BANCO DE MÉXICO®

Executive Summary

Quarterly Report April - June 2024

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Summary*

During the period analyzed by this Report, in view of the significant increases in non-core inflation, headline inflation rose in Mexico. Core inflation continued decreasing as the effects of the global shocks continued fading in the context of a tight monetary policy stance. However, regarding its components, the services index showed greater persistence than expected. The notorious weakness of domestic economic activity exhibited since the end of last year continued. Looking ahead, economic activity is expected to expand at a slower pace than previously anticipated, which could contribute to ease inflation pressures. On the other hand, episodes of financial volatility were observed in Mexico due to both idiosyncratic and global factors, and the Mexican peso depreciated notably. Thus, the outlook for inflation in Mexico was affected by various macroeconomic and financial factors. Considering the environment described above, in the May and June meetings, the Governing Board decided to pause the downward adjustments to the reference rate. Subsequently, at the August meeting, it lowered the reference rate by 25 basis points (bps). This was done considering the decline in core inflation and prospects that headline inflation will resume a downward trajectory as the shocks on non-core inflation dissipate.

Externally, world economic activity expanded in the second quarter of 2024 at a slower pace than in the previous quarter, albeit heterogeneously among countries. This generally reflected the slower growth in emerging economies, after performing robustly during the first quarter. Meanwhile, advanced economies grew at a faster pace than in the previous quarter. In the particular case of the United States, based on GDP's flash estimate, its quarterly variation rate was higher than that of the previous quarter. In the euro area, the economy registered growth similar to that of the first quarter of 2024. The recovery of economic activity in Japan exceeded expectations, after having contracted in the previous quarter. The Chinese economy decelerated during the second quarter of 2024. Forecasts for 2024 by international organizations suggest that world economic activity could grow at a marginally lower rate than that observed in 2023.

The box *Export similarity index between advanced and emerging countries in the context of world trade reconfiguration* presents a measure of the similarity in the composition of manufactured goods' exports across various emerging and advanced countries. The results indicate that over the last four years China's exports have become more similar to those of advanced economies. In contrast, the similarity in exports of other developing countries and advanced economies has not increased significantly in recent years. The results suggest a growing direct competition in international trade between China and advanced countries.

Regarding global inflation, annual headline inflation exhibited mixed behavior across economies in the second quarter of 2024. On the one hand, it declined in several of the major advanced economies. In particular, in the United States, it declined during the reported period, partly as a result of lower pressures on services prices. However, in some other advanced economies, inflation readings registered slight increases in some months, to some extent, due to pressures on energy prices in those countries. On the other hand, headline inflation increased in a large number of major emerging economies. This was partly due to higher pressures on energy and food prices. In this environment, although progress in disinflation has advanced after the occurrence of global shocks, it continues facing challenges and risks.

In the period analyzed in this Report, central banks' decisions regarding their reference rates remained heterogeneous considering the specific economic circumstances of each country. Several central banks

* *Note: In the electronic version of this document, the information that allows to generate all the charts and tables included in this Report can be obtained by clicking on them, except for those that are not produced or prepared by Banco de México.*

in the main advanced economies lowered their reference rates. However, other central banks left them unchanged, most notably the US Federal Reserve. Japan, in contrast, increased it in July, after having raised it in March. Across emerging economies, some central banks, mainly in Latin America and Eastern Europe, continued lowering their reference rates. However, some central banks moderated the pace of their reference rate cuts or even kept their rates unchanged in their most recent decisions.

The resilience of economic activity and the persistence of inflation in some advanced economies during the first quarter of 2024 and the beginning of the second one generated expectations of slower reference rate adjustments in the future than previously expected. In this context, there was a temporary tightening of global financial conditions in April. However, subsequent data contributed to a greater confidence on the convergence of inflation to its target. In addition, in early August, lower-than-anticipated employment data in the United States led to an increased risk perception regarding a possible further weakening of economic activity in that country. In addition, the Bank of Japan's unanticipated increase in its reference rates contributed to a differentiated adjustment in the expected trajectory of monetary policy rates in different economies. In this context, stock markets, foreign exchange markets, and interest rates exhibited significant volatility.

Domestically, after Mexican markets exhibited a stable performance in May, in line with what was observed internationally, in early June there was an episode of lower risk appetite for Mexican assets due to idiosyncratic factors. Volatility in national financial markets increased. In addition, medium- and long-term interest rates on government bonds rose significantly, sovereign risk indicators showed an upturn, and the Mexican peso depreciated notably. Although financial markets began stabilizing in mid-June, they were affected by the volatility of international financial markets in August.

During the second quarter of 2024, the noticeable weakness that the Mexican economy had registered since the end of 2023 prevailed. This behavior reflected, primarily, the sluggishness of industrial activity and the loss of dynamism in services. In addition, so far this year, primary sector activities have contracted significantly in some months. The slowdown in economic activity has translated into a certain moderation in some labor market indicators. In particular, the pace of creation of formal jobs registered with IMSS has clearly decelerated, mainly as a result of stagnant job creation in manufacturing and lower employment growth in the construction sector. Looking ahead, the national economy is expected to continue growing at a moderate pace, mainly supported by domestic spending. Nevertheless, risks to the Mexican economy persist in light of the uncertainty associated with both internal and external factors.

Between the first and second quarters of 2024, annual headline inflation in Mexico increased from 4.57 to 4.77%, and then to 5.57% in July. This performance derived exclusively from the rise in non-core inflation. Nevertheless, in the first fortnight of August, annual headline inflation decreased to 5.16% as non-core inflation moderated. Core inflation, which better reflects the medium-term trend of inflation, decreased from 4.65 to 4.23% between these quarters and stood at 3.98% in the first fortnight of August. Its decline continued to respond to the fading of the shocks associated with the pandemic and with the military conflict in Ukraine, as well as to the implemented monetary policy actions. Regarding its components, merchandise inflation continued decreasing. Services inflation remained at high levels without showing a clear downward inflection point, although the annual variation in the prices of some of its components has moderated. Meanwhile, non-core inflation increased from 4.31 to 6.46% in this quarterly period and further to 10.36% in July. This upward trajectory was attributed to the higher variations in LP gas prices due to the evolution of its international references, as well as to greater variations in agricultural and livestock product prices affected by supply shocks. In the first fortnight of August, non-core inflation declined to 8.80% due to a certain reversal of the shocks that had affected it.

The box *Main elements of the update of the 2024 Consumer Price Index* outlines the most relevant changes implemented by INEGI to the CPI and made public in the release of inflation data corresponding to the first fortnight of August 2024. Some of the modifications include the update of the weights of the items that compose the CPI basket of goods and services using the expenditure data from the 2022 Seasonal ENIGH (the National Survey of Household Income and Expenditure). The purpose of this update is to reflect changes in household consumption patterns in Mexico. Also, the number of items comprising the CPI basket was adjusted.

Regarding monetary policy decisions, after the Governing Board reduced the reference rate by 25 bps at its March meeting, it paused these adjustments at its May and June meetings. At the May meeting, although core inflation continued to decline due to the downward trajectory of merchandise inflation, services inflation displayed a greater persistence than anticipated. The effects of the shocks were thus estimated to dissipate more gradually than previously expected, implying that inflation would converge to its target by the fourth quarter of 2025. Subsequently, at the June meeting, as previously mentioned, available information indicated a greater-than-expected weakness in economic activity. Nevertheless, the risk of an exchange rate depreciation materialized, in a context in which headline inflation had increased due to the behavior of its non-core component. Lastly, at the August meeting, the Board considered the nature of the shocks that have put upward pressure on non-core inflation and the expectation that their effects on headline inflation will dissipate in the coming quarters. It also considered the path followed by core inflation and the prospects that it will continue declining. It considered that, although the inflationary outlook still calls for a restrictive policy stance, given the evolution it has shown, it was appropriate to reduce the level of monetary tightening. In this context, the Board decided to lower the reference rate by 25 bps to 10.75%.

Looking ahead, the Board foresees that the inflationary environment may allow for discussing reference rate adjustments. It will consider that global shocks will continue fading and the effects of the weakness in economic activity. It will take into account the incidence of the monetary policy stance that has been maintained and that prevailing in the future on the evolution of inflation throughout the horizon in which monetary policy operates. Actions will be implemented in such a way that the reference rate remains consistent at all times with the trajectory needed to enable an orderly and sustained convergence of headline inflation to the 3% target during the forecast period. The central bank reaffirms its commitment with its primary mandate and the need to continue its efforts to consolidate an environment of low and stable inflation.

The box *Evidence of the pass-through from the monetary policy target rate to bank interest rates in Mexico* shows how these adjusted upwards in response to the change implemented in the monetary policy stance as of 2021. These adjustments reflected the functioning of monetary policy's transmission mechanism operating through the loanable funds market in Mexico. In terms of credit to the private sector, the increase was greater in the corporate segment. With respect to bank deposits, the increase in yields on term instruments was greater than that observed in demand deposits.

As for Banco de México's macroeconomic outlook, the following stands out:

Growth of the national economy: Economic activity in Mexico is experiencing a period of marked weakness. It slightly contracted in the last quarter of 2023. Subsequently, it exhibited marginal growth in the first quarter of 2024. In the previous Report, the pace of growth of economic activity was expected to recover in the second quarter. However, during that period, growth continued surprising to the downside and turned out to be significantly lower than expected. Thus, the estimate for the variation of GDP in 2024 as a whole published in the current Quarterly Report is lower than that of the previous Report.

Economic growth is expected to be moderate in 2024 and 2025, supported mainly by domestic spending. In particular, private consumption and, to a lesser extent, private investment, are expected to continue increasing. The contribution of the latter would be lower than previously expected, given the lower dynamism that this aggregate has shown and the environment of uncertainty that persists due to both domestic and external factors. Although positive effects from public spending are still expected, they are foreseen to be lower than originally anticipated. External demand will continue making a low contribution to Mexico's growth during 2024 as the US manufacturing sector is expected to remain weak. By 2025, the better performance of US industrial production that is expected would contribute to a higher external demand in Mexico, although these forecasts are subject to high uncertainty.

Based on the above, the GDP point estimate for 2024 is revised from 2.4% in the previous Report to 1.5% in the current one (Chart 1a and Table 1). The range of expected GDP growth for the year is adjusted to one between 1.1 and 1.9%. This range is tighter than that of the previous Report given the greater available information. The point estimate of GDP growth for 2025 is 1.2%, which compares to that of 1.5% in the previous Report. The range for the expected GDP variation for that year is adjusted to between 0.4 and 2.0%.[1]

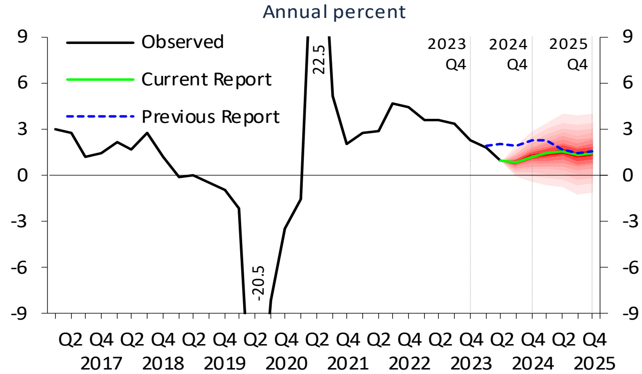
Regarding the cyclical position of the economy, the point estimate of the output gap is expected to remain close to zero for the remainder of 2024, and then become persistently negative throughout 2025, albeit not statistically different from zero (Chart 1b). The estimate of this non-observable indicator is subject to a high degree of uncertainty.

Table 1
Forecasts for GDP growth
Annual percent

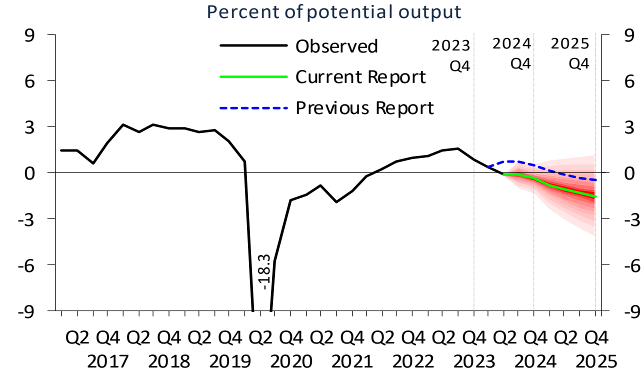
Year	Central	Interval
2024	1.5	Between 1.1 and 1.9
2025	1.2	Between 0.4 and 2.0

Note: Not seasonally adjusted forecasts. The central estimates for 2024 and 2025 compare with the previous Report's forecasts of 2.4 and 1.5% for each year. Intervals compare to those published in the previous Report of 1.9 and 2.9% for 2024 and 0.7 and 2.3% for 2025. Mexico's GDP increased 3.2% in 2023 with figures that are not seasonally adjusted.
Source: Banco de México.

Chart 1
a) Fan chart: GDP growth, s.a.
Annual percent



b) Fan chart: output gap estimate, s.a.
Percent of potential output



s.a. Seasonally adjusted figures.
Note: In the present Report the forecast begins in Q3 2024. In the previous Report, it started in Q2 2024.
Source: a) INEGI and Banco de México. b) Banco de México.

Employment: Table 2 presents the forecasts for the number of IMSS-insured jobs.

[1] Using seasonally adjusted data, the forecast for GDP growth in 2024 is 1.2% and 1.4% in 2025. The difference between seasonally adjusted and original data is greater than usual for these years, to a large extent, because 2024 is a leap year.

Table 2
Forecasts for the number of IMSS-insured jobs
Annual change in thousands of jobs

Year	Interval current report	Interval previous report
2024	Between 410 and 550	Between 510 and 670
2025	Between 430 and 630	Between 510 and 710

Note: In 2023, the number of IMSS-insured jobs increased by 662 thousand jobs.
Source: Banco de México.

The box *Sectoral contributions to labor productivity growth in Mexico: 1990-2022* shows the results of an accounting breakdown of aggregate labor productivity changes that differentiates between labor productivity improvements at the sectoral level and changes in the relative sizes of economic sectors over time. In recent decades, progress in labor productivity at the sectoral level was the factor that contributed the most to the increase in aggregate labor productivity in Mexico. The manufacturing sector was the one with the highest growth in labor productivity, although the decline in its relative weight offset its contribution to the increase in aggregate labor productivity. Meanwhile, although the increase in labor productivity of services was lower than that of manufacturing, the former was the one that had the greatest impact on the evolution of aggregate labor productivity, given its increasing relative weight in the economy. Overall, the sectors that raised their labor productivity decreased their relative size, and vice versa.

Current account: Table 3 shows the forecasts for the trade balance and the current account based on the latest information.

Table 3
Forecasts for the trade balance and current account

Year	2024	2025
Trade balance		
% of GDP	Between -1.0 and -0.6	Between -1.3 and -0.8
Billions of dollars	Between -19.0 and -11.0	Between -23.7 and -13.7
Current account		
% of GDP	Between -1.2 and -0.5	Between -1.3 and -0.4
Billions of dollars	Between -22.0 and -9.5	Between -23.4 and -7.4

Note: Figures for 2024 compare with those of the previous Report of a trade balance of between -27.5 and -19.5 billion dollars (-1.4 and -1.0% of GDP) and a current account balance of between -24.6 and -12.1 billion dollars (-1.3 and -0.6% of GDP). Figures for 2025 compare with the previous Report's figures of a trade balance of between -28.5 and -18.5 billion dollars (-1.5 and -1.0% of GDP) and a current account balance of between -28.1 and -12.1 billion dollars (-1.5 and -0.6% of GDP). In 2023, the trade balance was -5.5 billion dollars (-0.3% of GDP) and the current account balance was -5.5 billion dollars (-0.3% of GDP).
Source: Banco de México.

Risks to growth: Some downside risks to economic activity are considered to have gained relevance compared to the previous Report. Thus, the balance of risks to the growth of economic activity over the forecast horizon is now considered to be biased to the downside. Among risks to the downside in the forecast horizon, the following stand out:

i. That, despite the dynamism of the US economy, it grows less than expected, to the detriment of Mexico's external demand.
ii. That numerous electoral processes around the world and their results increase uncertainty in the short term regarding the actions to be implemented or that in the long term they lead to policies that adversely affect external demand and consumption and investment spending in Mexico.

iii. That public spending provides a lower-than-expected boost to economic activity.

iv. That the escalation of several geopolitical conflicts in different regions of the world negatively affects the global economy or international trade flows in particular.

v. That tighter-than-expected financial conditions and/or episodes of volatility in international financial markets materialize, affecting financial flows to emerging economies.

vi. That severe weather phenomena, such as extreme temperatures, cyclones, or droughts adversely impact the Mexican economy.

Among risks to the upside in the forecast horizon, the following stand out:

i. That growth of the US economy is greater than expected, favoring Mexico's external demand.

ii. That public spending provides a greater-than-expected boost to economic activity.

iii. That, within the USMCA framework, the global reconfiguration of production processes provides a greater-than-expected boost to investment.

Inflation: In this Quarterly Report, forecasts for headline and core inflation remain unchanged compared to those announced in the Monetary Policy Statement of August 8, 2024. Compared to the forecast of the previous Report, the current one considers higher levels of headline inflation between the third quarter of 2024 and the first quarter of 2025 (Charts 2 and 3, and Table 4). This upward adjustment reflects the pressures that have affected non-core inflation. In particular, this revision considers higher-than-anticipated variations in the prices of agricultural and livestock products as a result of the supply shocks they have been subject to, as well as greater variations in energy prices, mainly due to the increase in their international references. Given their nature, non-core inflation shocks are expected to fade in the coming quarters. Specifically, supply shocks on agricultural and livestock products resulting from adverse weather conditions tend to reverse relatively fast as production recovers.

The forecast for core inflation in the current Report is similar to that published in the previous Report. However, it incorporates two factors that tend to counteract each other. On the one hand, it considers a more depreciated exchange rate. On the other hand, it includes a weaker-than-expected level of economic activity. Consequently, the forecast for core inflation to continue decreasing and to reach 3% in the fourth quarter of 2025 is maintained. It is still expected that in the coming quarters, services inflation will show a clearer downward trend and that merchandise inflation will no longer exhibit the downward trend it has had until now.

The purpose of the box *Evolution of the exchange rate pass-through to inflation* is to update estimates of the effect of exchange rate fluctuations on consumer prices in Mexico. The results suggest that the pass-through from the exchange rate to inflation has remained relatively stable in the periods that span up to the pandemic and up until the most recent data. Moreover, the results of estimates conditional on economic activity suggest a higher pass-through when the economy is operating above its potential compared to when it is below.

Given the expectation of a reduction in core inflation, particularly in its services component, and that the shocks to non-core inflation will fade in the following quarters, as of the second quarter of 2025 the forecast for headline inflation is at practically the same levels as those considered in the forecast of the previous Report. Thus, headline inflation is still expected to converge to the target of 3% in the fourth quarter of 2025.

Table 4 and Chart 4 present the annual rate of change and annualized seasonally adjusted quarterly rate of change of headline and core inflation. It is observed that, after the third quarter of 2024, the seasonally adjusted annualized quarterly rates of the headline index decline faster than the annual variations. Also, the annualized seasonally adjusted quarterly rates of the core index, which would stand at 3.7% in the third quarter of 2024, would be around 3% starting from the first quarter of 2025. Since annual rates are influenced over twelve months by short-term shocks on inflation, their reduction is slower than that of seasonally adjusted quarterly rates of change. Thus, annual variations are above seasonally adjusted ones at the stage when shocks to inflation are assimilated, during most of the forecast horizon, for both headline and core inflation.

The box *Pass-through of variations in non-core inflation to core inflation* seeks to assess the impact of shocks to non-core inflation on core inflation using linear time series models. The results of the estimates suggest that the pass-through of fluctuations in CPI agricultural and livestock prices and PPI energy prices to core inflation is low, and thus the effects have been limited during the analyzed period.

In addition to Banco de México's monetary policy actions, the expected trajectories for headline and core inflation reflect the prevision that the effects of the shocks from the pandemic and the military conflict in Ukraine will continue fading. They also consider the mitigation of the shocks that have increased non-core inflation, moderating the high and atypical levels it has exhibited. However, the possibility that the effects of the shocks on inflation may be longer-lasting, that they may worsen, or that new shocks may occur that exert upward pressure on inflation cannot be ruled out. In this context, the balance of risks for the expected trajectory of inflation within the forecast horizon is considered to still remain biased to the upside.

The results of the box *Update of the estimate of the neutral rate in Mexico* indicate that, in real terms, it lies within an interval of 1.8 to 3.6 percent, with a mid-point of 2.7 percent. These estimates are similar to those obtained previously, which were published in the Quarterly Report April-June 2019. The neutral rate is interpreted as the interest rate level that, in the absence of shocks, would prevail with inflation equal to its target and economic activity at its potential.

Among main risks for inflation, the following stand out:

On the upside:

i. Persistence of core inflation, given the magnitude, scope and duration of the shocks that have been faced.
ii. That the Mexican peso shows a greater depreciation.
iii. Higher cost-related pressures that could pass on to consumer prices.
iv. Climate-related impacts that could affect the prices of several agricultural and livestock products.
v. An escalation of geopolitical conflicts that could cause disruptions in global production chains.

On the downside:

i. A lower-than-anticipated economic activity in the United States and in Mexico, which could entail lower pressures on inflation in Mexico.
ii. That the pass-through of cost-related pressures to prices is limited.
iii. That the recent depreciation of the Mexican peso has a lower-than-anticipated effect on inflation.

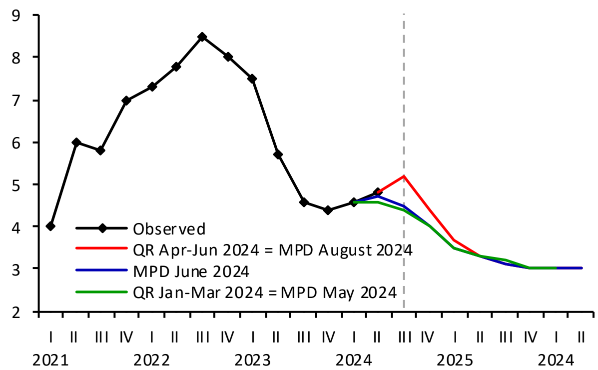
Table 4
Forecasts for headline and core inflation
Annual percentage change of quarterly average indices

	2024				2025				2026	
	I	II	III	IV	I	II	III	IV	I	II
CPI										
Current Report = Monetary Policy Statement of August 2024 1/	4.6	4.8	5.2	4.4	3.7	3.3	3.1	3.0	3.0	3.0
Previous Report = Monetary Policy Statement of May 2024 2/	4.6	4.6	4.4	4.0	3.5	3.3	3.2	3.0	3.0	
Core										
Current Report = Monetary Policy Statement of August 2024 1/	4.7	4.2	4.0	3.9	3.6	3.3	3.1	3.0	3.0	3.0
Previous Report = Monetary Policy Statement of May 2024 2/	4.7	4.3	4.0	3.8	3.5	3.3	3.2	3.0	3.0	
Memo										
Annualized seasonally adjusted quarterly variation in percent 3/										
Current Report = Monetary Policy Statement of August 2024 1/										
CPI	5.3	4.4	5.2	2.6	2.9	2.8	3.9	2.3	2.8	2.8
Core	4.3	3.6	3.7	3.7	3.2	2.7	3.0	3.1	3.0	2.8

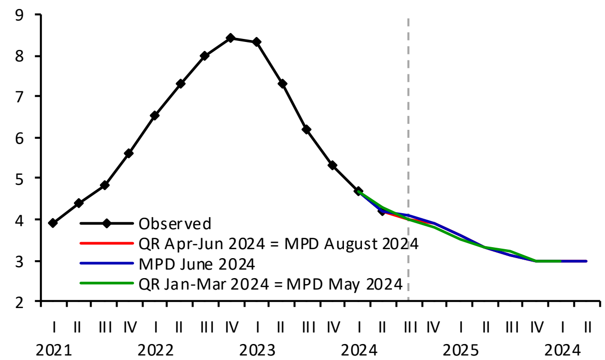
1/ Forecast starting August 2024. It corresponds to the forecast published in the Monetary Policy Statement of August 8th 2024.
2/ Forecast starting April 2024. It corresponds to the forecast published in the Monetary Policy Statement of May 9th 2024.
3/ See Methodological Note on seasonal adjustment process.
Source: INEGI for observed annual variation figures and Banco de México for seasonally adjusted figures and forecasts.

Chart 2

Annual headline inflation forecasts 1/
Percent



Annual core inflation forecasts 1/
Percent

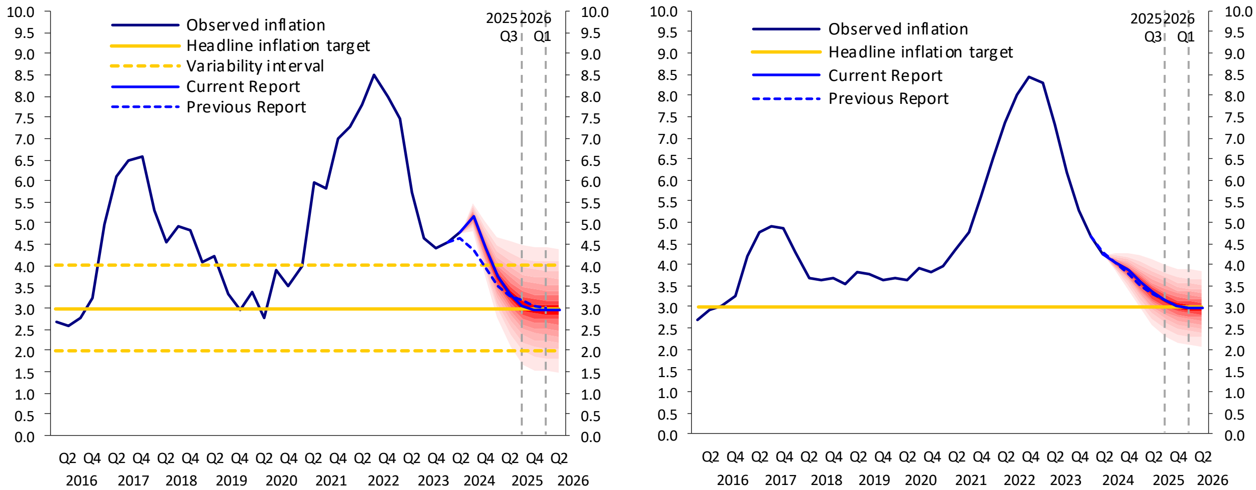


1/ Annual percentage change of quarterly average indices. QR refers to Quarterly Report and MPD refers to Monetary Policy Decision. Vertical line corresponds to second quarter of 2024.
Source: Banco de México and INEGI.

Chart 3

a) Fan chart: annual headline inflation[1/]
Percent

b) Fan chart: annual core inflation[1/]
Percent

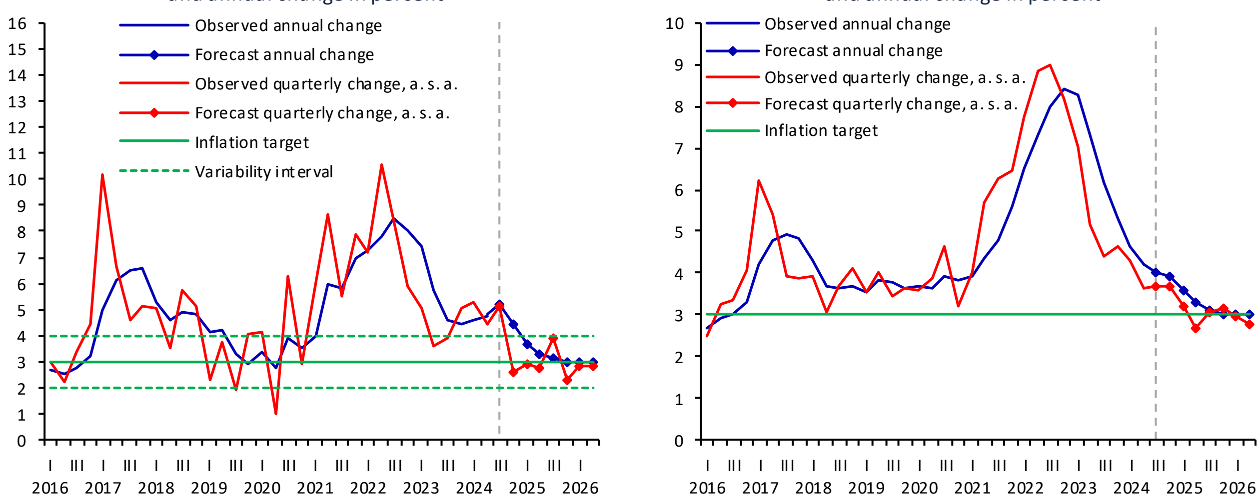


1/ Annual percentage change of quarterly average indices. The next four and six quarters are indicated with vertical lines, using as a reference the third quarter of 2024, that is, the third quarter of 2025 and the first quarter of 2026, respectively, to indicate the time frames in which the transmission channels of monetary policy fully operate.
Source: Banco de México and INEGI.

Chart 4

a) Headline index
Quarterly change, annualized and s.a., and annual change in percent[1/]

b) Core index
Quarterly change, annualized and s.a., and annual change in percent[1/]



s.a./ seasonally adjusted figures.
a.s.a./ annualized seasonally adjusted figures.
1/ Calculated using the quarterly average indices.
Vertical line corresponds to third quarter of 2024.
Source: Banco de México and INEGI.

The significant deceleration of economic activity in Mexico has occurred in a global environment in which uncertainty prevails regarding the evolution of monetary policy stances, and of trade policies in advanced economies, and in which various geopolitical conflicts persist. In addition, there have been episodes of volatility in Mexican financial markets caused by domestic factors. The country's solid macroeconomic framework has allowed it to face this complex scenario. In order to continue addressing future challenges, it is important to consistently uphold these fundamentals through fiscal discipline, a sound financial system, a well-capitalized banking sector, sustainable external accounts, a flexible exchange rate that helps to absorb potential shocks, and a monetary policy focused on maintaining the purchasing power of the Mexican peso. In this vein, Banco de México's Governing Board will continue to set its monetary policy stance with the firm commitment to foster an orderly adjustment of relative prices, financial markets, and the economy as a whole, in order to lead inflation to its 3% target and ensure the anchoring of inflation expectations. In addition, given the deterioration of the balance of risks for national economic growth, continuing to foster a business environment and strengthening the rule of law would help to enhance Mexico's attractiveness as an investment destination. Similarly, continuing to provide the right incentives to efficiently allocate the economy's productive resources would boost productivity and increase value creation. All of this would foster a more robust and sustained economic growth that would lead to a greater national development and, consequently, to a greater well-being of Mexico’s population.

BANCO DE MÉXICO®

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