BANCO DE MÉXICO®

Executive Summary

Quarterly Report October - December 2024

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Summary*

Headline inflation in Mexico declined during the fourth quarter of 2024, after having increased in the previous three quarters due to supply shocks affecting non-core inflation. Core inflation continued its downward trend for its eighth consecutive quarter, reaching levels similar to those registered before the onset of the pandemic. Meanwhile, non-core inflation declined as the shocks that had affected it eased. Mexico's economic activity contracted. Domestic financial markets exhibited volatility during the reporting period, mainly due to the possible implementation of some measures that could weaken integration with our main trade partner. In this context, Banco de México continued with the reference rate cutting cycle, moderating the level of monetary restriction. Looking ahead, it could continue calibrating the monetary policy stance and consider adjusting it by a magnitude similar to that of the February decision. It foresees that the inflationary environment will allow the cutting cycle of the reference rate to continue, while maintaining a restrictive stance.

Externally, world economic activity during the fourth quarter of 2024 grew at a rate slightly lower than that registered throughout the year, with marked differences across countries. In the case of the United States, although its economy grew at a slightly lower rate than in the previous quarter, this growth continued to be solid and relatively more dynamic than the rest of the main advanced economies. As for the euro area, its economy practically stagnated in the last quarter of 2024. The Chinese economy expanded at a faster pace compared to the previous quarter. Global growth forecasts by international organizations for 2025 point to a performance of economic activity similar to that observed in 2023 and that expected for 2024, although with significant differences in growth rates across countries.

Throughout 2024, progress was made in the convergence of inflation to central banks' targets mainly in advanced economies, although various of these economies registered an increase in headline inflation in the fourth quarter of the year. In emerging economies, headline inflation fluctuated during the year, reflecting specific circumstances in each country. Thus, when comparing the current inflation level with that of the previous year-end, the result is mixed, as inflation increased in some economies and decreased in others. Regarding annual core inflation, although it exhibited certain persistence, it is below the levels registered at the end of 2023 in the vast majority of countries. In this context, the convergence of inflation to the central banks' targets continues facing challenges worldwide.

During the period covered by this Report, many central banks in the main advanced and emerging economies lowered their reference rates. However, some of them have kept them unchanged in recent decisions after having previously reduced them. Others decided to raise them in response to local conditions. The US Federal Reserve lowered the federal funds rate on two additional occasions, accumulating three reductions over 2024. It subsequently left it unchanged in its January 2025 decision. The median of the Federal Open Market Committee's (FOMC) forecasts for the federal funds rate for the end of 2025 increased in December from that of September. The above, together with the uncertainty associated with the possible impact on economic and inflationary conditions derived from the implementation of economic policies by the new US administration, contributed to an upward revision of the expected path for the federal funds rate implicit in the swap curves (OIS) compared to what was anticipated at the end of the third quarter.

* *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.*

The box *An econometric model to explain the recent behavior of US financial markets* analyzes the evolution of the 10-year rate and the stock market in the US, as well as the dollar index during the second half of 2024. Making use of the co-movements among these variables, it is possible to extract shocks that can be interpreted as reflecting changes in expectations of monetary, growth and risk conditions. The results suggest that the US Federal Reserve's downward revision of the expected path of monetary policy at the beginning of the semester boosted stock markets and weakened the dollar. However, uncertainty about growth moderated this effect. Towards the end of the year, an improvement in the growth outlook contributed to the dollar's recovery and raised the yields on 10-year Treasury notes.

This contributed to a tightening of global financial conditions and to several episodes of volatility in international financial markets, particularly in fixed-income assets. In this context, the US dollar appreciated against the currencies of most major advanced and emerging economies and government bond interest rates rose overall. Domestic financial markets were also volatile, mainly due to the electoral process in the United States and the measures that may be adopted by its new administration, as well as to shifts in the outlook for monetary policy in some advanced economies. In light of the above, the Mexican peso depreciated between September and November. Subsequently, at the beginning of February, following the announcement of the imposition of tariffs on US imports from Mexico, the exchange rate depreciated significantly. This adjustment reversed once the agreement to pause the implementation of these tariffs was negotiated. Long-term interest rates on government securities increased, while those for short- and medium-terms decreased. Consequently, the slope of the yield curve went from negative to positive values.

During the fourth quarter of 2024, the weakness in economic activity deepened as a significant contraction with respect to the previous quarter was observed. This behavior reflected declines in primary and secondary activities, as well as a lower dynamism in tertiary activities. Thus, the Mexican economy as a whole was sluggish in 2024. Growth of 1.5% in 2024 represents a marked slowdown relative to the increases of 3.7 and 3.3% observed in 2022 and 2023, respectively. In the labor market, job creation continued decelerating, although the unemployment rate has remained at historically low levels. Looking ahead, the Mexican economy could slow down further in 2025, in an environment where high uncertainty prevails due to both domestic and external factors.

The box *Cyclical fluctuations of hours worked in Mexico* presents a decomposition of the variance of total hours worked, suggesting that adjustments to changes in labor demand occur mostly through changes in the number of employed individuals (extensive margin of employment) and, to a lesser extent, through variations in the average hours worked by employed individuals (intensive margin of employment). This result is generalized across sectors of economic activity. By gender, the proportion of the variance of hours worked explained by the extensive margin is higher for women. After both margins increased significantly in the recovery phase of the pandemic, in recent quarters the employed population component has remained above its trend, while the average hours worked per employed individual has closed the gap with respect to its long-term behavior.

Between the third and fourth quarters of 2024, annual headline inflation decreased from 5.04 to 4.51%, reaching 3.59% in January 2025. This behavior reflected the continued decline in core inflation, as well as the decrease in non-core inflation after the effects of some supply shocks had dissipated. In particular, influenced by the monetary policy actions implemented and the fading effects of global shocks, core inflation decreased from 3.99 to 3.68% between those quarters, reaching 3.66% in January 2025.

Regarding its components, merchandise inflation declined between quarters, registering lower levels than those observed at the beginning of the pandemic. Meanwhile, annual services inflation declined in the fourth quarter, albeit very gradually. Non-core annual inflation, which is more volatile, decreased from 8.29 to 7.07% in the same quarterly period, reaching 3.34% in January 2025.

Given the evolution of the inflationary outlook, during the reporting period the Governing Board continued the cycle of cuts in the reference rate. At the November and December meetings, the Board took into account the nature of the shocks that have affected the non-core component and the perspective that their effects on headline inflation would dissipate in the following quarters. It also considered the core component's downward trend, the levels it has reached and that it foreseen to continue decreasing. In both decisions it deemed that, although the inflationary outlook still calls for a restrictive stance, its evolution implies that it is appropriate to continue reducing the level of monetary restriction. In this context, the Governing Board lowered the reference rate by 25 basis points in both decisions to reach a level of 10.00%. For the February decision, it assessed the significant progress in the resolution of the inflationary episode derived from the global shocks. The Board considered that the fight against inflation is at a stage in which it will seek to bring inflation from its current levels, which are close to the historical pre-pandemic averages, to the 3% target. It estimated that reference rate levels lower than those demanded by the global shocks are consistent with the challenges posed by this stage. Thus, it deemed appropriate to implement a larger reduction of the reference rate, and decided to lower it by 50 basis points to 9.50%.

The Board estimates that looking ahead it could continue calibrating the monetary policy stance and consider adjusting it in a similar magnitude. It anticipates that the inflationary environment will allow to continue the rate-cutting cycle, albeit maintaining a restrictive stance. It will take into account the effects of the country's weak economic activity as well as the incidence of the restrictive monetary policy stance that has been maintained and the stance 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.

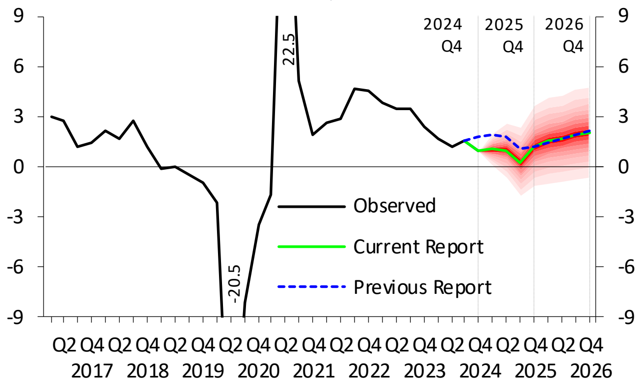
As for Banco de México's macroeconomic outlook, the following stands out:

Growth of the national economy: According to the flash estimate, economic activity contracted significantly in the fourth quarter of 2024. This contrasts with the moderate growth previously anticipated for that quarter. Thus, productive activity was clearly weaker than expected. The lower-than-expected growth at the end of the year resulted in a flash estimate of 1.5% for 2024 as a whole, which is lower than the point estimate of 1.8% published in the previous Report.

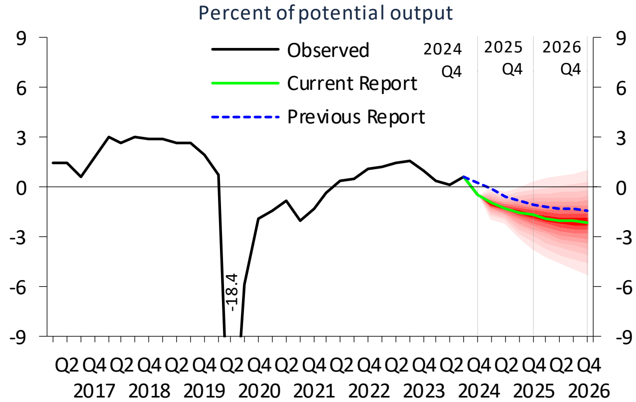
As in the previous Report, the outlook assumes that economic activity will continue weakening in 2025. This would be more evident in the first half of the year. Private consumption and, especially, private investment, would exhibit low dynamism as a reflection of the high uncertainty that persists. The announced fiscal consolidation would limit the contribution of public spending to productive activity. External demand would increase throughout the year, in line with the anticipated performance of US industrial activity. While these expected growth dynamics are similar to those of the previous Report, the lower-than-expected performance in the last quarter of 2024 induces an arithmetic effect of a lower base growth for 2025 that reduces the forecast for GDP growth for that year from 1.2% in the previous Report to 0.6% in the current one. The range for the expected variation of GDP in 2025 is updated to between -0.2% and 1.4%. High uncertainty prevails regarding the policies that the new US administration could implement and their potential scope that they could have. Therefore, these forecasts do not incorporate estimates of the possible effects on Mexico's economic activity of the announced measures, including those associated with trade issues.

Mexico's growth rate is expected to be higher in 2026. The point estimate for that year remains unchanged at 1.8%.[1] The range for the change in GDP remains between 1.0 and 2.6% (Chart 1a and Table 1).

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 Q1 2025. In the previous Report, it started in Q4 2024.
Source: a) INEGI and Banco de México. b) Banco de México.

Regarding the cyclical position of the economy, it is projected that, given the expected trajectory of economic activity and after it became negative in the last quarter of 2024, the point estimate for the output gap will widen into negative territory throughout 2025 and 2026 (Chart 1b). The estimation of this unobservable indicator is subject to high uncertainty.

Table 1
Forecasts for GDP growth
Annual percent

Year	Central	Interval
2025	0.6	Between -0.2 and 1.4
2026	1.8	Between 1.0 and 2.6

Note: Not seasonally adjusted forecasts. The central estimates for 2025 and 2026 compare with the previous Report's forecasts of 1.2 and 1.8% for each year. Intervals compare to those published in the previous Report of 0.4 and 2.0% for 2025 and 1.0 and 2.6% for 2026. According to INEGI's 2024 IV flash estimate, Mexico's GDP increased 1.5% in 2024, with figures that are not seasonally adjusted.
Source: Banco de México.

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

Table 2
Forecasts for the number of IMSS-insured jobs [1/]
Annual change in thousands of jobs

Year	Interval current report	Interval previous report
2025	Between 220 and 420	Between 340 and 540
2026	Between 360 and 560	Between 400 and 600

1/ It refers to permanent and temporary urban IMSS-insured jobs.
Note: In 2024, the number of IMSS-insured jobs increased by 230 thousand jobs.
Source: Banco de México.

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

[1] Using seasonally adjusted data, the forecast for GDP growth in 2025 is 0.8% and for 2026 it is 1.8%. For 2025, differences between the seasonally adjusted and non-seasonally adjusted figures are explained by the effect of having one day less compared to the leap year of 2024.

Table 3
Forecasts for the trade balance and current account

Year	2025	2026
Trade balance		
% of GDP	-1.0 to -0.6	-1.2 to -0.7
Billions of dollars	-17.4 to -9.4	-22.1 to -12.7
Current account		
% of GDP	-0.7 to 0.0	-1.0 to -0.1
Billions of dollars	-12.0 to 0.7	-18.5 to -2.0

Note: Figures for 2025 compare with those of the previous Report of a trade balance of between -22.1 and -14.1 billion dollars (-1.2 and -0.8% of GDP) and a current account balance of between -19.3 and -6.6 billion dollars (-1.1 and -0.4% of GDP). Figures for 2026 compare with the previous Report's figures of a trade balance of between -24.3 and -14.9 billion dollars (-1.3 and -0.8% of GDP) and a current account balance of between -22.9 and -6.4 billion dollars (-1.2 and -0.3% of GDP). In 2024, the trade balance was -8.2 billion dollars (-0.4% of GDP) and the current account balance is estimated at -7.6 billion dollars (-0.4% of GDP).
Source: Banco de México.

The box *Factors that have led to the recent increase in contributions to retirement savings funds in Mexico* shows that, since 2023, the pension system reform approved in 2020 has strongly contributed to increasing financial flows to the Afores (*Administradoras de Fondos para el Retiro*). This is due to the fact that the reform increases employer's contributions per employee to the individual accounts of the insured individuals. Additionally, the increase in workers' real wages and the evolution of employment in the formal sector during the period have also had a positive impact on the growth of contributions to the savings funds. This has resulted in a rise in household financial savings in Mexico, which, in turn, has supported the continued allocation of resources to various sectors of the economy.

Risks to growth: The outlook for economic activity remains uncertain. The new US administration has announced actions regarding immigration, trade and other areas, the scope of which is still unknown. In addition, uncertainty persists about further measures that could be taken. This poses significant challenges for any growth forecast. The balance of risks for growth is considered to remain biased to the downside over the forecast horizon. Among the risks to the downside in the forecast horizon, the following stand out:

i. That the current environment of uncertainty, associated with the policies that could be implemented in the United States, particularly regarding trade, or by idiosyncratic factors, may intensify and negatively affect external demand as well as consumption and investment spending in Mexico.
ii. That, despite the dynamism that the US economy has shown, its growth is lower than expected, to the detriment of Mexico's external demand.
iii. That volatility episodes materialize in domestic or international financial markets.
iv. That the intensification of different geopolitical conflicts in various regions of the world negatively affects the global economy overall or international trade flows in particular.
v. That the reduction in public spending as a result of the announced fiscal consolidation has a stronger impact on economic activity.
vi. That severe weather phenomena, such as extreme temperatures, cyclones, or droughts adversely impact the Mexican economy.

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

i. That growth of the US economy is greater than expected, which would favor Mexico’s external demand.
ii. That public spending provides a greater-than-expected boost to economic activity.
iii. That, within the framework of the USMCA, 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 from those announced in the Monetary Policy Statement of February 6, 2025. Headline and core inflation are still expected to follow a downward trajectory over the forecast horizon (Charts 2 and 3, and Table 4). However, compared to the forecasts for these variables published in the previous Report, the current estimates indicate a more gradual decline in their trajectories. This is due to the greater persistence of services inflation, which exerts upward pressure on the expected levels of core and headline inflation. As a result of these modifications, annual headline inflation is now estimated to converge to the 3% target in the third quarter of 2026, whereas the previous Report forecasted such convergence in the fourth quarter of 2025. In addition, due to the estimated more gradual reduction in core inflation over most of the forecast horizon, this variable is expected to reach 3% in the second quarter of 2026, two quarters later than forecast in the previous Report.

In greater detail, in the case of headline inflation, the current forecast presents a slight downward adjustment in the short term with respect to the previous forecast due to a lower-than-anticipated non-core inflation in that horizon. Subsequently, the forecast for headline inflation in this Report is adjusted upwards until the second quarter of 2026 due to a more gradual downward trajectory in annual core inflation. The latter, in turn, reflects the expectation that services inflation will decline at a slower rate compared to that in the previous Report. Regarding core inflation components, while services price variations were higher than expected, merchandise price variations were lower than anticipated. Looking ahead, the former are expected to continue declining, while the latter are projected to increase gradually. Annual non-core inflation forecasts were revised with respect to the previous Report, mainly in the short term. This short-term adjustment is to the downside and is due to lower-than-anticipated variations in agricultural and livestock product prices over this horizon.

The annual rate of change and annualized seasonally adjusted quarterly rate of change of headline and core indices are presented in Table 4 and Chart 4. For headline inflation, in the forecast horizon the values of its annualized seasonally adjusted quarterly rate of change fluctuate around 3% since the fourth quarter of 2025. Meanwhile, the values of the core index would be around 3% as of the second quarter of 2025. Since annual rates are influenced during twelve months by upward short-term shocks on inflation, their reduction is slower than that of seasonally adjusted quarterly changes. This behavior has been observed since late 2022. As their effects dissipate, the values of the annual and seasonally adjusted quarterly rates appear more similar, as can be seen in the estimates over the forecast horizon.

The box *Evolution of the trimmed mean and extreme variations in core inflation* presents indicators that suggest that core inflation is now closer to its pre-pandemic pattern, as the effects of global shocks have diminished. It shows that the evolution of most seasonally adjusted price variations of CPI items across different percentiles of the distribution of these variations is now closer to the levels observed before the pandemic. The box also indicates that the dynamics of extreme variations in core CPI items point to lower inflationary pressures, which have even reached levels below those prior to the pandemic.

The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. However, the inflationary episode resulting from the effects of the pandemic and from the outbreak of war in Ukraine has been resolving. At the same time, announcements of possible economic policy changes by the new US administration have added uncertainty to the outlook. Their realization could lead to inflationary pressures on both sides of the balance.

Among the main risks for inflation in the forecast horizon, 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. A greater depreciation of the Mexican peso.

iii. An escalation of geopolitical conflicts or the implementation of trade policies that could cause disruptions in global production chains.

iv. Higher cost-related pressures that could be passed on to consumer prices.

v. Climate-related impacts that could affect different agricultural and livestock products' prices.

On the downside:

i. A lower-than-anticipated economic activity in the United States or in Mexico, which could lead to lower pressures on inflation in Mexico.

ii. That the pass-through of cost-related pressures onto prices is limited.

iii. That the exchange rate depreciation that has been observed since June has a smaller-than-anticipated effect on inflation.

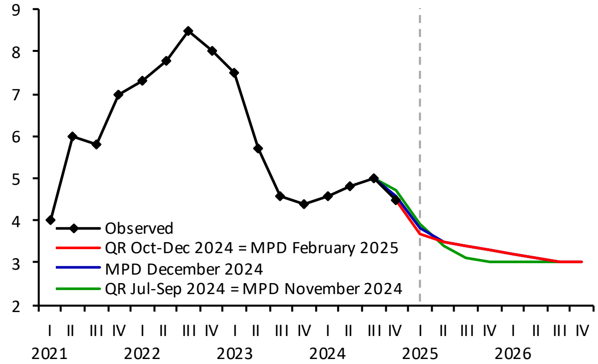
Table 4
Forecasts for headline and core inflation
Annual percentage change of quarterly average indices

	2024		2025				2026			
	III	IV	I	II	III	IV	I	II	III	IV
CPI										
Current Report = Monetary Policy Statement of February 2025 1/	5.0	4.5	3.7	3.5	3.4	3.3	3.2	3.1	3.0	3.0
Previous Report = Monetary Policy Statement of November 2024 2/	5.0	4.7	3.9	3.4	3.1	3.0	3.0	3.0	3.0	
Core										
Current Report = Monetary Policy Statement of February 2025 1/	4.0	3.7	3.6	3.5	3.4	3.3	3.2	3.0	3.0	3.0
Previous Report = Monetary Policy Statement of November 2024 2/	4.0	3.7	3.5	3.3	3.1	3.0	3.0	3.0	3.0	
Memo										
Annualized seasonally adjusted quarterly variation in percent 3/										
Current Report = Monetary Policy Statement of February 2025 1/										
CPI	5.2	3.2	2.8	3.6	4.0	3.0	2.4	3.1	3.5	2.9
Core	3.6	3.4	3.8	3.2	3.2	3.0	3.1	2.8	3.0	3.0

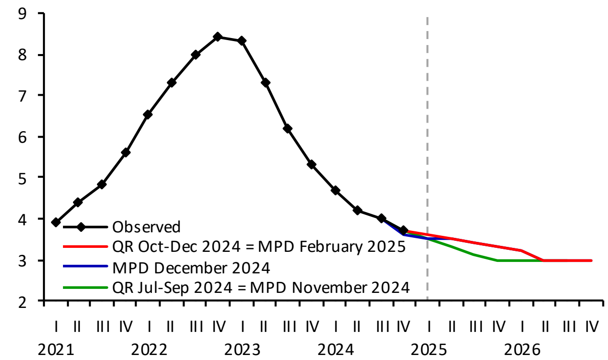
1/ Forecast starting February 2025. It corresponds to the forecast published in the Monetary Policy Statement of February 6th 2025.
2/ Forecast starting November 2024. It corresponds to the forecast published in the Monetary Policy Statement of November 14th 2024.
3/ See Methodological Note on seasonal 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



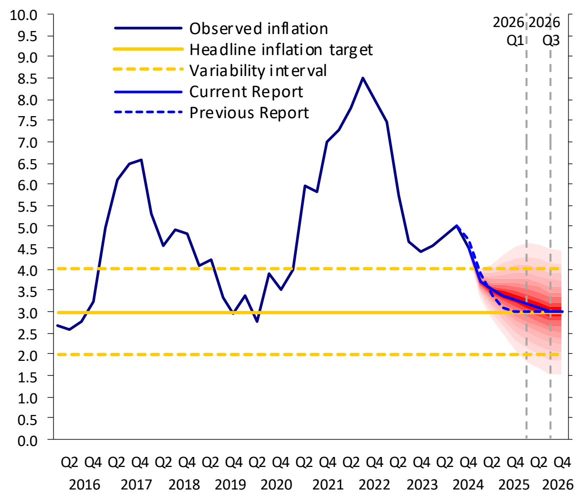
Annual core inflation forecasts[1/]
Percent



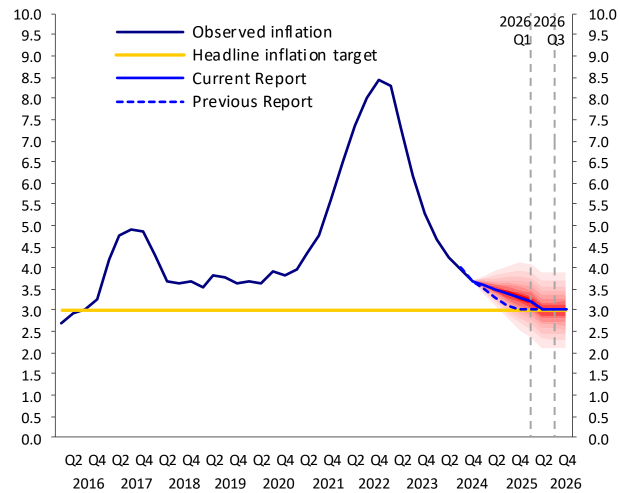
1/ Annual percentage change of quarterly average indices. QR refers to Quarterly Report and MPD refers to Monetary Policy Decision. Vertical line corresponds to the first quarter of 2025.
Source: Banco de México and INEGI.

Chart 3

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



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

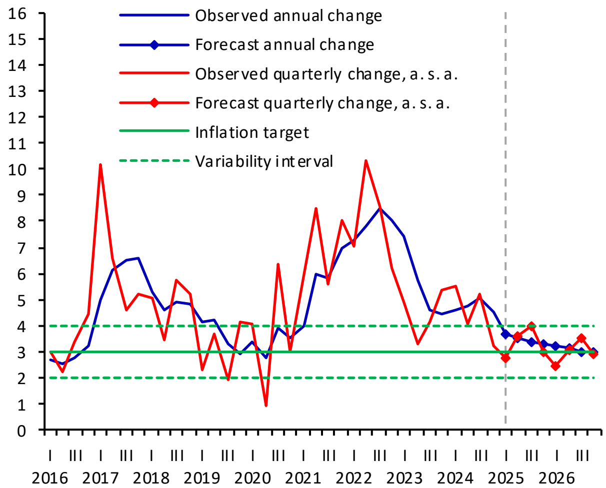


1/ Annual percentage change of quarterly average indices. The next four and six quarters are indicated with vertical lines, using as a reference the first quarter of 2025, that is, the first quarter of 2026 and the third quarter of 2026, respectively, to indicate the time frames in which the transmission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

Chart 4

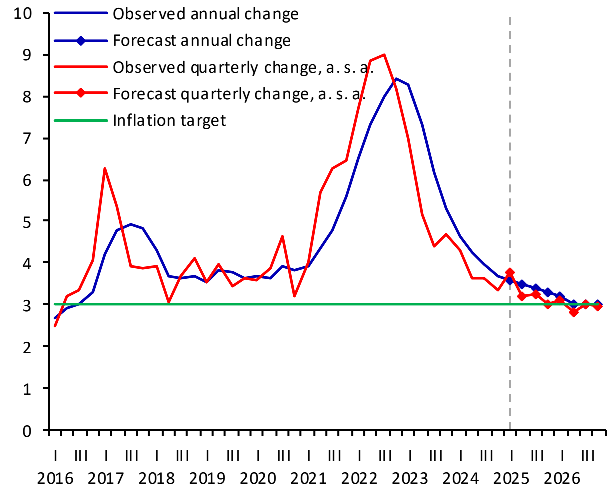
a) Headline index

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 first quarter of 2025.
Source: Banco de México and INEGI.

The Mexican economy is facing challenges. On the one hand, economic activity is undergoing a period of weakness, with growth expected to be moderate over the next years. On the other hand, an environment of high uncertainty persists, driven by both domestic and external factors. Among the external ones, trade tensions with our main trading partner and potential public policies it could implement could have negative implications for the Mexican economy. While the imposition of US tariffs on imports from Mexico was paused, the announcement underscored the potential risks. This environment stresses the importance of maintaining sound macroeconomic fundamentals to ensure the resilience of the Mexican economy against global risks and potential shocks. In this regard, it is essential to preserve fiscal discipline, while also maintaining a robust and well-capitalized financial system and sustainable external accounts. Mexico's flexible exchange rate regime allows the exchange rate to adjust to absorb potential shocks, contributing to a more orderly adjustment of the economy. Additionally, monetary policy focused on preserving the purchasing power of the national currency must be maintained. Thus, Banco de México's Governing Board will continue making decisions based on the evolution of the economic outlook, with the firm commitment to reach the 3% inflation target.

Likewise, in order to face the uncertainty and promote a more dynamic and sustained economic growth of the Mexican economy, which will allow to address the various lags of the country as required to improve the living standards of the population, it is essential for Mexico to enhance its productivity, becoming a more competitive country and an attractive investment destination. This requires strengthening the rule of law, fostering incentives conducive to value creation, adopting innovative technologies and encouraging greater market competition. These actions would propitiate a more efficient allocation of resources and a better use of the country's trade openness, especially in the context of the opportunities offered by the ongoing reconfiguration of global value chains. This would contribute to Mexico’s economic development, ultimately leading to greater well-being for the population.

BANCO DE MÉXICO®

February 19th, 2025

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