar to pre-pandemic ones. Within consumer credit, credit card interest rates have been adjusting with a lag to changes in the reference rate, after having remained relatively stable until June 2022. Lastly, interest rates on payroll loans have remained relatively stable since August 2021.

As for portfolio quality, corporate delinquency rates remained at low levels in October 2023, despite increasing slightly with respect to September. Mortgage delinquency rates also remained at low levels. Finally, consumer portfolio delinquency rates continued being at levels lower than those registered prior to the onset of the pandemic, although they have increased since May 2023.

Chart 20
Performing credit from commercial banks to the non-financial private sector
Annual percentage change[1/]

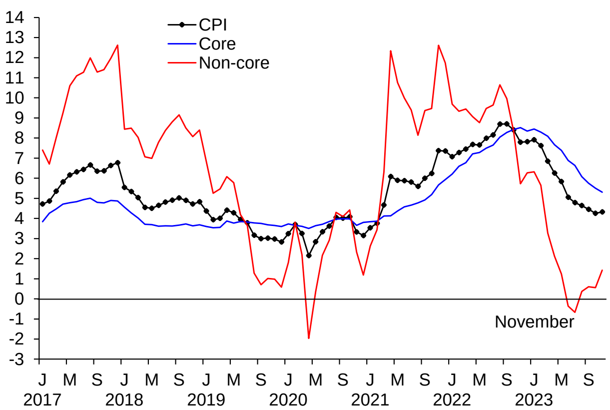


1/ Adjusted to account for the withdrawal from and the incorporation of nonbank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

In October and November 2023, annual headline inflation rose from 4.26 to 4.32%, as a result of the increase in non-core inflation, while core inflation continued decreasing (Chart 21 and Table 1).

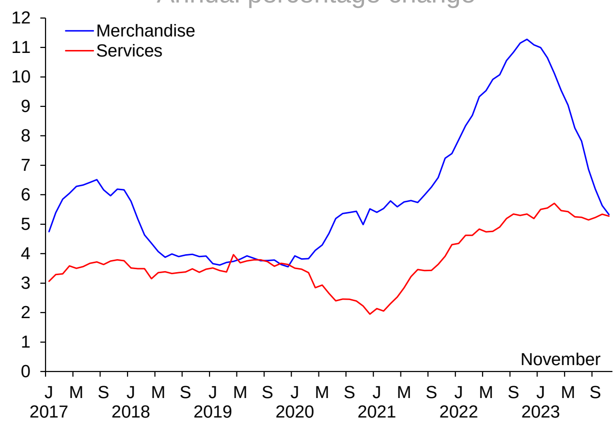
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

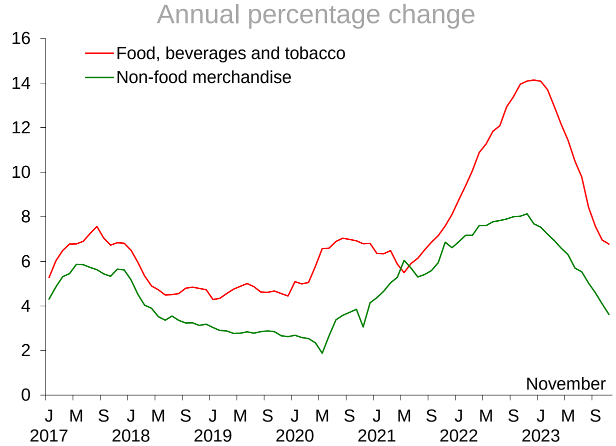
Annual core inflation decreased from 5.50 to 5.30% between October and November 2023. During that period, as the pressures that had affected it kept easing, annual merchandise inflation continued decreasing, going from 5.64 to 5.33% (Chart 22). This performance reflected a reduction from 6.95 to 6.78% in the annual inflation of food merchandise and from 4.09 to 3.62% in that of non-food merchandise (Chart 23). Annual services inflation went from 5.34 to 5.28% during said period. Regarding its components, mixed behaviors were observed, as the annual inflation of services other than education and housing, while still elevated, decreased from 6.48 to 6.28%, whereas inflation of education services registered 6.60% in both months. Meanwhile, annual housing inflation increased from 3.67 to 3.74%.

Chart 22
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

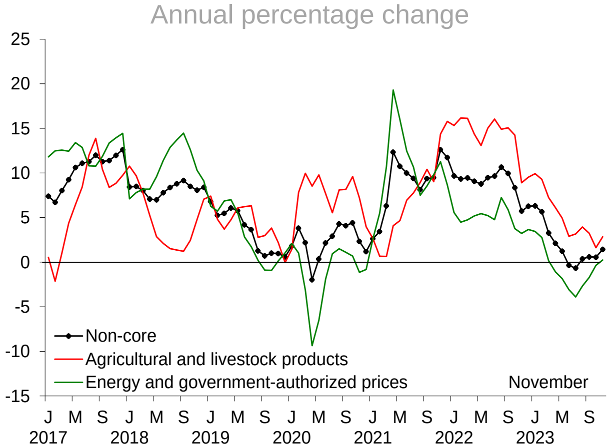
Chart 23
Merchandise core price subindex
Annual percentage change



Source: INEGI.

Annual non-core inflation increased from 0.56 to 1.43% between October and November 2023 (Chart 24 and Table 1). This evolution reflected an increase from 1.62 to 2.85% in the annual inflation of agricultural and livestock products. Within this category, the annual variation in the prices of fruit and vegetables rose from 4.77 to 5.59%, while that of livestock products increased from -0.97 to 0.62%. Additionally, during this period, the annual inflation of energy products rose from -2.59 to -1.64%, influenced primarily by higher annual variations in the prices of electricity and L.P. gas, which went from 2.06 to 3.73% and from -16.40 to -15.49%, respectively.

Chart 24
Non-core price subindex
Annual percentage change



Source: INEGI.

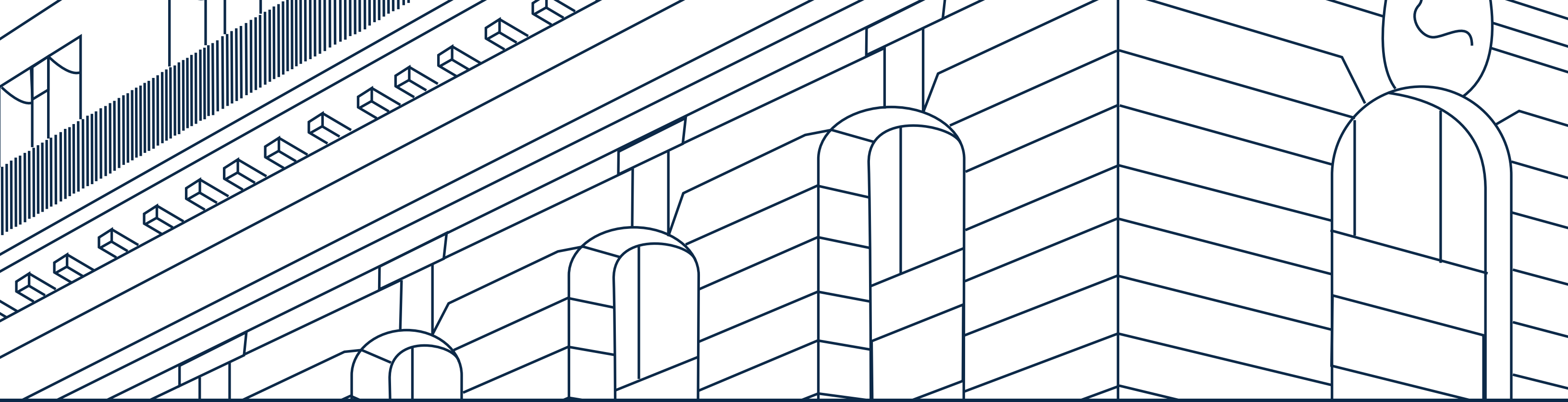
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between October and November 2023, the median for headline inflation for the end of 2023 decreased from 4.60 to 4.54%, while that for core inflation increased from 5.11 to 5.16%. Inflation expectations for the end of 2024 remained practically unchanged. The median of headline inflation expectations remained at 4.00%, while that of the core component adjusted from 4.11 to 4.10%. Inflation expectations for the end of 2025 adjusted slightly downwards. The median of headline inflation expectations adjusted from 3.76 to 3.74%, while that of core inflation went from 3.78 to 3.76%. The median of headline inflation expectations for the next four years decreased from 3.80 to 3.76%, while that of core inflation adjusted from 3.78 to 3.77%. The medians of headline and core inflation expectations for the long term (5 to 8 years) adjusted downwards from 3.60 to 3.50% and from 3.59 to 3.50%, respectively. Finally, compensation for inflation and inflationary risk has decreased since the previous monetary policy decision. Regarding its components, inflation expectations implied by market instruments remained relatively stable, while the inflation risk premium declined.

Inflation is still projected to converge to the target in the second quarter of 2025. This forecast is subject to risks. On the upside: i) persistence of core inflation at high levels; ii) foreign exchange depreciation; iii) greater cost-related pressures; iv) a greater-than-expected resilience of the economy, and v) 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, and iii) that the lower levels registered by Mexico's exchange rate in relation to early 2023 contribute more than expected to ease certain pressures on inflation. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.

Table 1
Consumer Price Index and components
Annual percentage change

Item	September 2023	October 2023	November 2023
CPI	**4.45**	**4.26**	**4.32**
Core	**5.76**	**5.50**	**5.30**
Merchandise	**6.20**	**5.64**	**5.33**
Food, beverages and tobacco	7.57	6.95	6.78
Non-food merchandise	4.59	4.09	3.62
Services	**5.23**	**5.34**	**5.28**
Housing	3.58	3.67	3.74
Education (tuitions)	6.59	6.60	6.60
Other services	6.32	6.48	6.28
Non-core	**0.60**	**0.56**	**1.43**
Agricultural and livestock products	**3.25**	**1.62**	**2.85**
Fruits and vegetables	6.75	4.77	5.59
Livestock products	0.33	-0.97	0.62
Energy and government-authorized prices	**-1.71**	**-0.35**	**0.24**
Energy products	-4.61	-2.59	-1.64
Government-authorized prices	5.14	5.03	4.84

Source:INEGI.



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