Global economic activity remains on a moderate growth trajectory, which is expected to strengthen further over 2018-2019.

### World Gross Domestic Product

#### Annual % change

<table>
<thead>
<tr>
<th></th>
<th>World</th>
<th>Emerging Market and Developing Economies</th>
<th>Advanced Economies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>3.6</td>
<td>2.3</td>
<td>2.2</td>
</tr>
<tr>
<td>2018</td>
<td>3.7</td>
<td>2.5</td>
<td>2.0</td>
</tr>
<tr>
<td>2019</td>
<td>3.7</td>
<td>2.2</td>
<td>1.8</td>
</tr>
<tr>
<td>2017</td>
<td>4.6</td>
<td>4.8</td>
<td>4.9</td>
</tr>
<tr>
<td>2018</td>
<td>4.9</td>
<td>4.9</td>
<td>5.0</td>
</tr>
<tr>
<td>2019</td>
<td>5.1</td>
<td>5.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>

#### Source:
- IMF (World Economic Outlook, October 2017 and April 2018).

### Oil Prices and World Trade Volume

#### Dollars per barrel and Index 2010 = 100 (s.a.)

- **Mexican Crude Oil Basket**
- **WTI**
- **Trade Volume**

#### Source:
- Pemex, Bloomberg and CPB Netherlands.

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Source: IMF (World Economic Outlook, October 2017 and April 2018).
The US is the advanced economy with the largest upward revisions to growth projections. Expectations for industrial output growth in 2018 have also increased substantially.
Notwithstanding the improved outlook for the global economy in the short term, there is a generalized perception that the balance of risks displays a negative bias over longer horizons:

- Monetary policy normalization in the US.
- Possible over-valuation of some assets.
- Renewed trade tensions between China and the US.
- Geopolitical risks.
- Persistent vulnerabilities in several economies, notably high debt levels.
During the first months of this year, the Mexican economy has continued to recover from the contraction observed in 3Q-2017.
On the demand side, private consumption maintains an upward trend.

Aggregate Consumption
Index 2013 = 100, s.a.

Private Consumption
Index 2013 = 100, s.a.

s.a. / Seasonally adjusted series.
Source: INEGI.
Investment remains weak, but partly as a result of the reconstruction efforts from the natural disasters experienced last year, it has picked up in recent months.
Meanwhile, exports maintain an upward trajectory, on the back of a strong external demand and a competitive exchange rate.
The difficulty to assess the overall degree of slack in the economy is clearly illustrated by the situation in the labor market. Notwithstanding very low levels of unemployment…

Unemployment Rate

Unemployment Rate
%

- Total

- Urban

Labor Market Gap: Unemployment Rate

%-points

Note: The interval corresponds to two average standard deviations among all estimates; see Banco de México (2017), "Quarterly Report, October-December 2016", page 47. Source: Banco de México.
... alternative, broader estimations of the unemployment rate display figures similar to those prevailing prior to the global financial crisis.
In addition, the fall in the unemployment rate is less pronounced when adjusted by the declining trend in labor force participation.

**Labor Force Participation Rate**

\% s.a.

**NAIRU and Participation-Adjusted Unemployment Rate**

\%

Note: Each counterfactual exercise considers a constant labor force participation rate at the level observed in the indicated years (2008, 2015 and 2016), assuming that the remaining labor force stayed unemployed. Source: Banco de México with data from INEGI.
At the same time, wage pressures remain contained, while unit labor costs for the economy have continued to decline.

<table>
<thead>
<tr>
<th>Average Wage of Salaried Workers 1/</th>
<th>% Variation</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Nominal</th>
<th>Real*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
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<td>2010</td>
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<td>2016</td>
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</tr>
<tr>
<td>2017</td>
<td></td>
</tr>
</tbody>
</table>

1/ According to the National Employment Survey (ENOE).  
* Real wages were calculated with the CPI.  
Source: Banco de México with data from INEGI.

<table>
<thead>
<tr>
<th>Labor Productivity and Unit Labor Cost 2/</th>
<th>Index 2013 = 100, s. a.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Productivity</th>
<th>Unit Labor Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>100</td>
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<tr>
<td>2007</td>
<td>105</td>
</tr>
<tr>
<td>2008</td>
<td>110</td>
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<tr>
<td>2009</td>
<td>115</td>
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<td>2010</td>
<td>120</td>
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<td>2011</td>
<td>125</td>
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<td>2012</td>
<td>130</td>
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<td>2013</td>
<td>135</td>
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<td>2014</td>
<td>140</td>
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<tr>
<td>2015</td>
<td>145</td>
</tr>
<tr>
<td>2016</td>
<td>150</td>
</tr>
<tr>
<td>2017</td>
<td>155</td>
</tr>
</tbody>
</table>

2/ Labor productivity based on worked hours.  
Source: Banco de México with data from INEGI.
Although the unemployment rate may not reflect accurately the situation of the labor market, taken as a whole the above indicators suggest a situation of reduced, if any, slack in the labor market.

In addition, current estimates of the output gap are at levels statistically not different from zero.

The above highlights the need to continue monitoring closely the degree of resource utilization in the economy, in view of the risk of wage and demand pressures on prices.
Economic activity is expected to continue expanding in coming months, resulting in an output gap statistically not different from zero.

**Real GDP Growth Expectations**

*Annual %*

**Banco de México Forecasts**

- **2018**: 2.0 – 3.0
- **2019**: 2.2 – 3.2

*Memo: 2017 (Actual)*

*2018*

*2019*

Source: Banco de México and INEGI.
Inflation declined sharply in 1Q-18, at a pace slightly faster than anticipated. This is explained by a combination of factors, including the monetary policy actions implemented, the dissipation of last year’s supply shocks, and peso appreciation.

**Contributions to CPI Inflation**

<table>
<thead>
<tr>
<th></th>
<th>December 2017</th>
<th>April* 2018</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline CPI</td>
<td>6.77</td>
<td>4.69</td>
<td>-2.08</td>
</tr>
<tr>
<td>Core</td>
<td>4.87</td>
<td>3.7</td>
<td>43.1</td>
</tr>
<tr>
<td>Non-Core</td>
<td>12.62</td>
<td>7.67</td>
<td>56.9</td>
</tr>
</tbody>
</table>

*/Data through the first fortnight of April 2018.

Source: Banco de México and INEGI.
Survey-based inflation expectations remain relatively stable, but surpass Banco de México’s projections, both in the short and the long term. Meanwhile, inflation breakevens have declined from recent peaks although increasing lately.

Source: Banco de México with data from PiP.
Even though NAFTA prospects have improved, the balance of risks for this scenario continues to be tilted to the upside.

- The future trajectory of the exchange rate remains the main risk, as it may be affected by a number of factors:
  - NAFTA renegotiation.
  - Monetary policy normalization in the US.
  - Volatility linked to Mexico’s elections.

- Additional pressures may be derived from:
  - The typically volatile behavior of non-core prices.
  - The evolution of aggregate demand.
The peso exchange rate has appreciated over the course of this year relative to the US dollar and other EME currencies, although a weakening has been observed in recent days. Operating conditions in the foreign exchange market have remained adequate.
Likewise, financial markets have shown an orderly behavior, while interest rate differentials with respect to the US have declined.

Source: Banco de México and PiP. Note: 5 April 2018 is the date around which long-term interest rates in Mexico started to display an upward trend.

Source: Banco de México, PiP and US Department of the Treasury.
The banking system is well capitalized and profitable, and has liquidity buffers well above requirements.

**Mexico’s Economic Perspectives**

Capital Adequacy Ratio
% of risk-weighted assets

Liquidity Coverage Ratio
%

Source: Banco de México.

Minimum Requirement

Source: Banco de México.
Furthermore, Mexican non-financial firms are adequately protected against scenarios of depreciation of the exchange rate and increase in interest rates.

- Debt placed by firms in international markets has been mostly contracted at fixed rates and long term.
- FX risks on foreign obligations are hedged, either naturally or via financial derivatives.
- Although some firms face refinancing and FX risks, the exposure of Mexican financial entities is low relative to their regulatory capital or their assets.
The monetary policy actions taken so far have allowed:

- To avoid second-round effects on prices from a number of shocks over a prolonged period.
- A downward trend in inflation.

Notwithstanding the accumulated increase of the reference rate since December 2015 (450 basis points), the monetary policy adjustment can hardly be deemed as excessive.

- Output gap projected at close to zero in 2018-2019.
- Upside balance of risks for inflation.
- Long-term inflation expectations above the target.
Even though some risks for the inflation outlook have receded, they have not dissipated and, in general, we continue to face high uncertainty levels.

Under these circumstances, monetary policy must continue to adhere to a cautious approach, and the possibility of further increases in the reference rate remains.

Naturally, actions of this nature will depend on a comprehensive analysis of:

- The performance of inflation and its expectations.
- The risks derived from either internal or external factors.

In addition, monetary policy would continue to carefully assess the potential implications of actions in this front for economic activity.
Further to the publication of quarterly forecasts for inflation a few months ago, the Banco de México has recently announced additional adjustments to its communications strategy to increase transparency and accountability:

- Inclusion of voter’s identity in the minutes of monetary policy decisions, as well as the reasons for dissents should they arise.

- Publication, with a three-year delay, of transcripts of the Board’s monetary policy meetings.

- Publication, simultaneously in both Spanish and English, of monetary policy statements and the corresponding minutes.

- Publication, no later than two days after the event, of speeches and public presentations of members of the Board.
Concluding Remarks

- The Mexican economy remains in a situation of high uncertainty, and risks of a considerable magnitude persist.

- However, its fundamentals provide a solid basis to face them.

- Important tasks are still pending, particularly for the medium and long terms.

- We must ensure the preservation of our achievements, continue to build upon the progress made so far, and implement any additional measures needed to tackle the remaining challenges.