The opinions and views expressed herein are the sole responsibility of the author and do not necessarily represent the institutional stance of Banco de México or of its Governing Board.
Outline

1. External conditions
2. Current situation of the Mexican economy
3. Low and stable inflation environment
4. Economic outlook
5. Final remarks
During 2019, the world economy continued to decelerate. This reflected the effects of: 1) prolonged trade tensions; 2) high geopolitical risks; and 3) certain idiosyncratic factors in several economies.
In this context, the growth outlook for the main advanced economies has been revised downwards.

Advanced Economies: GDP Growth Forecasts\(^1\), %

United States

- **Median**
  - 2019 – Jan survey: 2.5%
  - 2019 – Dec survey: 2.3%
  - 2020 – Dec survey: 1.8%

- **2019 Forecast (Jan 19)**: 2.9%

- **2019 Forecast (Current)**: 2.3%

- **2020 Forecast**: 2.0%

Euro area

- **Median**
  - 2019 – Jan survey: 1.4%
  - 2019 – Dec survey: 1.2%
  - 2020 – Dec survey: 1.0%

- **2019 Forecast (Jan 19)**: 1.9%

- **2019 Forecast (Current)**: 1.2%

- **2020 Forecast**: 1.0%

Japan

- **Median**
  - 2019 – Jan survey: 1.0%
  - 2019 – Dec survey: 0.9%
  - 2020 – Dec survey: 0.3%

- **2019 Forecast (Jan 19)**: 0.8%

- **2019 Forecast (Current)**: 0.9%

- **2020 Forecast**: 0.3%

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1/2019 growth corresponds to the median forecast of the December survey.
Source: Consensus Forecast. The current survey corresponds to the one conducted in December 2019.
Although trade tensions have subsided in recent weeks, geopolitical risks have increased.

United States Trade Policy Uncertainty Index¹/ and Geopolitical Tensions Index²/

1/ The United States trade uncertainty index is constructed using the volume of articles in high-circulation news sources that address political and economic uncertainty topics and that include trade-related terms. 2/ The geopolitical tensions index is constructed using the number of searches in Google around the world from news sources using the words: “War”, “Middle East”, “Iran-Iraq War”, “US-Iran War”. Such index is normalized in relation to the period in which the term had the highest number of searches.


Status of Trade Negotiations
Phase 1 China- United States Trade Agreement
Signing: January 15, 2020

2. Cancellation of the imposition of additional tariffs (planned for Dec 15).
   • Removal of some existing rates in stages.
3. Measures to prevent intellectual property theft.
4. Measures to avoid forced technology transfers³/.
5. Opening of Chinese financial sector.
   • Market-based exchange rate.
6. Bilateral consultations and dispute resolution mechanism.

3/ The Technology Transfer chapter sets out binding and enforceable obligations to address several of China’s unfair technology transfer practices that were identified in USTR’s Section 301 investigation. For the first time in a trade agreement, China has agreed to end its long-standing practice of forcing or pressuring foreign companies to transfer their technology to Chinese companies as a condition for obtaining market access, administrative approvals, and receiving advantages from the government.

Source: Banco de México and Agreement between the United States of America and the People’s Republic of China.
In the main advanced economies, inflation remains below their central banks’ targets.

**Advanced Economies**

**Headline Inflation**
Annual % change

**Core Inflation**

1/ Refers to the Personal Consumption Expenditure Price Index (PCE). Source: BEA, Eurostat and Japan’s Statistics Bureau.

2/ Refers to the Personal Consumption Expenditure Price Index that excludes food and energy (PCE).

3/ Excludes energy and fresh food and the direct effect of the consumption tax increase. Source: BEA, Eurostat and Japan’s Statistics Bureau.
The weakness of economic activity together with inflation being below the central banks’ targets has been reflected in more accommodative monetary policy stances in advanced economies.

### Reference Rates and Implied Trajectories in OIS Curves

- **US Federal Reserve**
- **Bank of Japan**
- **European Central Bank**

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**10-year Government Bonds Interest Rates**

- **United States**
- **Euro area**
- **Japan**

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1/ OIS: Fixed-for-floating swap where the fixed interest rate is the one-day effective reference rate.

2/ Data for the observed federal funds rate corresponds to the average between the lower and upper bounds of the target range (1.50% - 1.75%).

Source: Bloomberg.
Easing of Global Financial Conditions

The moderation of several risks to the global economy together with monetary policy easing has been reflected in an improvement of financial markets.

Government Bond Rate Curve and One Year Forward Curve

United States

Japan

Euro area

Government and Corporate Debt with Investment Grade by Interest Rate

% of total outstanding debt

United States

Europe

Japan

Other developed countries

Note: Other developed countries include: United Kingdom, Switzerland and Sweden.
Source: Amundi.

Government Debt and Corporate Debt

% of total outstanding debt

United States

Europe

Japan

Other developed countries

Note: Other developed countries include: United Kingdom, Switzerland and Sweden.
Source: Bloomberg.

Stock Markets of Emerging and Advanced Economies

Index 01-Jan-2018=100

Note: The MSCI indices of both advanced (MSCI World Index) and emerging (MSCI Emerging Market Index) economies are presented. The MSCI of emerging economies includes Mexico, Brazil, Chile, China, Colombia, Peru, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, South Korea, Malaysia, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. The MSCI of advanced economies includes Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Holland, New Zealand, Norway, Portugal, Singapore, Sweden, Switzerland, United Kingdom, and the United States. Source: Bloomberg.
Easing of Global Financial Conditions

The latter has been reflected in the financial assets of both advanced and emerging economies.

United States: Change in the Financial Conditions Index by Component 1/

<table>
<thead>
<tr>
<th>Units</th>
<th>USD index weighted by trade</th>
<th>Credit differentials</th>
<th>Federal funds</th>
<th>10-year rate</th>
<th>S&amp;P index</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.5</td>
<td>1.2</td>
<td>0.9</td>
<td>0.6</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>1.2</td>
<td>0.9</td>
<td>0.6</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>0.9</td>
<td>0.6</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>0.6</td>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>0.0</td>
<td>-0.3</td>
<td>-0.6</td>
<td>-0.9</td>
<td>-1.2</td>
<td>-1.5</td>
<td>-1.8</td>
</tr>
</tbody>
</table>

1/ The financial conditions index is constructed based on the effect of the five variables on economic activity: the reference interest rate, the 10-year government note, the spread of the bond with investment grade on the government debt bond with equivalent maturity, the ratio of a stock index with average earnings per share of 10 years and the trade weighted exchange rate. The countries that make up the global sample include the G10 countries and Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Israel, Malaysia, Mexico, Philippines, Russia, South Africa, South Korea, Thailand and Turkey. Source: Banco de México with Bloomberg and Goldman Sachs data.

Asset Performance in 2019

% basis points

<table>
<thead>
<tr>
<th>Region</th>
<th>Country</th>
<th>Currencies</th>
<th>Stock indices</th>
<th>2Y Interest rates</th>
<th>10Y Interest rates</th>
<th>CDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America</td>
<td>Mexico</td>
<td>3.68%</td>
<td>4.56%</td>
<td>-194</td>
<td>-204</td>
<td>-76</td>
</tr>
<tr>
<td>Brazil</td>
<td>-4.02%</td>
<td>31.58%</td>
<td>-210</td>
<td>-255</td>
<td>-108</td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>-8.38%</td>
<td>-8.53%</td>
<td>-155</td>
<td>-114</td>
<td>-20</td>
<td></td>
</tr>
<tr>
<td>Colombia</td>
<td>-1.01%</td>
<td>19.26%</td>
<td>-20</td>
<td>-58</td>
<td>-85</td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td>-58.95%</td>
<td>37.56%</td>
<td>5,238</td>
<td>809</td>
<td>2,497</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>11.08%</td>
<td>28.55%</td>
<td>-324</td>
<td>-224</td>
<td>-98</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>-1.53%</td>
<td>0.25%</td>
<td>-6</td>
<td>-63</td>
<td>-9</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>-12.51%</td>
<td>25.37%</td>
<td>-852</td>
<td>-394</td>
<td>-79</td>
<td></td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>-1.16%</td>
<td>13.08%</td>
<td>24</td>
<td>-3</td>
<td>-6</td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>-5.45%</td>
<td>17.74%</td>
<td>-44</td>
<td>-68</td>
<td>-19</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>China</td>
<td>-1.23%</td>
<td>22.30%</td>
<td>-13</td>
<td>-48</td>
<td>-36</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.03%</td>
<td>-6.02%</td>
<td>-43</td>
<td>-17</td>
<td>-75</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>-2.30%</td>
<td>14.38%</td>
<td>-65</td>
<td>-67</td>
<td>-45</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>3.67%</td>
<td>4.68%</td>
<td>-241</td>
<td>-248</td>
<td>-55</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>7.93%</td>
<td>1.02%</td>
<td>-64</td>
<td>-84</td>
<td>-19</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>3.64%</td>
<td>1.70%</td>
<td>-152</td>
<td>-90</td>
<td>-70</td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>South Africa</td>
<td>2.42%</td>
<td>8.24%</td>
<td>-75</td>
<td>-51</td>
<td>-60</td>
</tr>
<tr>
<td>North America</td>
<td>United States</td>
<td>2.22%</td>
<td>28.88%</td>
<td>-92</td>
<td>-77</td>
<td>-8</td>
</tr>
</tbody>
</table>

Note: Interest rates correspond to swap rates for a period of two and ten years, except for Indonesia and Turkey, where the government values of these terms are used as a reference. Additionally, for Argentina, the sovereign debt rates denominated in US dollars of 2- and 9-year terms are used, as they are the most liquid and those that best reflect the performance of this country’s fixed income market. Source: Bloomberg.
Capital flows to emerging economies have been sensitive to global risk appetite and have improved insofar as risks associated with trade tensions have decreased.

**EMBI and Global Risk Appetite Index**

- Basis points and index
- Risk appetite
- Panic
- Euphoria

**Story Count for “TRADE WAR” and Emerging Economies Currency Index**

- Index Jan-2019=100, Number of news
- Emerging economies currency index \(^1\)
- Story count “TRADE WAR”

**Accumulated Capital Flows to Emerging Economies During 2019\(^2\)**

- Billion dollars

---

1/ The emerging economies currency index includes Peru, Philippines, Poland, Hungary, South Korea, South Africa, Russia, Brazil, Colombia, Chile, Malaysia, Czech Republic, India and Mexico.

Fuente: Banco de México with Bloomberg data.

2/ The sample covers funds used for the buying-selling of stocks and bonds from emerging countries, recorded in advanced countries (includes debt and equity). Flows exclude portfolio performance and exchange rate fluctuations.

Source: Emerging Portfolio Fund Research.
Although available information for Q4-2019 is limited, the weakness that economic activity has been exhibiting for several quarters is expected to persist.
The Mexican economy has faced a sequence of adverse shocks since 2015: ① Fall in oil prices; ② Contraction of oil production; ③ Trade uncertainty USMCA; ④ US monetary policy uncertainty.

### Sources and Uses of Financial Resources of the Economy

#### Annual flows as % of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Total External</th>
<th>Total Domestic</th>
<th>Total</th>
<th>Other items</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>10.0</td>
<td>5.7</td>
<td>15.7</td>
<td>-1.0</td>
</tr>
<tr>
<td>2014</td>
<td>4.2</td>
<td>5.6</td>
<td>9.8</td>
<td>4.1</td>
</tr>
<tr>
<td>2015</td>
<td>9.7</td>
<td>4.6</td>
<td>14.3</td>
<td>4.3</td>
</tr>
<tr>
<td>2016</td>
<td>5.7</td>
<td>5.5</td>
<td>11.2</td>
<td>2.9</td>
</tr>
<tr>
<td>2017</td>
<td>7.4</td>
<td>6.6</td>
<td>14.0</td>
<td>2.6</td>
</tr>
<tr>
<td>2018</td>
<td>3.9</td>
<td>4.2</td>
<td>8.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Q3 2019</td>
<td>0.2</td>
<td>0.6</td>
<td>0.8</td>
<td>0.0</td>
</tr>
</tbody>
</table>

#### Uses

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Non-oil</th>
<th>Total Oil</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2014</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2015</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2016</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2017</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>2018</td>
<td>5.0</td>
<td>5.4</td>
<td>10.4</td>
</tr>
<tr>
<td>Q3 2019</td>
<td>0.8</td>
<td>0.6</td>
<td>1.4</td>
</tr>
</tbody>
</table>

### Trade Balance

#### USD million

<table>
<thead>
<tr>
<th>Year</th>
<th>Current account % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>-1.5</td>
</tr>
<tr>
<td>2013</td>
<td>-2.5</td>
</tr>
<tr>
<td>2014</td>
<td>-1.9</td>
</tr>
<tr>
<td>2015</td>
<td>-2.6</td>
</tr>
<tr>
<td>2016</td>
<td>-2.2</td>
</tr>
<tr>
<td>2017</td>
<td>-1.7</td>
</tr>
<tr>
<td>2018</td>
<td>-1.8</td>
</tr>
<tr>
<td>Q3 2019</td>
<td>-0.2</td>
</tr>
</tbody>
</table>
Private consumption remained weak due to the slowdown of consumption of services and goods (especially imported ones). Regarding consumption determinants, remittances and the real wage bill have trended upward.

**Total Private Consumption and Components**
Index 2013=100, s. a.

**Remittances**
Billion USD and constant pesos, s. a.

**Consumer Confidence and Total Real Wage Bill**
Response balance and index 2013=100, s. a.

---

s. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their share in 2013.
Source: Mexico’s National Accounts System (SCNM, for its acronym in Spanish), INEGI.

s. a. / Seasonally adjusted figures.
1/ Prices as of the second fortnight of July 2018.
Source: Banco de México and INEGI.

s. a. / Seasonally adjusted figures.
Source: Prepared by Banco de México data from the National Survey of Occupations and Employment (ENOE, for its acronym in Spanish) and the National Survey of Consumer Confidence (ENCO, for its acronym in Spanish), INEGI and Banco de México.
As for gross fixed investment, the unfavorable performance shown by this indicator since 2S-2015 and especially since the beginning of 2018 continued, as a reflection of lower spending on machinery and equipment and weak construction.

**Investment and its Components**
Index 2013=100, s. a.

**Investment in Residential and Non-residential Construction**
Index 2013=100, s. a.

**Real Value of Construction Output by Contracting Institutional Sector**
Index Jan-2016=100, s. a.

---

S. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their share in total in 2013.
Source: Mexico’s National Accounts System (SCNM, for its acronym in Spanish), INEGI.
As to the labor market, it has exhibited a lesser degree of tightness and job creation has slowed down.

Labor Market Gap: Unemployment Rate

- Percentage points, s. a.

Jobs Insured by IMSS: Permanent and Temporary in Urban Areas

- Annual change in thousands

Daily Nominal Wage Associated with IMSS-insured Workers

- Annual % change

1/ Seasonally adjusted figures. 1/ Shadows represent confidence bands. The interval corresponds to two average standard deviations among all estimates. Source: Prepared by Banco de México with data from ENOE (INEGI).

2/ Made up by the municipalities mentioned in the DOF of December 26, 2018, most of which share boundary with the northern border. Source: Calculated by Banco de México with data from IMSS.
Slack conditions appear to have negatively expanded at a faster rate than expected. The slack indicator related to consumption has loosened more and that associated with the labor market continued to reduce its level of narrowness.

**Total Output Gap Estimates**  
% of potential output, s. a.

**Slack Indicators: Monthly Main Component by Group of Indicators**

4/ Indicators constructed using CCM methodology; see Banco de México (2018), “Quarterly Report, October-December 2017”, p.47. Monthly slack indicators are constructed with the main component of sets of series which includes 11 and 12 indicators, respectively. Slack indicators of consumption, aggregate demand, labor market and demand conditions in the lending market are based on the first main component of sets of series which includes 6, 4, 3 and 6 indicators, respectively. The first component accounts for 65, 49 and 62% of the joint variation of consumption, labor market and demand conditions in the lending market, in that order.

Source: Prepared by Banco de México with data from INEGI and Banco de México.

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s. a. / Seasonally adjusted data. 1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), “Inflation Report (April-June 2009)”, p.74. 2/ Global Indicator of Economic Activity (IGAE, for its acronym in Spanish). 3/ Output gap confidence interval calculated with a method of unobserved components. 4/ Indicators constructed using CCM methodology; see Banco de México (2018), “Quarterly Report, October-December 2017”, p.47. Monthly slack indicators are constructed with the main component of sets of series which includes 11 and 12 indicators, respectively. Slack indicators of consumption, aggregate demand, labor market and demand conditions in the lending market are based on the first main component of sets of series which includes 6, 4, 3 and 6 indicators, respectively. The first component accounts for 65, 49 and 62% of the joint variation of consumption, labor market and demand conditions in the lending market, in that order.

Source: Prepared by Banco de México with data from INEGI and Banco de México.
Among the factors that business representatives and analysts believe could limit growth those related to governance stand out. Progress in certain problems that have affected the economy for years, such as the rule of law (corruption, insecurity and impunity), would foster an environment that would allow for incentivizing growth.

Percentage Distribution of Responses from Analysts and Business Representatives when Consulted on the Three Main Factors that Could Hinder Economic Activity Growth in the Next Six Months

1 Responses from the Survey of Private Sector Forecasters associated with the question: Which three main factors will limit economic growth in the next six months? 2 Responses from the Monthly Survey of Regional Economic Activity (EMAER, for its acronym in Spanish) associated with the question: In your opinion, which three main factors will limit economic activity growth in your state in the next six months? Source: Monthly Survey of Regional Economic Activity (EMAER, for its acronym in Spanish) and Survey of Private Sector Forecasters.
Headline inflation trended downwards from 4.83% in December 2018 to 2.83% in December 2019. This behavior can be attributed to the significant fall in annual non-core inflation, from 8.40 to 0.59% during this period. Annual core inflation, on the other hand, continued to exhibit persistence.

**Consumer Price Index**

**Annual % change**

1/ Since 2003, a permanent inflation target of 3%, with a variability interval of +/-1%, was established for headline inflation. Source: Banco de México and INEGI.
Non-core inflation decreased significantly, laying at 0.59% in December. Such behavior was due to the lower annual change in energy prices, although agricultural and livestock product prices have also decreased.

1/ In some cases, the sum of inflation’s components may not add up due to rounding.
Source: Calculated by Banco de México with INEGI data.
Annual core inflation continues to show persistence, although in November and December it slightly decreased.

Core inflation continues to show persistence, although in November and December it slightly decreased.

Core Inflation Trend Measures
Annual % change

Merchandise Price Subindex
Annual % change

Services
Annual % change

1/ The trimmed mean indicator excludes the contribution of extreme variations in the prices of certain generic items to the inflation of a price index. To eliminate the effect of these changes, the following is done: i) monthly seasonally adjusted changes of the generic items of the price index are arranged from the smallest to the largest value; ii) generic items with the largest and the smallest variation are excluded, considering in each distribution tail up to 10 percent of the price index basket, respectively, and, iii) using the remaining generic items, which by construction lie closer to the center of the distribution, the Trimmed Mean Indicator is calculated.

Source: Banco de México and INEGI.
Monetary Policy Conduction

August, September, November and December meetings

25bp reductions in each one to a level of 7.25%

✓ Press releases highlighted:
  - The lower levels of headline inflation.
  - The greater slack in the economy.
  - The recent behavior of external and domestic yield curves.

Overnight Interbank Interest Rate and Government Bond Yields

Source: Proveedor Integral de Precios (PIP).
Interest rates in Mexico have decreased reflecting the reduction in external interest rates and Banco de México’s monetary policy actions.

**Interest Rates on Government Securities**

Referenced to Nominal Rate (Bonds)

Referenced to Real Rate (Udibonos)

---

Note: Historical average calculated with data since November 2009. Source: Banco de México with PIP data.
Implicit Distributions in Market Prices of Annual Returns of Fixed Income Instruments (1 - 10 year maturities) of Selected Countries as of December 30, 2019

Mean Volatility* Efficiency**
South Africa 7.5% 5.8% 4.1%
Mexico 7.3% 3.7% 0.2%
India 5.8% 2.9% 0.2%
Brazil 4.7% 7.5% 9.9%
Colombia 3.8% 9.8% 14.9%
China 2.6% 3.7% 4.9%
Peru 2.0% 4.5% 7.1%
Chile 2.0% 3.6% 5.2%

Mean Volatility* Efficiency**
South Africa 3.3% 13.2% 25.0%
Brazil 2.5% 9.7% 18.2%
Mexico 2.4% 7.4% 15.7%
India 2.3% 4.9% 9.1%
Colombia 1.6% 12.0% 22.8%
China 1.4% 4.3% 8.4%
Peru -0.4% 5.9% 14.7%
Chile 0.9% 9.0% 19.9%

Mean Volatility* Efficiency**
Chile -0.9% 9.1% 22.0%
China -1.1% 3.9% 11.3%
Colombia -1.7% 8.5% 21.7%
Brazil -1.8% 8.3% 20.9%
Peru -2.3% 4.7% 15.8%
India -3.2% 4.8% 14.9%
South Africa -3.8% 10.5% 27.2%
Mexico -4.5% 6.7% 21.8%

Note: The Breeden-Litzenberger methodology is used in the implicit distributions to obtain the distribution of the foreign exchange market and the Ho-Lee model to obtain the distribution in the fixed income market. Epanechnikov kernels are also used to obtain the density function. 1/ A basket of government bonds with a 1-10 year maturity is used. *Volatility corresponds to the standard deviation of future yields over a 1-year horizon. **Efficiency is measured as the expected value of the wealth utility associated with each support element. The utility function used is the natural logarithm of wealth and the result is multiplied by 100 to facilitate comparison between the different assets.
Source: Banco de México con datos de Bloomberg.
Outline

1. External conditions
2. Current situation of the Mexican economy
3. Low and stable inflation environment
4. Economic outlook
5. Final remarks
Price stability has allowed a better functioning of the economy’s nominal system. Relative prices therefore convey information about the prevailing conditions in every market and function as signals for an efficient allocation of resources.

- A reduction in inflation’s level, volatility and persistence.
- A reduction in the pass-through effect from nominal exchange rate fluctuations to prices.
- Transitory effects of changes in relative prices of certain goods into inflation.
- The development of a liquid and deep foreign exchange market, capable enough of absorbing shocks.
**Inflation stability**

Since the adoption of the inflation targeting regime, a significant decrease in the level, volatility and persistence of inflation has been observed.

*Annualized Monthly Inflation %, s. a.*

`s. a. / Seasonally adjusted figures. Technical Chapter Inflation Report October - December 2010: Change in the Nominal System of the Mexican Economy in the early 2000’s. It is shown that as of October 2001, inflation began a stationary process ($I(0)$). Source: Banco de México.*
Despite the significant depreciation of the Mexican peso over the last years, the pass-through effect from the exchange rate to prices remains at low levels, thus reflecting a better functioning of the economy’s nominal system. Monetary policy has focused on avoiding effects on the price formation process.
Greater depth in the foreign exchange market

Among emerging economies, the Mexican peso stands out as one of the currencies with the highest trading volume in the world.

Foreign Exchange Market Turnover by Instrument for Emerging Markets and Mexico

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<tr>
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<td>Outright forwards</td>
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<td>63</td>
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Emerging economies’ average excl. China

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<tr>
<th>1</th>
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<td>Current situation of the Mexican economy</td>
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<td>3</td>
<td>Low and stable inflation environment</td>
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<td>4</td>
<td>Economic outlook</td>
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<tr>
<td>5</td>
<td>Final remarks</td>
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Quarterly Report Forecast Released on 11/27/19: The economy is expected to begin exhibiting higher growth rates in 2020.

Monetary Policy Statement 12/19/19: GDP growth prospects were in line with what was published in the mentioned Quarterly Report.

Fan Chart: GDP Growth
Annual %, s. a.

GDP Growth %

Increase in Number of IMSS-insured Jobs Thousands

Current Account Deficit % of GDP

<table>
<thead>
<tr>
<th>Report</th>
<th>QR Apr-Jun 2019</th>
<th>QR Jul-Sep 2019</th>
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<td>2019</td>
<td>0.2 - 0.7</td>
<td>-0.2 a 0.2</td>
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<td>2020</td>
<td>1.5 - 2.5</td>
<td>0.8 - 1.8</td>
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<td>2021</td>
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<td>1.3 - 2.3</td>
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<th>QR Jul-Sep 2019</th>
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<tr>
<td>2019</td>
<td>450 - 550</td>
<td>300 - 370</td>
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<tr>
<td>2020</td>
<td>590 - 690</td>
<td>500 - 600</td>
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<tr>
<td>2021</td>
<td>--</td>
<td>510 - 610</td>
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</table>

s. a. / Seasonally adjusted series. Source: INEGI and Banco de México.
Quarterly Report Forecast Released on 11/27/19: Annual headline inflation is still anticipated to remain at levels close to 3%, although it is expected to increase slightly during Q1-2020.

Monetary Policy Statement 12/19/19: For 2020, core and headline inflation will reflect both the greater amount of slack in the economy and the cost-related pressures resulting from the recent minimum wage revisions, which could locate them moderately above the levels anticipated in the mentioned Quarterly Report.

Banco de México Prospects
Quarterly Report Forecast Released on 11/27/19: In regards to annual core inflation, it is expected to lie at levels close to 3% starting from Q3-2020.

Monetary Policy Statement 12/19/19: For 2020, core and headline inflation will reflect both the greater amount of slack in the economy and the cost-related pressures resulting from the recent minimum wage revisions, which could locate them moderately above the levels anticipated in the mentioned Quarterly Report.

Fan Chart
Annual Core Inflation 1/

1/ Quarterly average of annual core inflation. The next four and six quarters are indicated as of the fourth quarter of 2019, that is, the fourth quarter of 2020 and the second of 2021, periods in which the monetary policy transmission channels fully operate. */ Forecast since November 2019. Source: Banco de México and INEGI.
Outline

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Final Remarks

1. The **global economy** has slowed.
2. **World financial conditions** have loosened.
3. While **trade tensions** have diminished, **geopolitical** ones have increased recently.
4. **Economic activity** in Mexico is expected to start **recovering** in the first quarter of 2020.
5. Recent **progress** in the **USMCA** approval reduces an important factor of uncertainty that has affected **investment** and **growth**.
6. Efforts must continue in advancing in those factors that contribute to increase **confidence** needed to foster **investment** and **growth**.
7. It is imperative to strengthen the **rule of law**, tackle **corruption** and fight **insecurity**.