Global activity has recovered, both in advanced and emerging economies. For 2018 and 2019, global output is expected to show a stronger expansion.

**GDP Growth Forecasts**

- **World**
  - April 2018
  - October 2017
- **Advanced**
- **Emerging**

**G4: 2018 and 2019 GDP Growth Forecasts**

- **U.S.**
- **Eurozone**
- **Japan**
- **U.K.**

**Emerging Economies: 2018 and 2019 GDP Growth Forecasts**

- **India**
- **China**
- **Russia**
- **Brazil**
- **Mexico**

Source: IMF, WEO October 2017 and April 2018.
Decreasing slack in advanced economies has led to a gradual rise of inflation and inflation expectations. Nonetheless, both indicators remain below central banks’ targets.

Advanced Economies

Output Gap¹
% of potential GDP

Unemployment Gap
%

G7: Evolution and Analysts’ Forecasts of Headline and Core inflation
%

¹ The model is estimated through a system of multiple equations that explain the distance between observed GDP and potential GDP as a result of three types of shocks, to: (1) the level of inflation, (2) the rate of unemployment, and (3) growth and inflation expectations. Source: IMF.

Note: The employment gap refers to the unemployment rate minus the natural rate of unemployment. Source: Bloomberg, Federal Reserve Bank of St. Louis, and OECD.

Note: Annual inflation is measured through the consumer price index of the G7 countries weighted by GDP. *Forecasts correspond to a GDP-weighted measure obtained from Bloomberg’s analysts survey. Source: Banco de México with data from Bloomberg and Haver Analytics.
Most of the advanced economies’ central banks are expected to move gradually towards a more neutral monetary policy stance. The Federal Reserve is expected to continue with a gradual normalization process, although there is greater uncertainty regarding interest rates in the medium term.

1/ OIS: Fixed-For-Floating swap where the fixed interest rate is the reference rate.
2/ Data for the observed federal funds rate corresponds to the average between the lower and upper bounds of the range (1.50% - 1.75%). Source: Banco de México with data from Bloomberg.

Source: Banco de México with data from Bloomberg.
U.S. interest rates have increased as a result of a strong cyclical recovery and an additional support from the fiscal expansion. This has generated more uncertainty in the outlook for inflation and induced an adjustment in other financial markets as well.
In this environment, Emerging Market Economies face three important challenges:

1. The end of the commodity super cycle:
   - Terms of trade shock.
   - Reduction of fiscal revenues.
   - Impact on GDP growth (cyclical and potential).

2. The normalization of monetary policy in advanced economies:
   - Federal Reserve’s monetary policy normalization (more uncertain environment).
   - More restrictive financial conditions that could affect investment decisions and capital flows.

3. Revision of the global integration model:
   - Review of regional integration agreements (Brexit and NAFTA renegotiation).
   - Less convergence in public policies (trade, fiscal, environmental, cooperation, among others).
   - Consequences for international trade, global chains of value and knowledge exchange.

These elements influence emerging economies in function of their:
   - Dependence to commodities (external and fiscal accounts).
   - Level of trade and financial flows’ openness.
In recent years, emerging market economies’ currencies have depreciated, reflecting the fall in commodity prices, higher interest rates in the United States, and the effects of the revision of the global integration model.

Nominal Exchange Rate and Commodities Prices

Index 2-jun-2014=100

Note: The vertical line refers to the commodities’ minimum price.
1/ Exchange rate in relation to USD.
Source: Bloomberg.
In this context, real exchange rates have depreciated, although this trend has recently reverted.

Real Exchange Rate 1/
Index jun-2014=100

1/ Refers to the BIS real effective exchange rate monthly averages. Source: BIS.
Outline

1. External Conditions Current Outlook

2. Monetary Policy and Inflation Determinants in Mexico
   2.1 Evolution of Economic Activity
   2.2 Recent Monetary Policy and Inflation

Outlook for the Mexican Economy
Available information suggests that, during the first months of 2018, Mexican economic activity kept expanding, driven mainly by the services sector and by a modest recovery of industrial production.
Private consumption kept expanding, although at a slower pace.

**Monthly Indicator of Private Consumption and its Components**
- Index 2013 = 100, s. a.

**Workers’ Remittances**
- Billions of dollars and constant pesos, s. a.

**Consumer Confidence Index and Real Total Wage Bill**
- Index 2013 = 100, s. a.

---

s. a. / Seasonally adjusted data.
1/ Prepared and seasonally adjusted by Banco de México. Includes national and imported goods.
Source: Mexican National Accounts System (SCNM), INEGI.

s. a. / Seasonally adjusted data.
2/ At prices from the December 2010 second half.
Source: Banco de México.

s. a. / Seasonally adjusted data.
Source: Prepared by Banco de México with data from the National Employment Survey (Encuesta Nacional de Ocupación y Empleo), INEGI.
Investment has shown a modest recovery in the last months.

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

**Real Value of Construction Output by Contracting Institutional Sector**  
Index Jan-2012=100, s. a.

s. a./ Seasonally adjusted data.  
Source: Mexican National Accounts System, INEGI.

s. a./ Seasonally adjusted data.  
1/ Seasonally adjusted by Banco de México, except for the total item.  
Source: Own calculations with data from ENEC, INEGI.
In recent years, the external sources of funding have declined, while domestic sources have substituted them. This, along with a decrease in the use of resources by the public sector, has allowed to mitigate the deceleration of financing to the private sector.

### Sources and Uses of Financial Resources
**Annual flows as % of GDP**

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total sources</strong></td>
<td>10.0</td>
<td>9.7</td>
<td>5.8</td>
<td>7.4</td>
<td>7.8</td>
</tr>
<tr>
<td>Domestic sources 1/</td>
<td>5.7</td>
<td>5.6</td>
<td>4.6</td>
<td>5.5</td>
<td>6.6</td>
</tr>
<tr>
<td>External sources 2/</td>
<td>4.2</td>
<td>4.1</td>
<td>1.2</td>
<td>1.9</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Total uses</strong></td>
<td>10.0</td>
<td>9.7</td>
<td>5.8</td>
<td>7.4</td>
<td>7.8</td>
</tr>
<tr>
<td>International reserves</td>
<td>1.0</td>
<td>1.3</td>
<td>-1.5</td>
<td>0.0</td>
<td>-0.4</td>
</tr>
<tr>
<td>Public sector financing</td>
<td>4.1</td>
<td>4.7</td>
<td>4.2</td>
<td>2.8</td>
<td>1.1</td>
</tr>
<tr>
<td>Private sector financing</td>
<td>4.2</td>
<td>2.5</td>
<td>3.1</td>
<td>3.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Domestic</td>
<td>2.5</td>
<td>1.7</td>
<td>3.0</td>
<td>3.0</td>
<td>3.3</td>
</tr>
<tr>
<td>External</td>
<td>1.7</td>
<td>0.8</td>
<td>0.1</td>
<td>0.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Other concepts 3/</td>
<td>0.7</td>
<td>1.2</td>
<td>0.1</td>
<td>1.6</td>
<td>3.2</td>
</tr>
<tr>
<td><strong>Current Account Deficit</strong></td>
<td>2.4</td>
<td>1.8</td>
<td>2.5</td>
<td>2.1</td>
<td>1.6</td>
</tr>
</tbody>
</table>

**Note:** Figures expressed in percent of the nominal average annual GDP.
1/ Corresponds to the domestic financial assets aggregate F1, which includes the monetary aggregate M3 plus other instruments held by resident sectors that hold money, and which are not considered in the monetary aggregates.
2/ Includes the monetary aggregate M4 held by non-residents, the external debt of the Federal Government, the external debt of public agencies and companies, the external liabilities of commercial banks, external financing to the non-financial private sector, the fund raising of agencies and other holdings of non-monetary instruments by non-residents.
3/ Includes capital accounts, and results and other assets and liabilities of commercial and development banks, non-bank financial intermediaries, of the National Housing Fund (Infonavit) and Banco de México—including the securities issued by this Central Institute for the purposes of monetary regulation, especially those related to neutralizing the monetary impact by the operational surplus—. Similarly, it includes non-monetary liabilities from the Institute for the Protection of Bank Savings (IPAB), as well as the effect of the change in the valuation of public debt instruments, among other concepts.

Source: Banco de México.

---

### Domestic Financing to the Non-Financial Private Sector 4/
**Real annual % change**

**Firms 5/**

**Housing**

**Consumption**

4/ Data adjusted due to the withdrawal from and the incorporation of some financial intermediaries to the credit statistics. 5/ Data adjusted due to exchange rate variations.

Source: Banco de México.
The external accounts have reverted their medium-term trends, and now the oil-trade balance is in deficit and the non-oil balance showed a surplus in 2017.

**Exports**
Index 2013=100, s. a.

**Trade Balance**
USD millions

s. a./ Seasonally adjusted data.
Source: Banco de México.

1/ Data up to February 2018.
Source: SAT, SE, Banco de México, INEGI. Merchandise Trade Balance, SNIEG. Information of National Interest.
Regarding the cyclical position of the economy, slack conditions have been tightening, particularly in the labor market.

Output Gap 1/
% of potential output, s. a.

Note: Confidence interval of the output gap calculated with an unobserved components method. The dotted line refers to the confidence interval for the gap calculated excluding the oil sector while the blue area is the interval corresponding to the total GDP.

1/ Estimated using the Hodrick-Prescott (HP) filter with tail correction; see Banco de México Inflation Report, April–June 2009, p.69.

Source: Estimated by Banco de México with data from INEGI.

Monthly Slack Index 2/
%

2/ Index constructed based on the Model Confidence Set (MCS) methodology; see Banco de México Inflation Report, October–December 2017. Monthly slack index is based on the first principal component of a set that includes 11 indicators. The first component represents 51% of the joint variation of the monthly indicator. Gray lines correspond to individual slack indicators used in the analysis of Principal Components.

Source: Own elaboration with data from INEGI and Banco de México.

Labor Market Gap: Unemployment Rate and Informal Salaried Workers
Percentage points, s. a.

s. a./ Seasonally adjusted data.
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.
Outline

1. External Conditions Current Outlook

2. Monetary Policy and Inflation Determinants in Mexico
   2.1 Evolution of Economic Activity
   2.2 Recent Monetary Policy and Inflation
In 2017, inflation was strongly influenced by a series of domestic and external shocks of considerable magnitude, including: the depreciation of the Mexican peso, higher energy prices, higher public transportation fares, and increased prices for some agricultural products. However, as anticipated, in January it started to decline as a result of a decrease in both core and non-core inflation, reaching 5.04% in March.
As for core inflation, the difference in the growth of merchandise and services prices reflects the adjustment in relative prices, originated by the real exchange rate depreciation. Both subindexes have started to decrease, partly due to the fading of indirect effects generated by cost increases.
In 2017, a number of significant shocks influenced non-core inflation, pushing it to high levels by late 2017. Even though in early 2018 non-core inflation began to decline, it continued to reflect the shocks that had affected it in late 2017.

Source: Banco de México and INEGI.
At the beginning of the year, the prices of LP gas, fruits and vegetables, and merchandise started to decrease.

Consumer Price Index (CPI)
Incidences in percentage points

Selected Components of CPI
Annual % change and incidences in percentage points

Source: Banco de México and INEGI.
Despite the significant depreciation of the peso in recent years, the exchange rate pass-through to prices remains at low levels, reflecting a better functioning of the nominal system of the economy.

Real Bilateral Exchange Rate
Between Mexico and the United States
Index 1992=100

Headline Inflation and Nominal Depreciation Rate
Annual % change

Outlook for the Mexican Economy

Source: Bureau of Labor Statistics, INEGI, and Banco de México.

Source: Banco de México and INEGI.
In the monetary policy meeting of February, Banco de México’s Governing Board raised the target for the Overnight Interbank Interest Rate to 7.50%. In April, the Board decided to leave the reference rate unchanged. The current monetary policy stance is consistent with both the anchoring of inflation expectations and the downward trend of annual inflation to its target.

Source: Banco de México and INEGI.

1/ The short-term ex-ante real rate is constructed using the Target for the Overnight Interbank Interest Rate and 12-month inflation expectations from Banco de México Survey. The dotted line corresponds to the midpoint of the range. Source: Banco de México.
The evolution of non-core inflation led to increases in headline inflation expectations for the end of 2018. However, medium- and long-term expectations remained stable, although at around 3.5%, slightly above the target level.

For a description of the estimation of log-term inflation expectations, see the Box “Decomposition of Break-even Inflation” in the Quarterly Report, October – December 2013. The estimate was updated by including data as of November 2017. Source: Banco de México Survey (monthly periodicity) and Citibanamex Survey (biweekly periodicity).
The increase in the reference rate in February has been reflected in higher short-term interest rates, while also contributing to a decline in medium- and longer-term rates.
Medium and long-term interest rate spreads between Mexico and the United States have decreased, while medium and long-term bond’s holdings by foreign investors have remained relatively stable.

1/ The United States objective rate is the average of the interval considered by the Federal Reserve. Source: Proveedor Integral de Precios (PIP) and U.S. Treasury Department.

2/ The countries selected are Brazil, Chile, Colombia, Turkey, South Africa, South Korea and Poland. Source: Bloomberg.

3/ The total includes CETES, bonds, udibonos, bondes and bondes D. Source: Banco de México.
Headline inflation is expected to continue to decline, approaching the 3.0% target during the year, attaining it in Q1 2019, and fluctuating around such target for the remainder of that year. Core inflation will continue to decline gradually, reaching levels close to 3.0% in Q1 2019, and it is expected to consolidate its convergence to 3.0% during the rest of that year.

1/ Quarterly average of annual inflation. The next four and six quarters are indicated as of the first quarter of 2018, that is, the first and third quarters of 2019, periods in which the monetary policy transmission channels fully operate. Note: For the tables presented, the calculation of annual inflation for each quarter is obtained by comparing the average index of the quarter with respect to the average index of the same quarter of the previous year. Hence, this figures can differ from the simple average of annual inflations of each month of the corresponding quarter.

Source: Banco de México and INEGI.
Monetary Policy Stance

- To guide monetary policy actions, the Governing Board closely monitors *inflation with respect to its expected path, considering the adopted monetary policy stance and the horizon at which monetary policy operates*, as well as available information of all inflation determinants and medium- and long-term inflation expectations, including the balance of risks.

- Looking forward, the Board has emphasized that it will continue to follow the:
  - Potential pass-through of exchange rate fluctuations on prices.
  - Relative monetary policy stance between Mexico and the U.S.
  - Evolution of slack conditions in the economy.

- In light of factors that imply risks for inflation and inflation expectations, the monetary policy will act in a *timely and robust* manner.