Quarterly Report

July-September 2019

November 27, 2019

BANCO DE MÉXICO

Outline

|	
1	**External conditions**
2	Current situation of the Mexican economy
3	Inflation
4	Monetary policy
5	Forecasts and final remarks

BANCO DE MÉXICO

During the third quarter of the year, the world economy continued to decelerate and its growth outlook was revised downwards again. Such deceleration reflects the effects of the prolonged trade tensions, the high geopolitical risks and certain idiosyncratic factors in some economies.

World Economy

World GDP Growth [1]
Annual % change, s. a.

Q3-2019

Emerging

World

Advanced
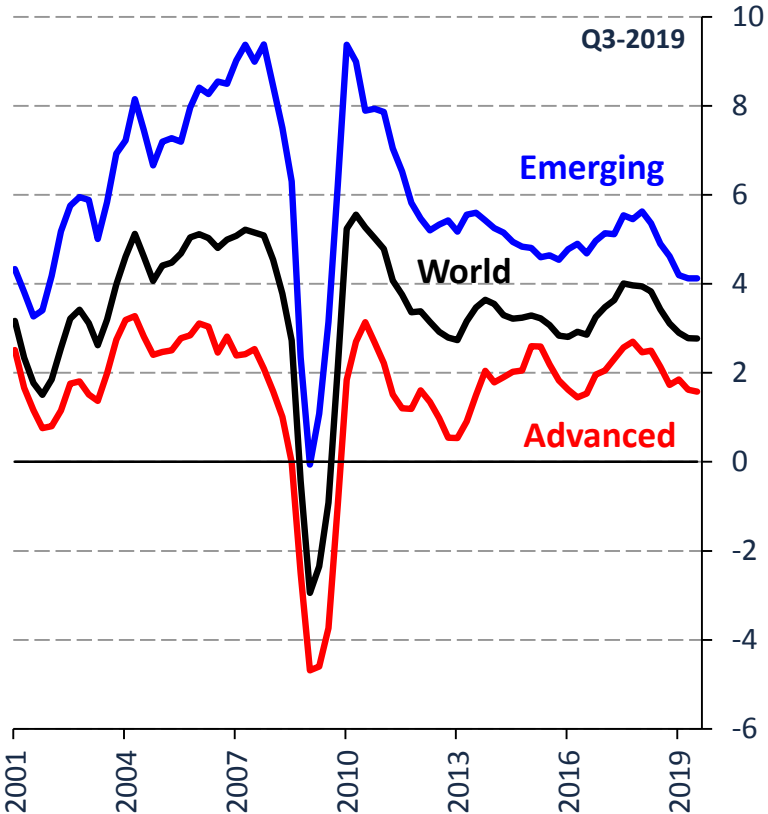
Global Activity Indicators
Annual % change of 3-month moving average and deviation from threshold of 50

September
October

World trade

Industrial production

PMI: new orders
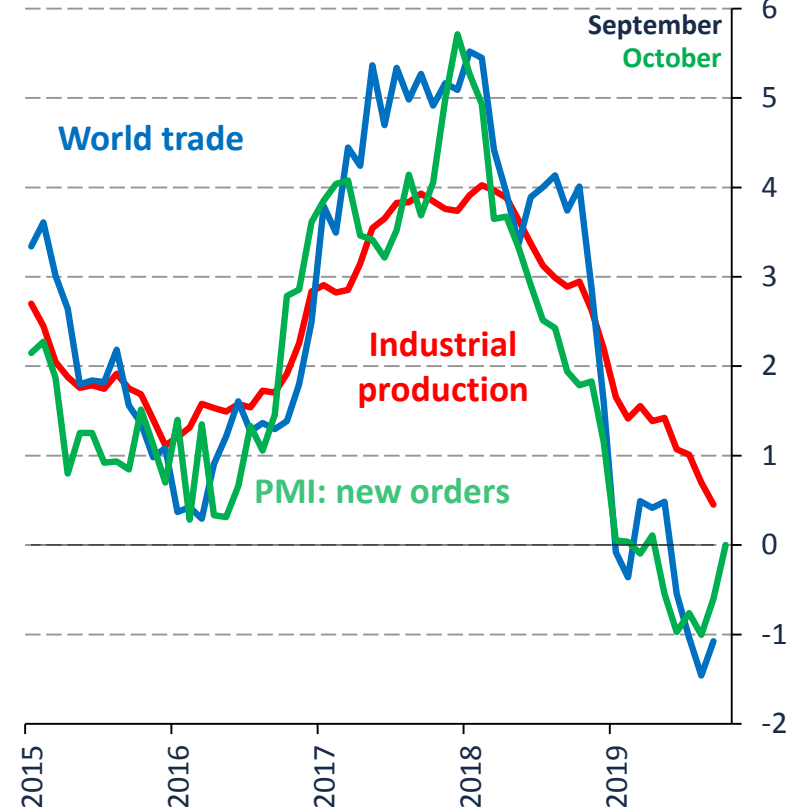
Global Consumer and Business Confidence [2]
Standard deviations of the average of 2010 and 2013 to date

Consumer confidence

October

Business confidence
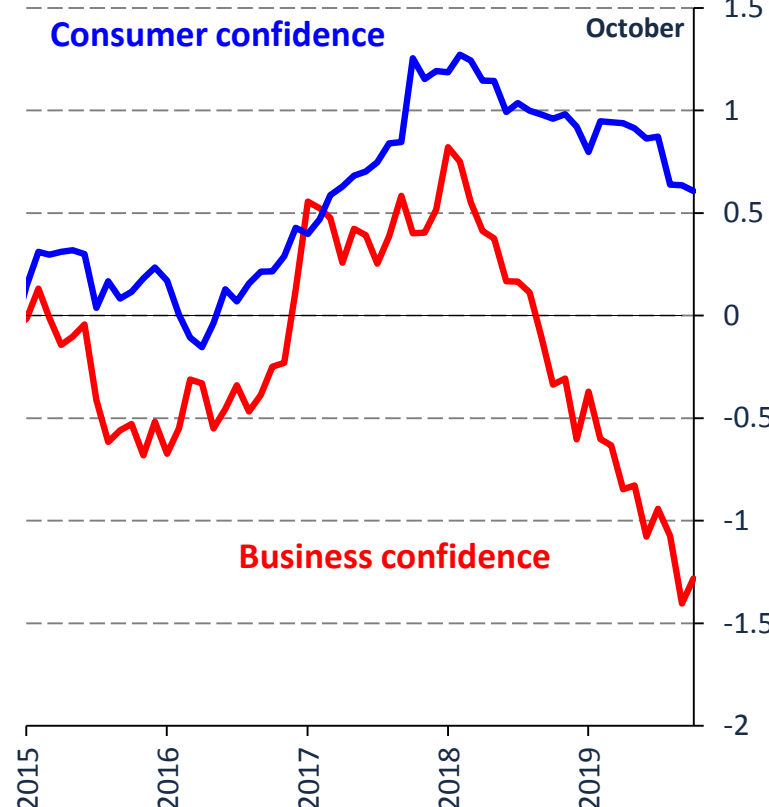
s. a. / Seasonally adjusted figures.
1/ Figures for Q3 include estimations for some countries. The sample of countries used in the calculations accounts for 85.6% of world GDP measured by purchasing power parity.
Source: Prepared by Banco de México with data from Haver Analytics, J.P. Morgan and International Monetary Fund (IMF).

Source: CPB Netherlands and Markit.

2/ Refers to expectations about manufacturing production in the coming months. The index includes 7 and 17 advanced economies and emerging economies, respectively. For several countries, the index uses more than one available indicator on business expectations.
Source: J.P. Morgan.

Labor markets in advanced economies remain strong and wages have increased at a moderate pace.
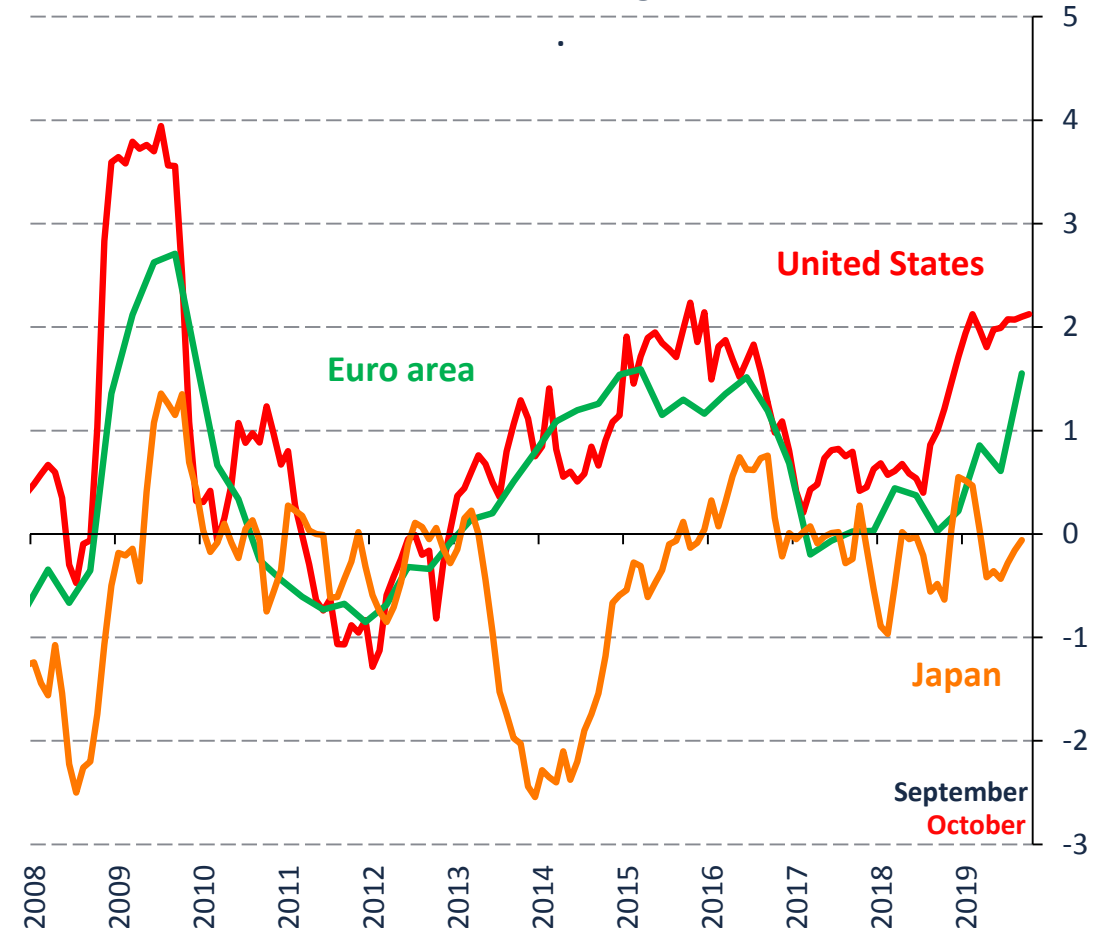
Advanced Economies

Unemployment Gap
Percentage points

Real Wages
Annual % change, s. a
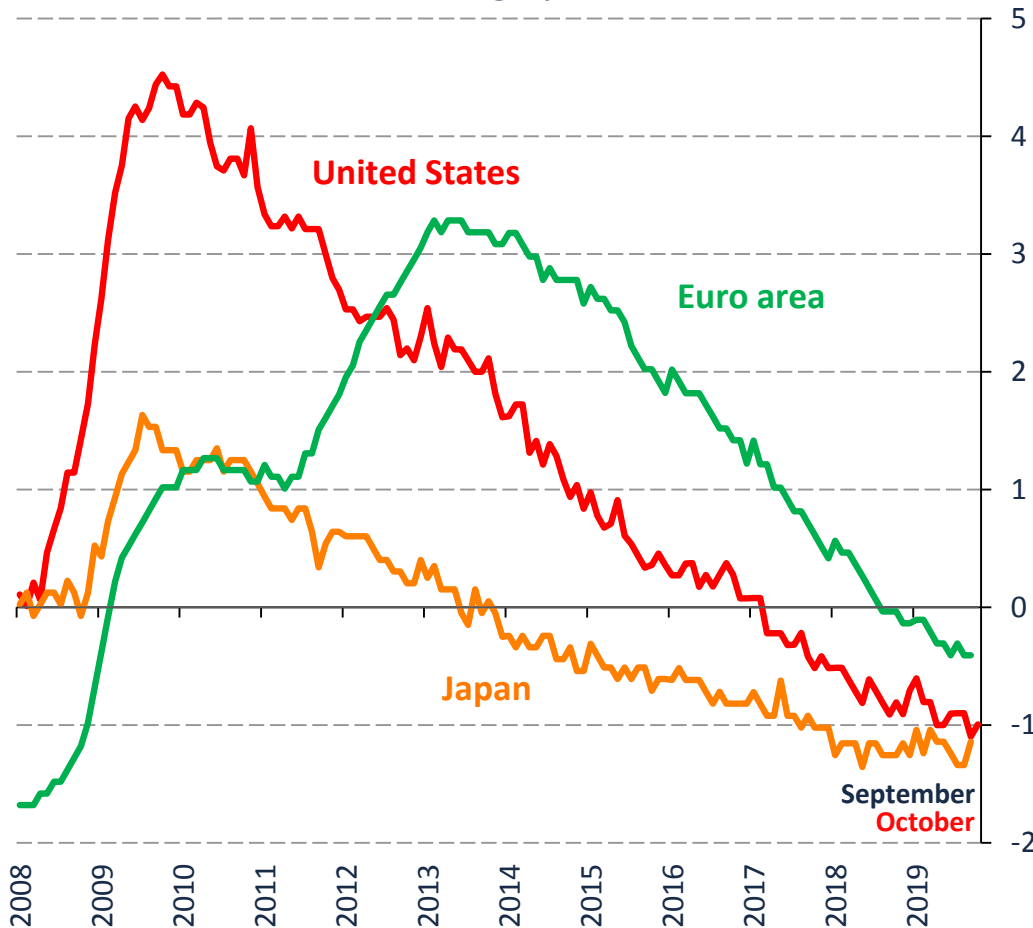
Source: Prepared by Banco de México with data from CBO, OECD, Economic Outlook, November 2019 and National Statistical Agencies.
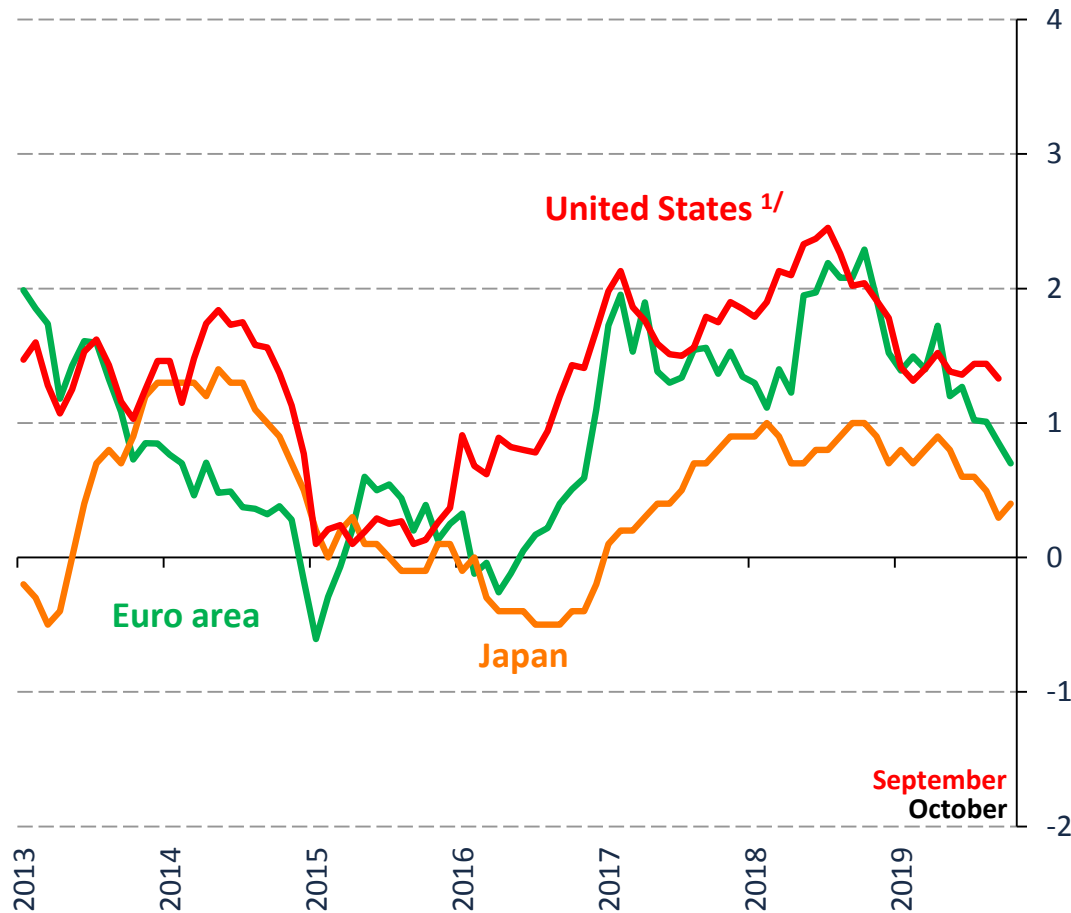
s. a. / Seasonally adjusted figures.
Source: BLS, ECB, Bloomberg, ONS and Haver Analytics.

In this context, headline and core inflation in the majority of advanced economies have remained low, thus remaining below their central banks' targets.
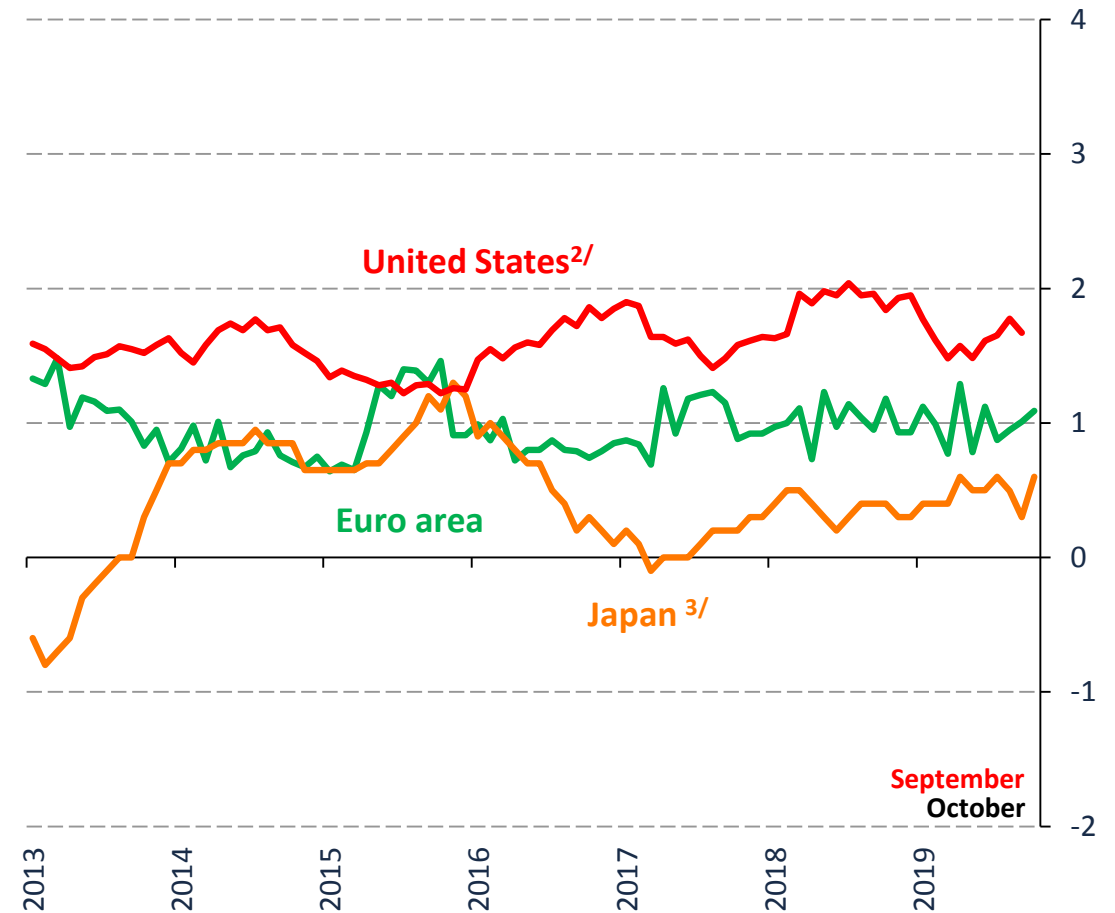
Advanced Economies
Annual % change

Headline Inflation

United States [1]

Euro area

Japan

September
October

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

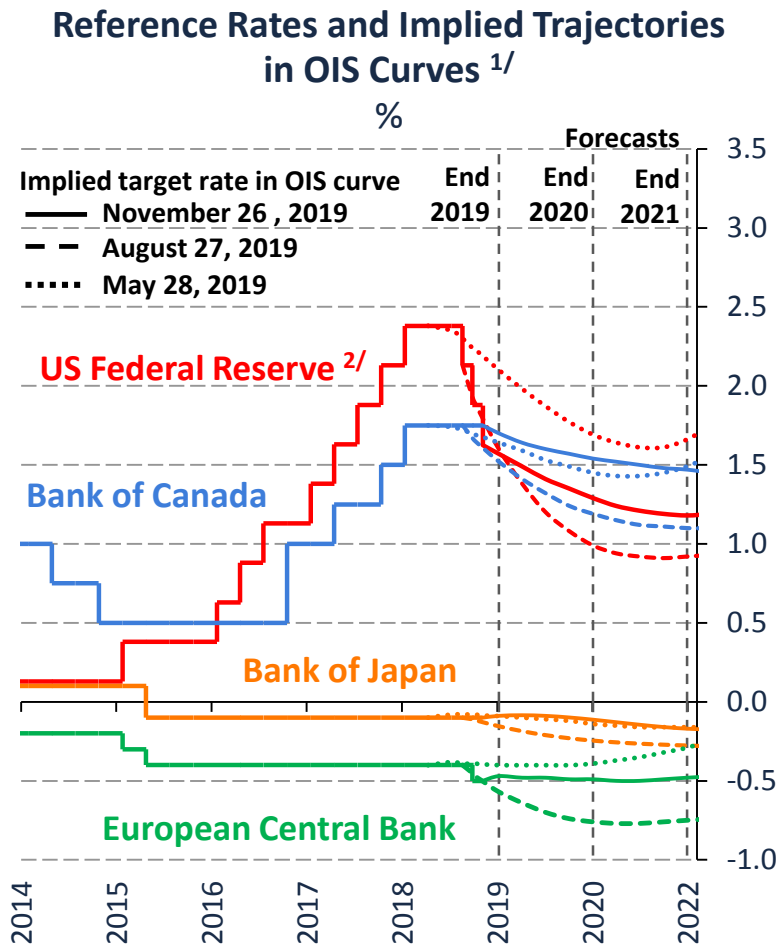**Core Inflation**

United States [2]

Euro area

Japan [3]

September
October

2/ Refers to the Personal Consumption Expenditure Price Index that excludes food and energy (PCE).
3/ It excludes energy and fresh food and the direct effect of the consumption tax increase.
Source: BEA, Eurostat and Japan's Statistics Bureau.

Some of the main central banks in both advanced and emerging economies have eased monetary policy in the last months.

Advanced Economies

Reference Rates and Implied Trajectories in OIS Curves [1]
%

Implied target rate in OIS curve
— November 26 , 2019
- - August 27, 2019
···· May 28, 2019

US Federal Reserve [2]

Bank of Canada

Bank of Japan

European Central Bank

2-year Government Bonds Interest Rates
%

November

United States

Japan

Euro area

10-year Government Bonds Interest Rates
%

November

United States

Euro area

Japan

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.
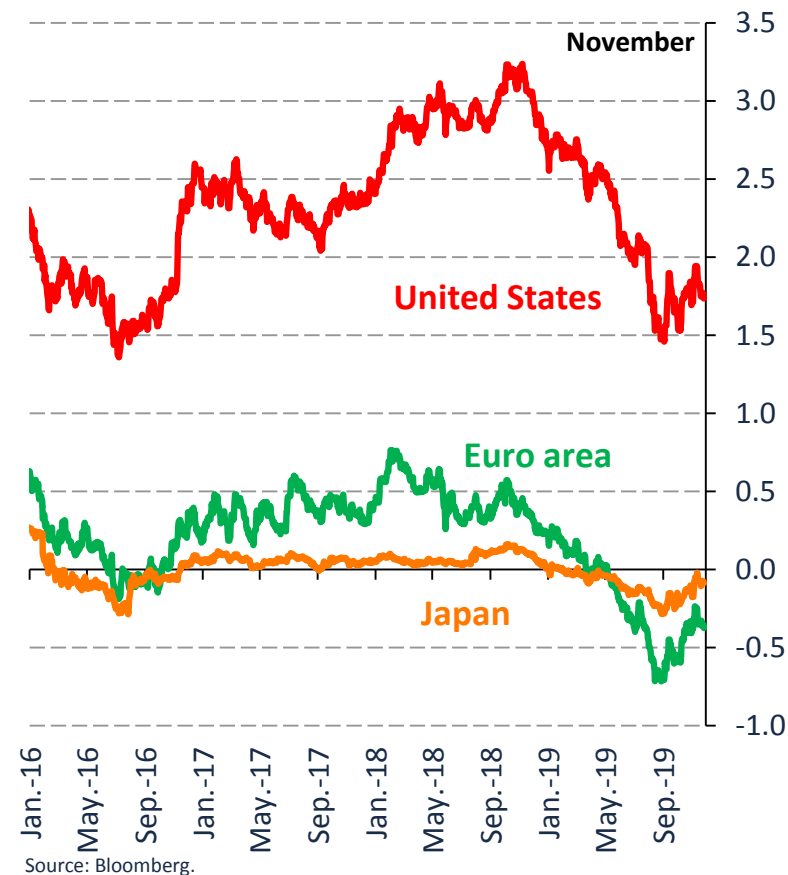
Source: Bloomberg.

Source: Bloomberg.
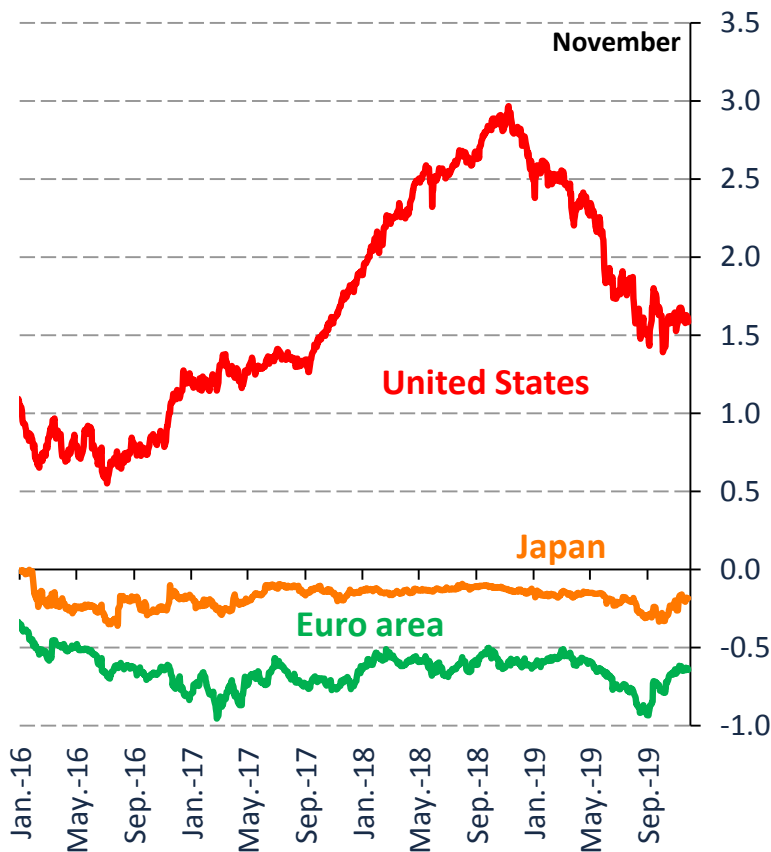
The prices of financial assets fluctuated significantly, mainly due to mixed developments in trade tensions and to the evolution of Brexit negotiations. However, these risks have recently eased. The aforementioned together with the accommodative monetary policy stances have contributed to improve markets' performance.
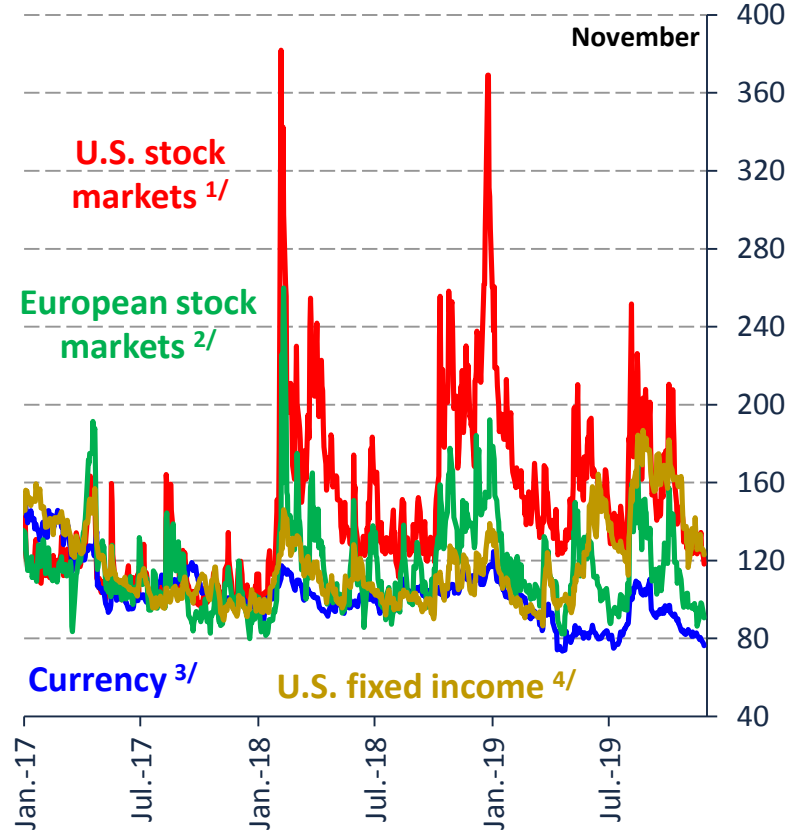
Global Risk Appetite Index
Index

November

Euphoria

Risk appetite

Panic

Selected Indices of Implied Volatility
Index 01-Jan-2018=100

November

U.S. stock markets [1]

European stock markets [2]

Currency [3]

U.S. fixed income [4]

Stock Markets of Emerging and Advanced Economies
Index 01-Jan-2018=100

November

Advanced

Emerging

Note: The risk appetite index compares several financial assets (such as stocks of advanced and emerging economies) as these tend to register high returns in periods of high appetite for higher risk assets, while safe assets (such as the US, Euro area and Japan's government bonds) tend to have negative returns. On the other hand, given that the opposite happens in periods of low appetite for risk, the index refers to the coefficient of a regression of the daily yield of 64 assets based on their volatility.
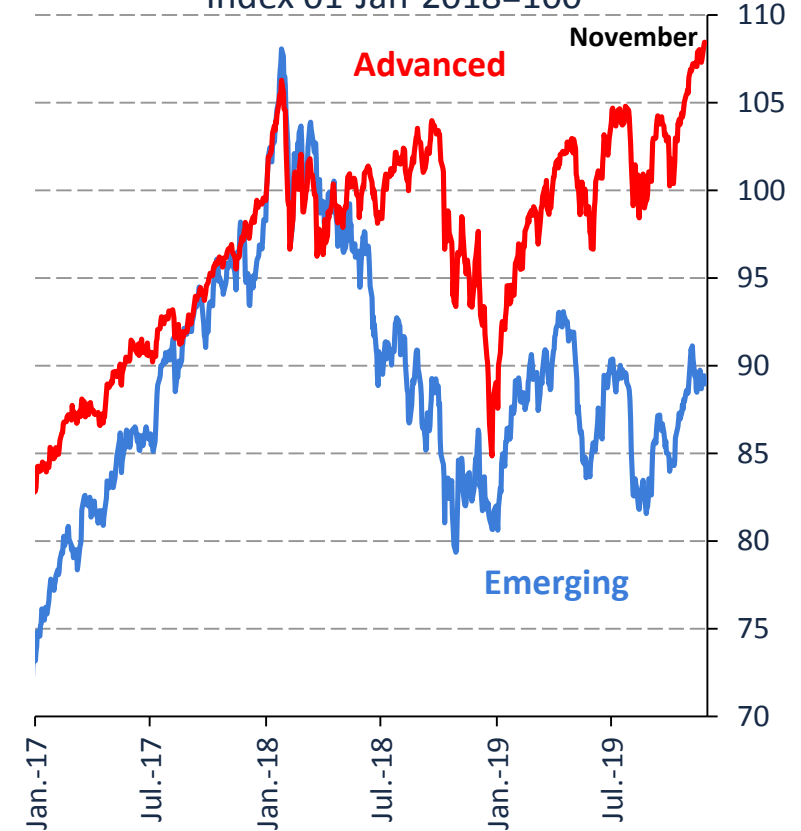Source: Credit Suisse.

1/ VIX Index: Chicago Board Options Exchange SPX Volatility Index. 2/ Weighted 1-month implied volatility index on options for the Euro Stoxx50 published by Deutsche Borse and Goldman Sachs. 3/ CVIX: 3-month Implied Volatility Index on the most traded currencies with the following weights: EURUSD: 35.9%, USDJPY: 21.79%, GBPUSD: 17.95%, USDCHF: 5.13%, USDCAD: 5.13%, AUDUSD: 6.14%, EURJPY: 3.85%, EURGBP: 2.56%, EURCHF: 1.28%. 4/ MOVE: Implicit volatility index of 1-month options at the money on Treasury bonds with a maturity of 2, 5, 10 and 30 years. This index is estimated by Merrill Lynch.
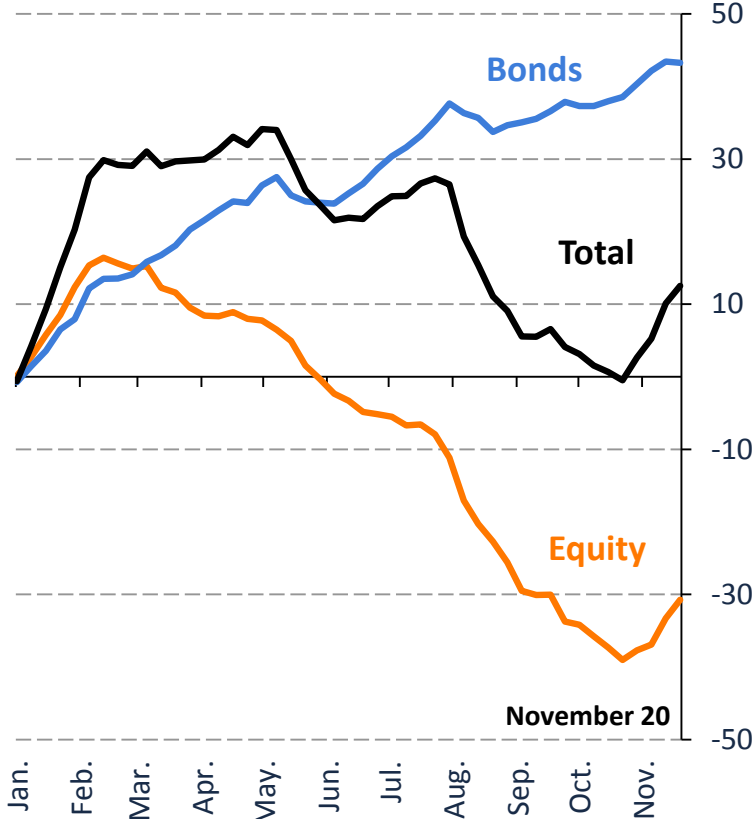Source: Banco de México with data from Bloombeg.

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
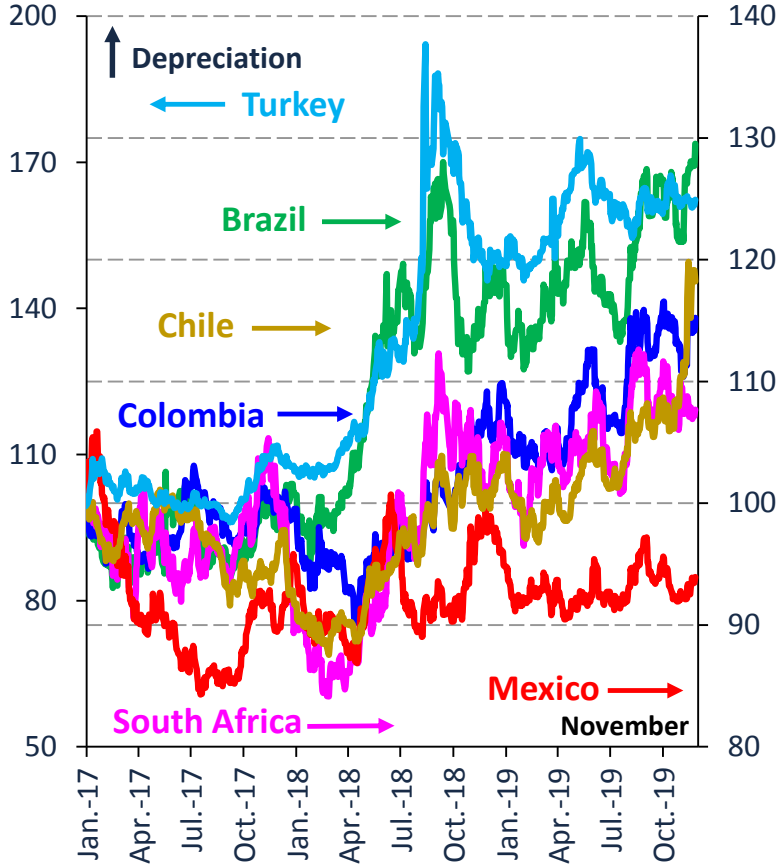
Trade tensions and their effect on global growth together with the easing of global financial conditions have recently affected the composition of capital flows, with reductions in equity and increases in fixed income as well as episodes of volatility in risk appetite.

Emerging Economies

Accumulated Capital Flows During 2019 [1/]
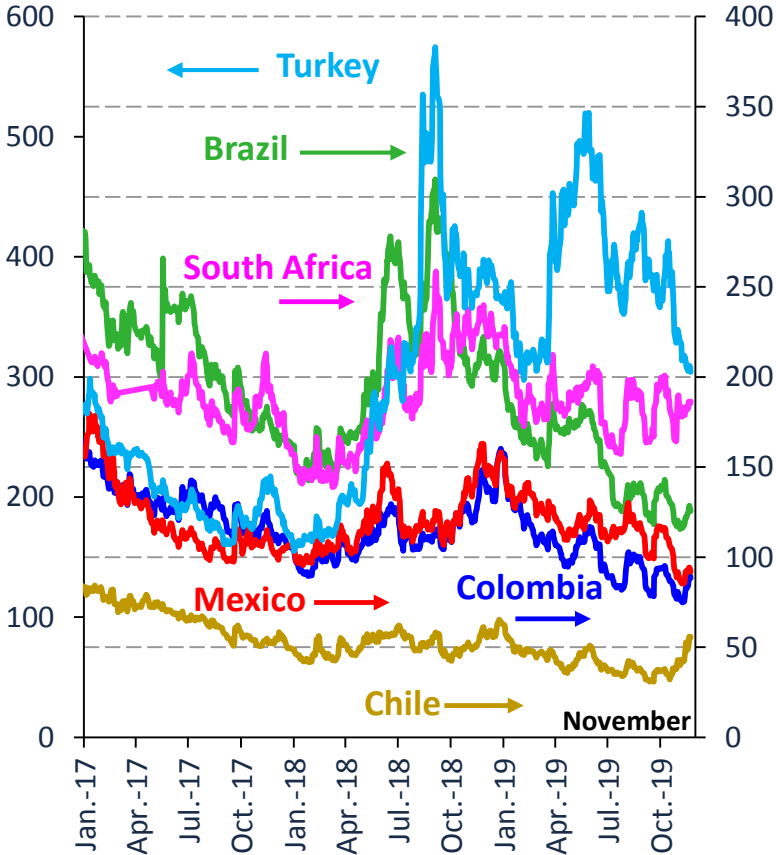Billions of dollars

Bonds

Total

Equity

November 20

Nominal Exchange Rate against USD
Index Jan-01-2017 = 100

↑ Depreciation

← Turkey

Brazil →

Chile →

Colombia →

Mexico →

South Africa →

November

5-year Credit Default Swaps
Basis points

← Turkey

Brazil →

South Africa →

Mexico →

Colombia →

Chile →

November

1/ 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.

Source: Bloomberg.

Source: Bloomberg.

Outline

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5	**Forecasts and final remarks**

According to the latest revision of GDP data, in Q3-2019 Mexico's economic activity stagnated after having slightly declined between Q4-2018 and Q2-2019. This behavior reflected a loss of dynamism of aggregate demand, in a context in which the uncertainty associated to both external and domestic factors prevailed.

Gross Domestic Product
Quarterly % change, s. a.

Global Index of Economic Activity
Index 2013=100, s. a.
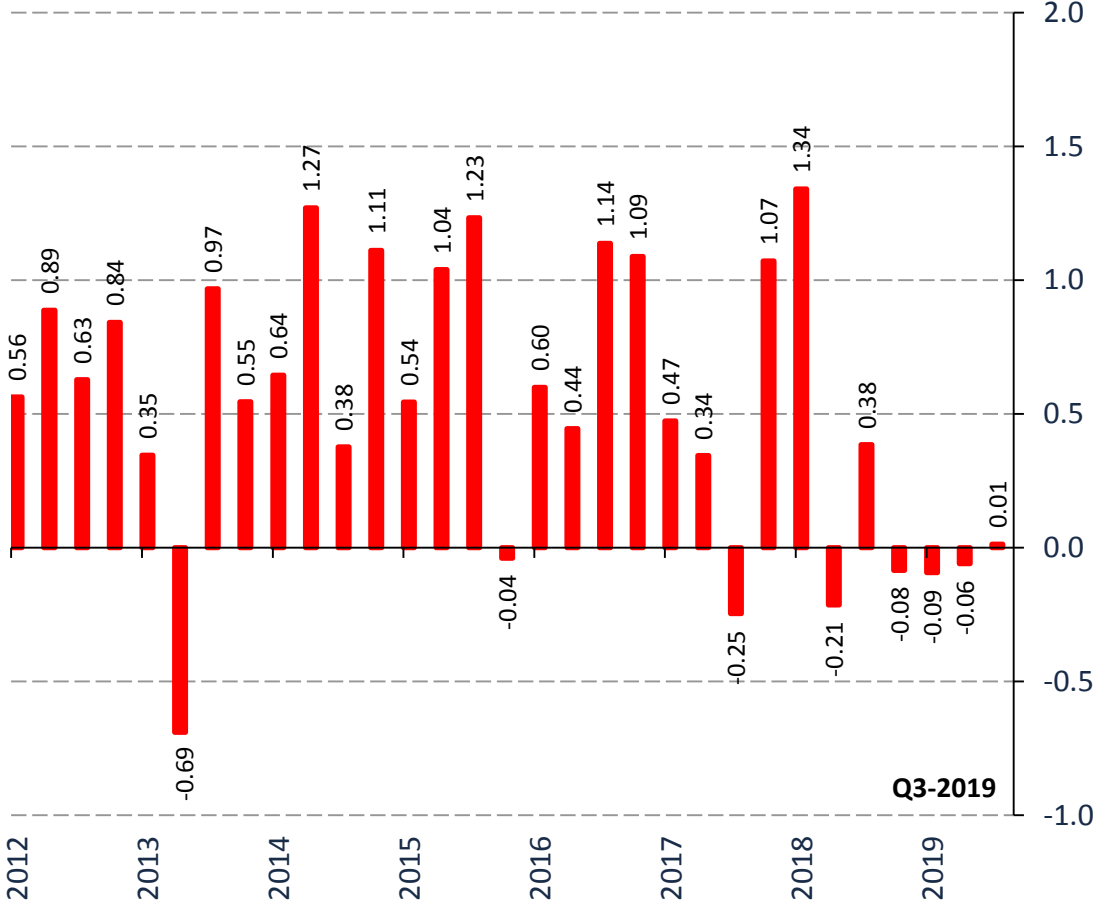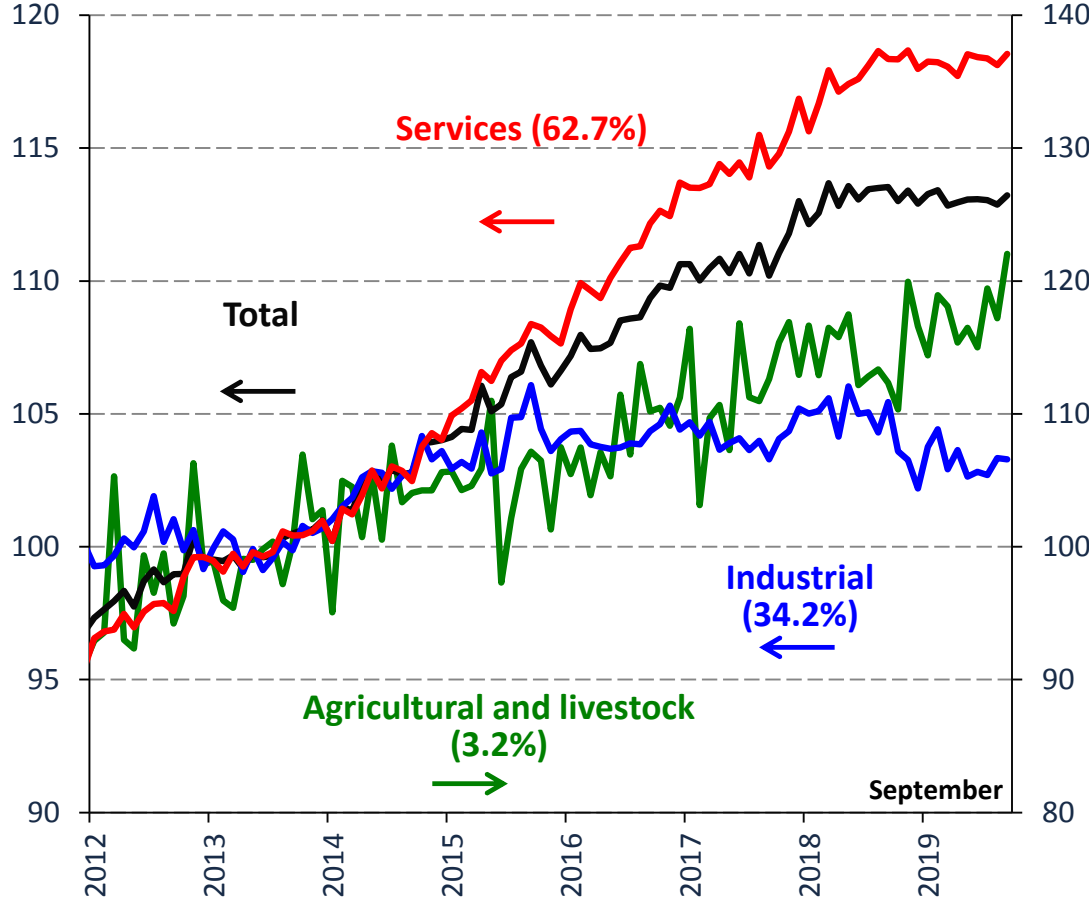
s. a. / Seasonally adjusted figures.
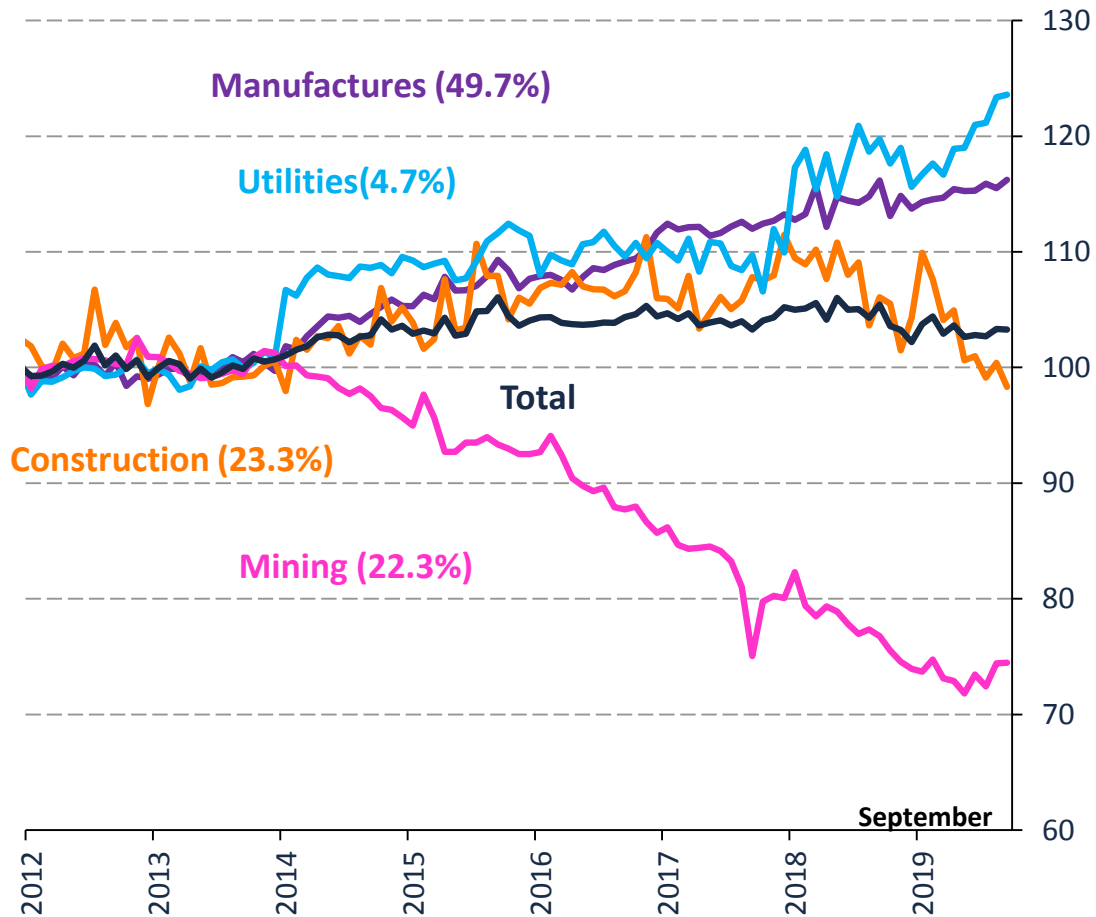Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

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

Industrial activity continued to exhibit a lackluster performance, while the services sector has exhibited a lack of dynamism.
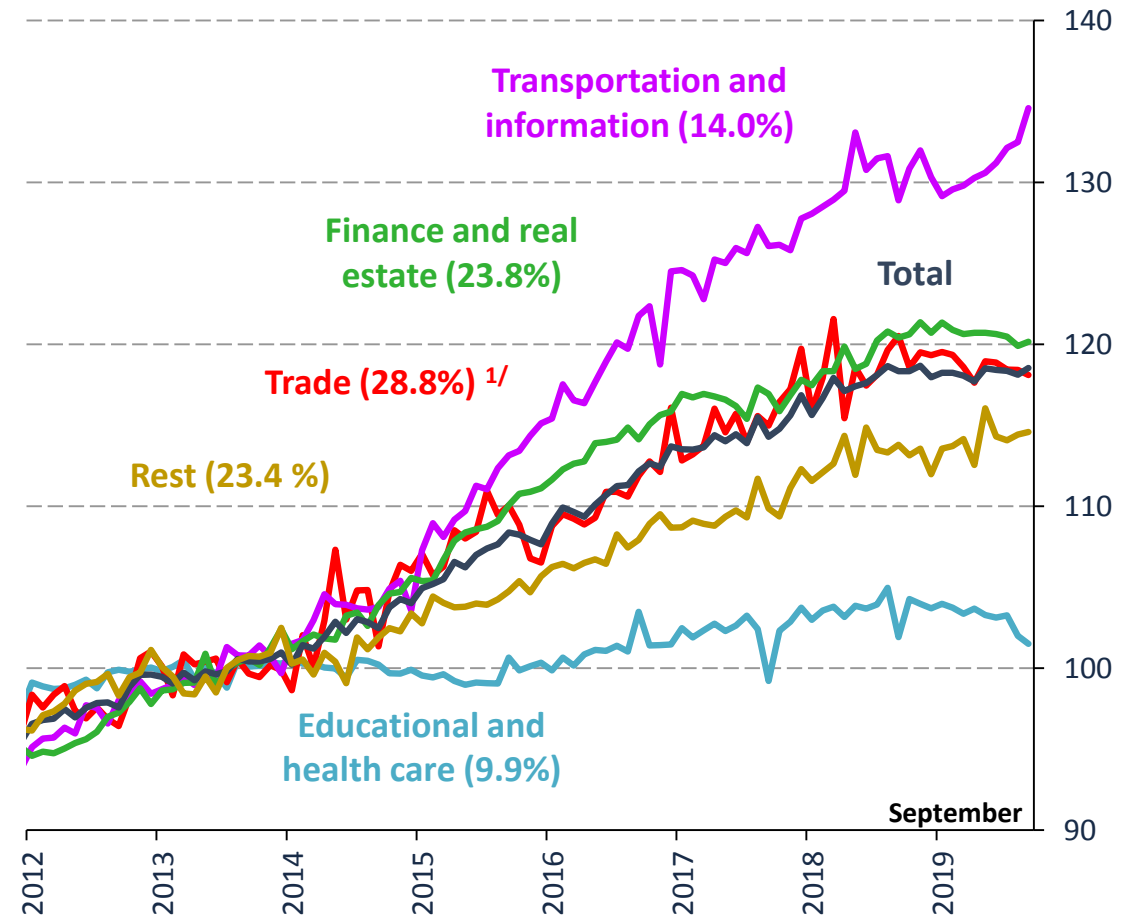
Industrial Activity
Index 2013=100, s. a.

Manufactures (49.7%)
Utilities(4.7%)
Total
Construction (23.3%)
Mining (22.3%)
September

IGAE Services
Index 2013=100, s. a.

Transportation and information (14.0%)
Finance and real estate (23.8%)
Total
Trade (28.8%) [1]
Rest (23.4 %)
Educational and health care (9.9%)
September

s. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their participation in 2013. Source: Monthly Indicator of Industrial Activity, Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.
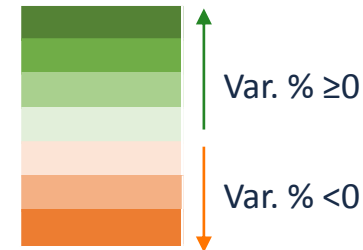
s. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their participation in 2013.
1/ Includes both wholesale and retail trade.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

Quarterly % Change of Sectors and Subsectors of Economic Activity, s. a.
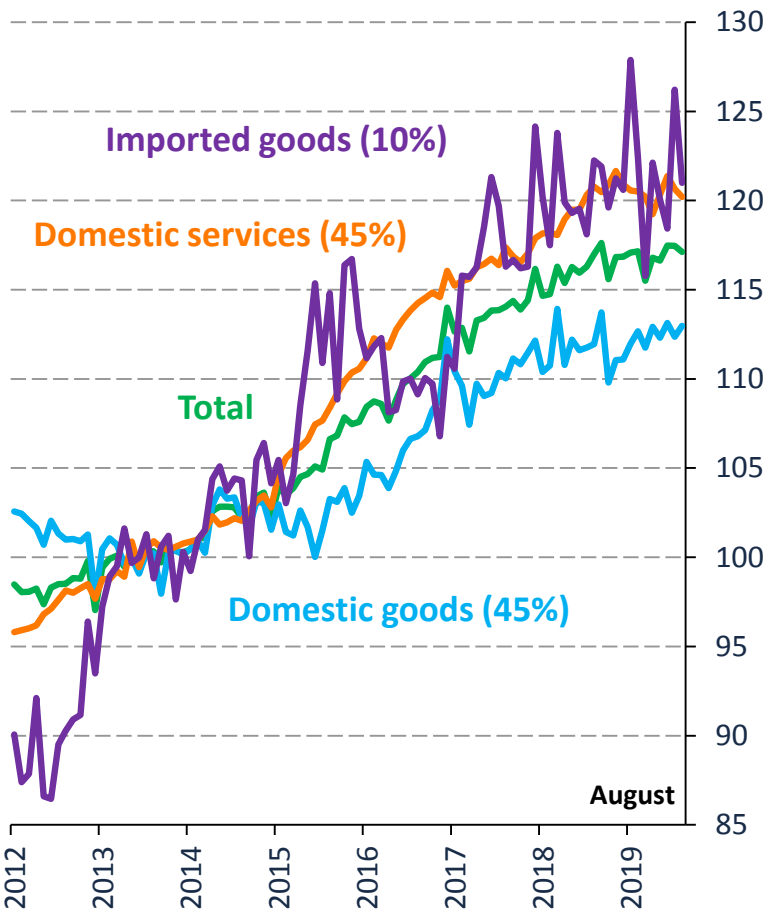

s. a. / Seasonally adjusted figures. Source: Prepared by Banco de México with information from Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

As for domestic demand, private consumption remained weak. This was the result of a slowdown of consumption of services and goods, especially imported ones. Meanwhile, remittances and the real wage bill have trended upward.

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

Imported goods (10%)
Domestic services (45%)
Total
Domestic goods (45%)
August

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

US dollars
Mexican pesos 1/
September

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

Consumer confidence
Real wage bill
Q3-2019
October

s. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their participation in 2013.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.
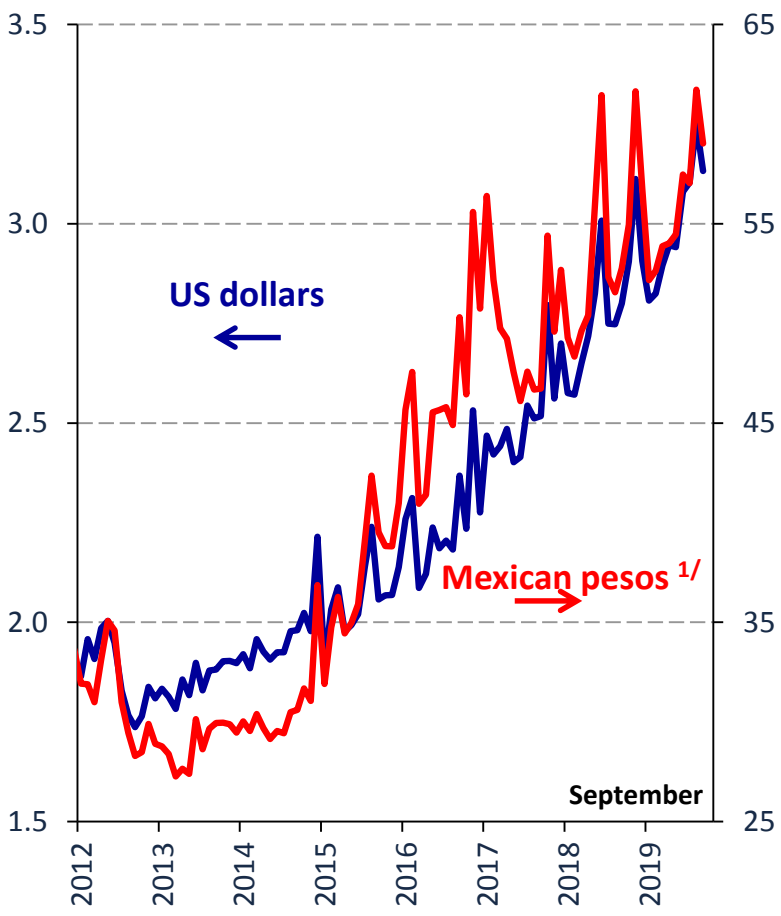
s. a. / Seasonally adjusted figures.
1/ Prices as of the second fortnight of July 2018.
Source: Banco de México and INEGI.
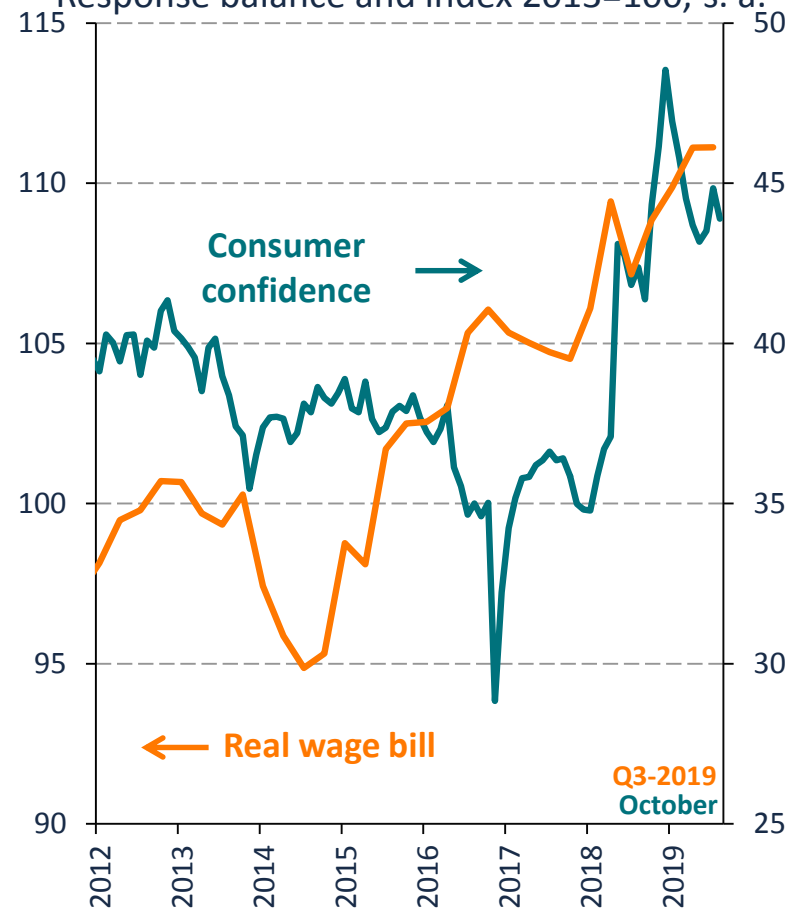
s. a. / Seasonally adjusted figures.
Source: Prepared by Banco de México with information from the National Survey of Occupations and Employment (ENOE, for its acronym in Spanish) and the National Survey of Consumer Confidence (ENCO, for its acronym in Spanish), INEGI and Banco de México.

With respect to gross fixed investment, the unfavorable performance that this indicator has been registering since 2S-2015 and especially since the beginning of 2018, prevailed, as a reflection of lower spending on machinery and equipment and the weakness of construction.

Investment and its Components
Index 2013=100, s. a.
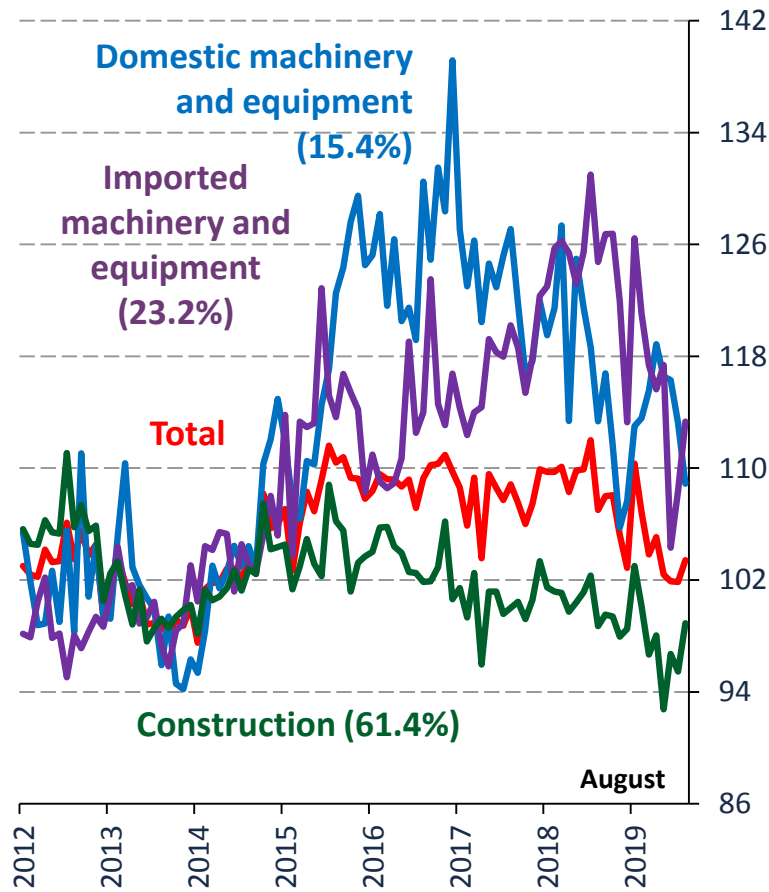
Domestic machinery and equipment (15.4%)

Imported machinery and equipment (23.2%)

Total

Construction (61.4%)

August

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

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

Residential (42%)

Total

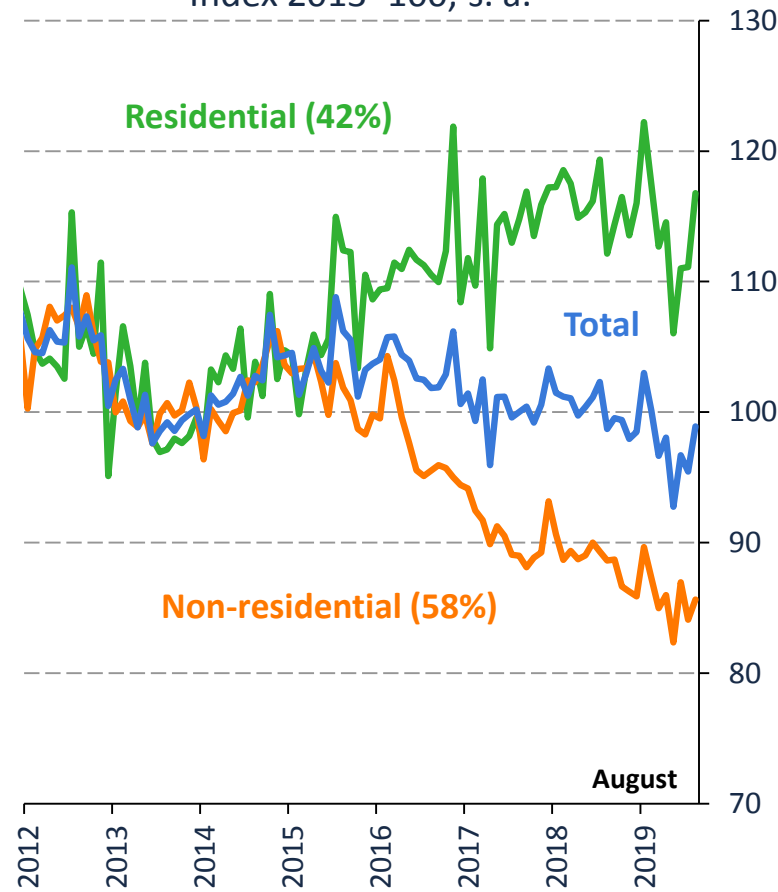Non-residential (58%)

August

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

Real Value of Construction Output by Contracting Institutional Sector [1]
Index 2013=100, s. a.
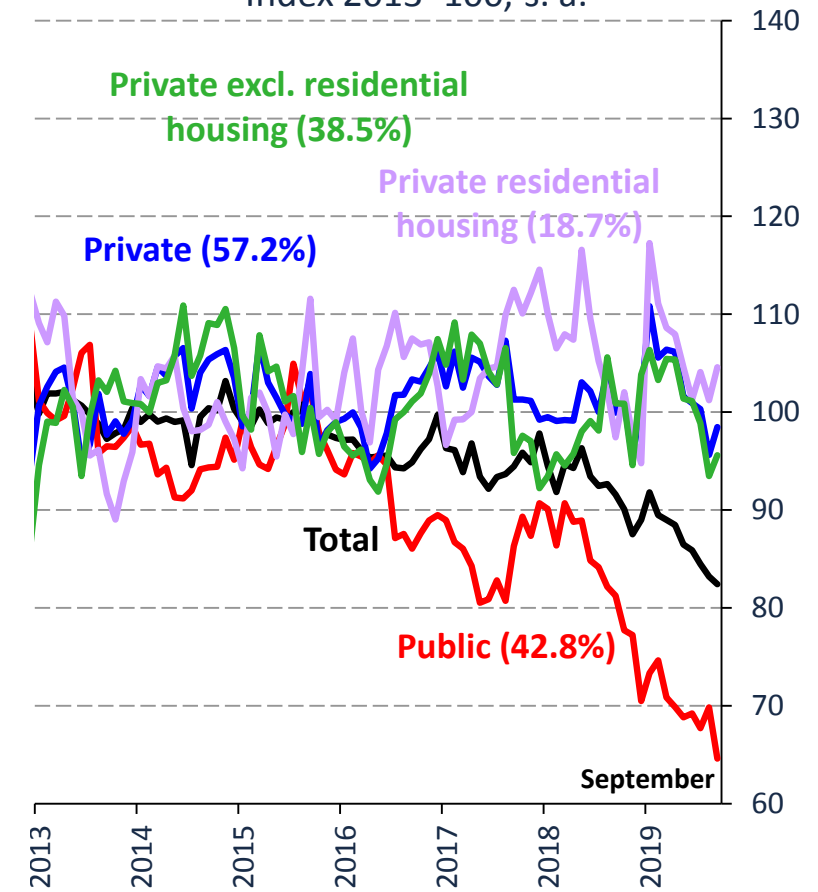
Private excl. residential housing (38.5%)

Private residential housing (18.7%)

Private (57.2%)

Total

Public (42.8%)

September

s. a. / Seasonally adjusted figures.
Note: Figures in parentheses represent their participation in 2018.
1/ Seasonally adjusted by Banco de México, except for the total series.
Source: Prepared by Banco de México with data from ENEC, INEGI.

In Q3-2019, manufacturing exports exhibited a loss of dynamism with respect to the growth exhibited in Q2, in line with the environment of trade tensions and of world trade deceleration, especially of manufacturing output.

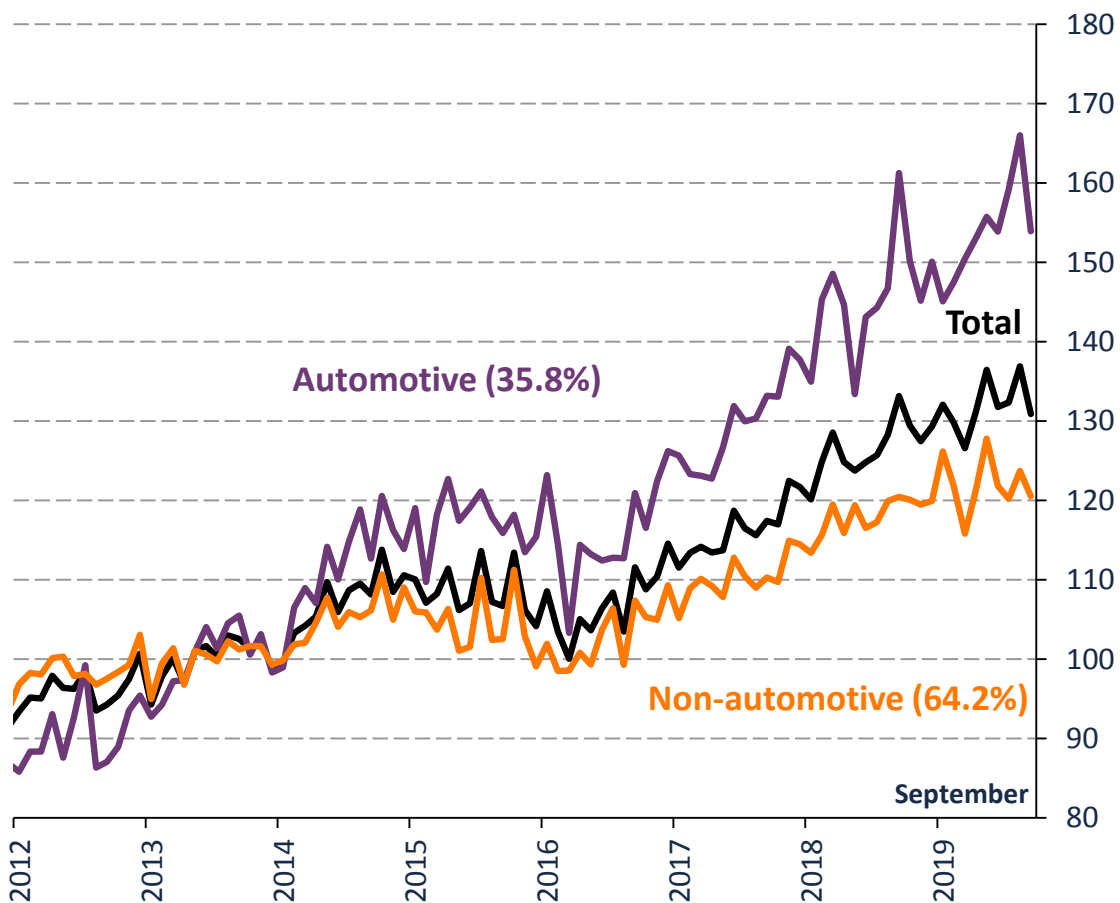## Manufacturing Exports
Index 2013=100, s. a.

Automotive and Non-automotive

Total
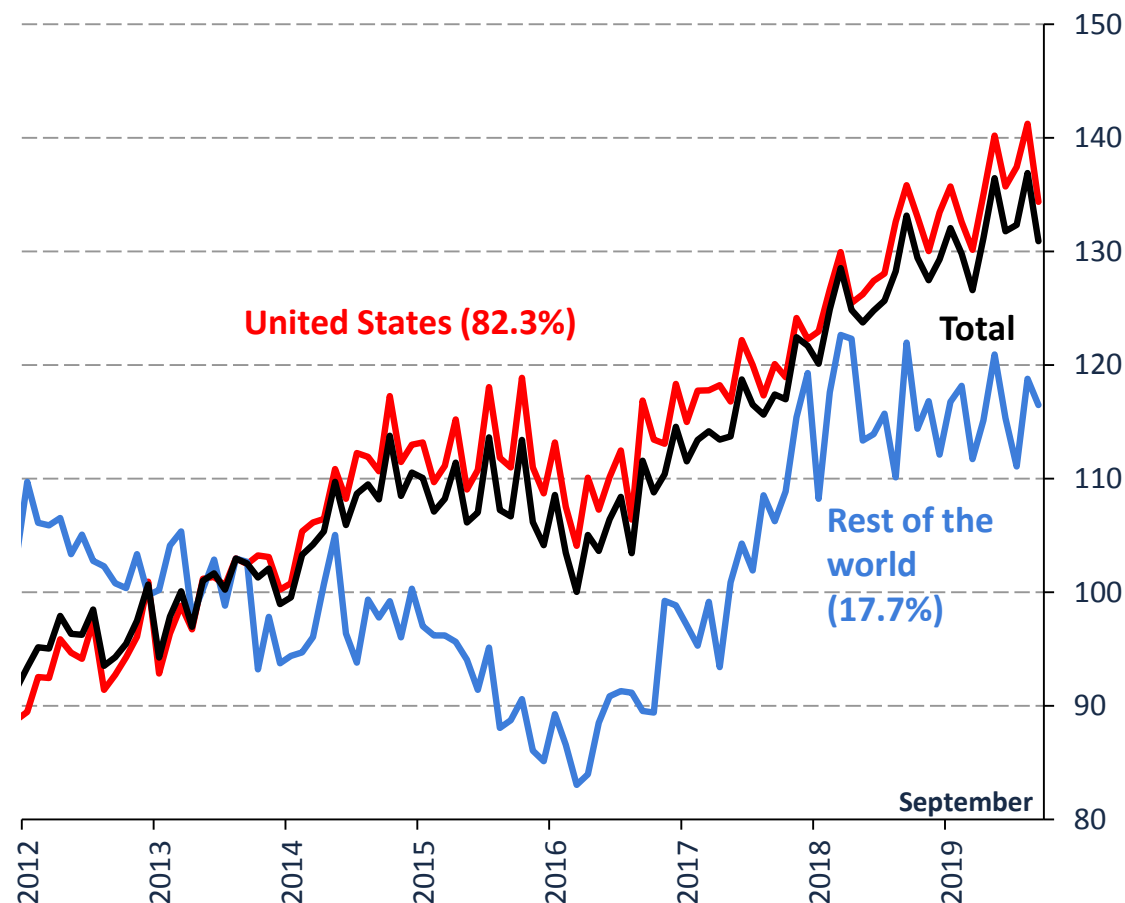
s. a./ Seasonally adjusted series.
Note: Figures in parentheses represent their participation in 2018.
Source: Prepared by Banco de México with data from Mexico's Tax Administration Service (SAT, for its acronym in Spanish), the Ministry of the Economy (SE, for its acronym in Spanish), Banco de México, the National Institute of Statistics and Geography (INEGI, for its acronym in Spanish). Mexico's Merchandise Trade Balance, and National System of Statistical and Geographical Information (SNIEG, for its acronym in Spanish). Information of national interest.

In Q3-2019, the sources of financial resources of the economy continued to grow at a slow rate relative to previous years, reflecting a lower growth rate of external sources and a slight upturn of domestic ones.

Sources and Uses of Financial Resources of the Economy
Annual flows as % of GDP

Total
External [2/]
Domestic [1/]

Total
Other items [5/]
Public sector Financing [6/]
Private sector financing [3/]
International reserves [4/]
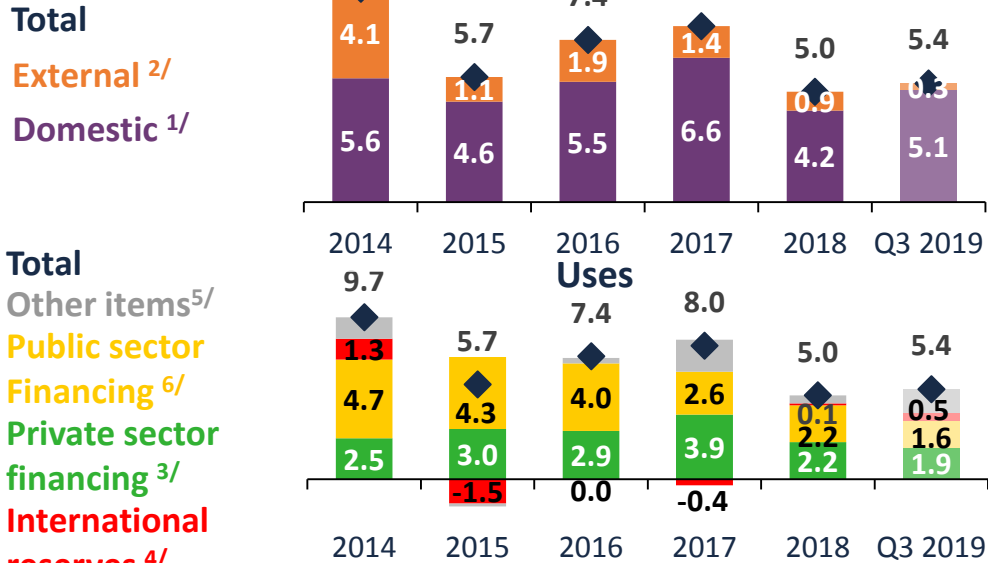
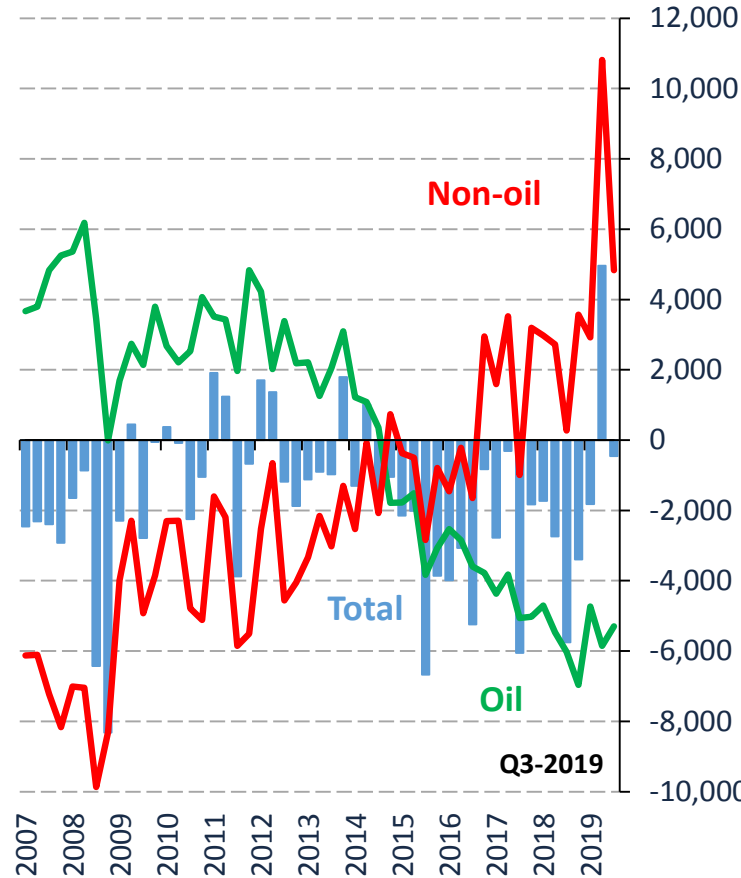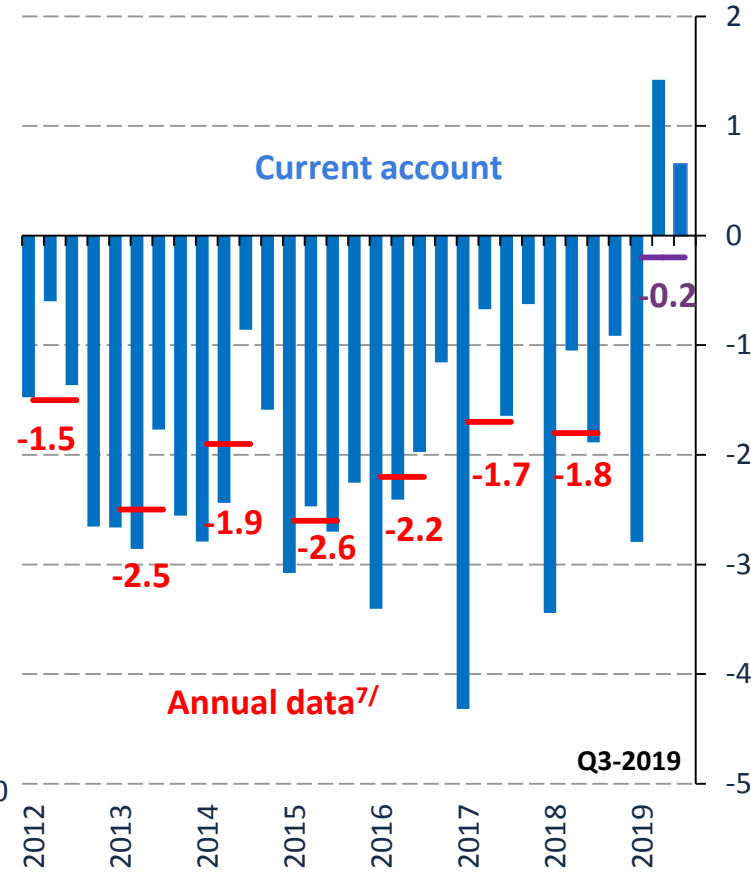Note: Annual flows as a percentage of GDP in each reported quarter refer to the total sources and uses of financial resources in the last four quarters, expressed as a % of average nominal GDP of the same four quarters. Q3-2019 figures correspond to preliminary data. All figures are annual except for the Q3 2019.
1/ Corresponds to domestic financial assets (aggregate F1), composed of monetary and non-monetary domestic sources. 2/ Includes monetary instruments held by non-residents (i.e. the aggregate MNR, which is the difference between M4 and M3) and other non-monetary external sources (external debt of the Federal Government and public agencies and companies, commercial banks' external liabilities, external financing to the nonfinancial private sector, and funds raised by agencies, among others). 3/ Refers to the loan portfolio of financial intermediaries, the National Housing Agencies (Infonavit and Fovissste), the issuance of domestic debt and external financing of firms. 4/ As stated in Banco de México's Law. 5/ Includes capital accounts, and earnings and other assets and liabilities of commercial and development banks, of non-bank financial intermediaries, of the National Housing Agency (Infonavit) and Banco de México –including securities issued by Banco de México for monetary regulation purposes, especially those related to sterilizing the monetary impact of the operational surplus. It includes non-monetary liabilities from the Institute for the Protection of Bank Savings (IPAB) as well as the effect of the valuation changes of public debt instruments, among other concepts. 6/ It refers to Public Sector Borrowing Requirements (RFSP for its acronym in Spanish) of each fiscal year, which include Banco de México's operational surplus turned in to the federal goverment. Source: Banco de México.

Trade Balance
USD million

Source: SAT, SE, Banco de México, INEGI. Mexico's Merchandise Trade Balance. SNIEG. Information of national interest.

Current Account
% of GDP

7/ The annual figure for 2019 corresponds to the January-September period. Source: Banco de México and INEGI.

Box 3. Estimates of Price and Quantity Effects on the Evolution of Non-oil Trade Balance Dynamics in Mexico

Annual change in the non-oil trade balance: estimates of price and quantity effects on the evolution of non-oil trade balance dynamics in Mexico January –September 2019, USD million; o. s.

	Δ Exports (+)	Δ Imports (-)	Δ Trade Balance (=)
Quantity Effect	9,388	8,628	760
Price Effect	5,098	-6,734	11,833
Total	14,486	1,893	12,593

$$\Delta SC_{t+n,t} = \Delta X_{t+n,t} - \Delta M_{t+n,t}$$

$$= \underbrace{P_{X_t}\left(Q_{X_{t+n}} - Q_{X_t}\right)}_{\substack{\text{Quantity Effect}\\\text{Exports}}} + \underbrace{Q_{X_{t+n}}\left(P_{X_{t+n}} - P_{X_t}\right)}_{\substack{\text{Price Effect}\\\text{Exports}}} - \underbrace{P_{M_t}\left(Q_{M_{t+n}} - Q_{M_t}\right)}_{\substack{\text{Quantity Effect}\\\text{Imports}}} - \underbrace{Q_{M_{t+n}}\left(P_{M_{t+n}} - P_{M_t}\right)}_{\substack{\text{Price Effect}\\\text{Imports}}}$$

$\Delta SC_{t+n,t}$: Change in non oil trade balance between periods *t and t+n*.
$\Delta X_{t+n,t}$: Change in exports value between periods *t and t+n*.
$\Delta M_{t+n,t}$ Change in imports value between periods *t and t+n*.
P_{i_t}: Refers to prices of operation *i* (exports or imports) during period *t*, approximated using Unit Value Index.
Q_{i_t}: Refers to volumes of operation *i* during period *t*, obtained through amounts in USD and unit values.

- Using the methodology of unit values, a decomposition of the price effect and of the quantity effect of the value of exports and imports was performed to analyze how these margins of adjustment have contributed to the surplus recently observed in the non-oil trade balance.

  ✓ The results indicate that **the annual increase in the value of exports was supported by both higher prices and higher volume.**

  ✓ On the other hand, **the relative weakness of the value of imports reflected the lower prices, as their volume continued to grow.**

In Q3-2019, both the national and urban unemployment rates continued registering higher levels than those reported in 2018.

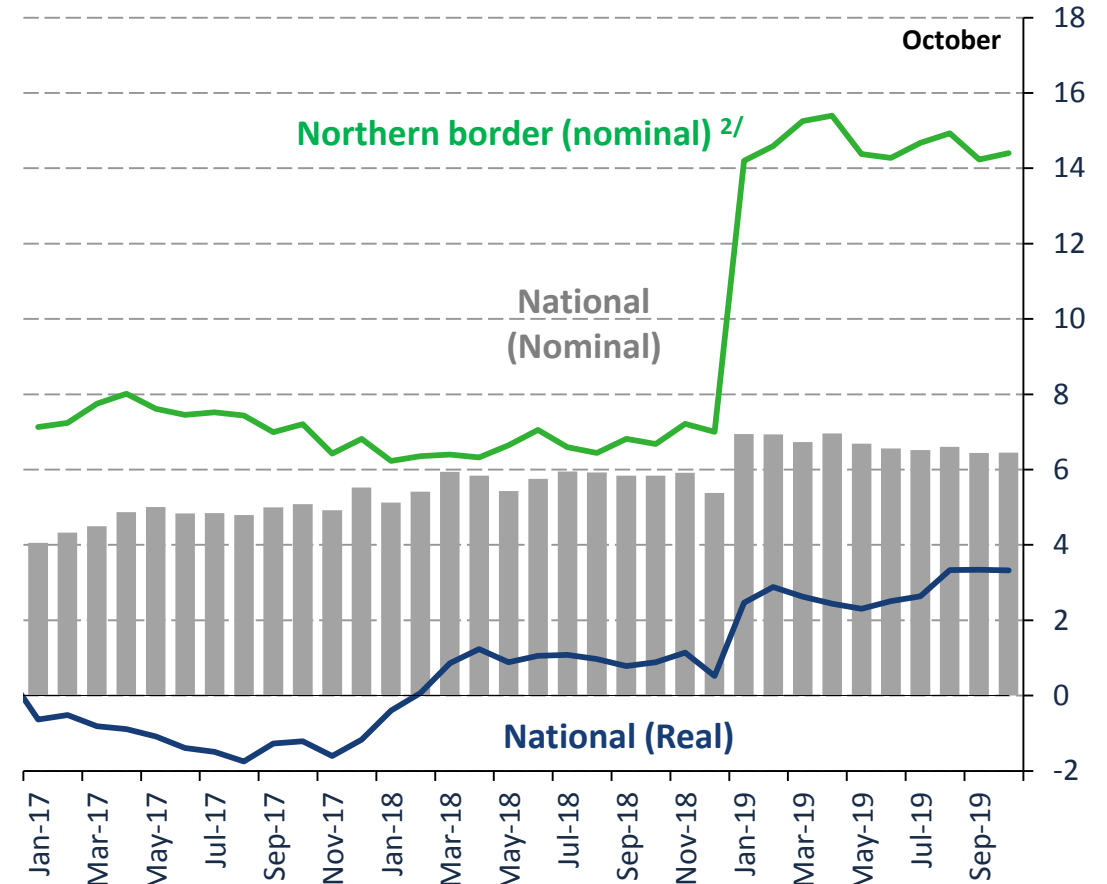## National and Urban Unemployment Rates
%, s. a.
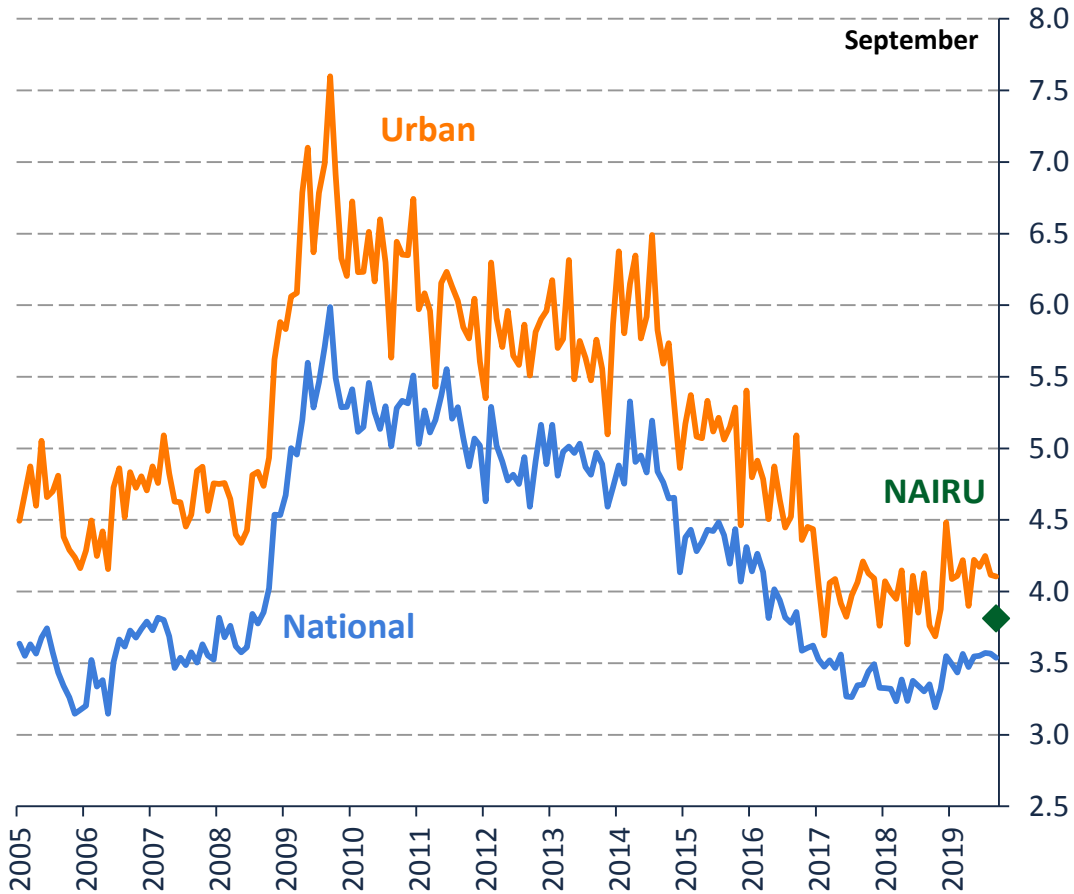
s. a. / Seasonally adjusted data.
Source: Prepared by Banco de México with IMSS and INEGI data.

Daily Wage of IMSS-insured Workers [1]
Annual % change

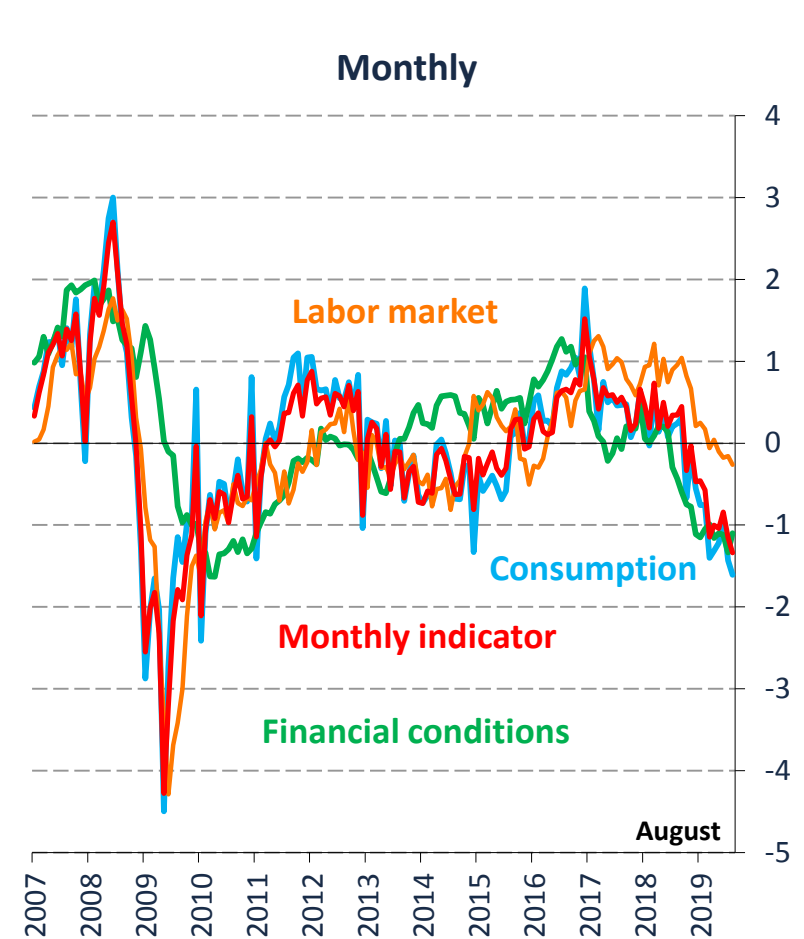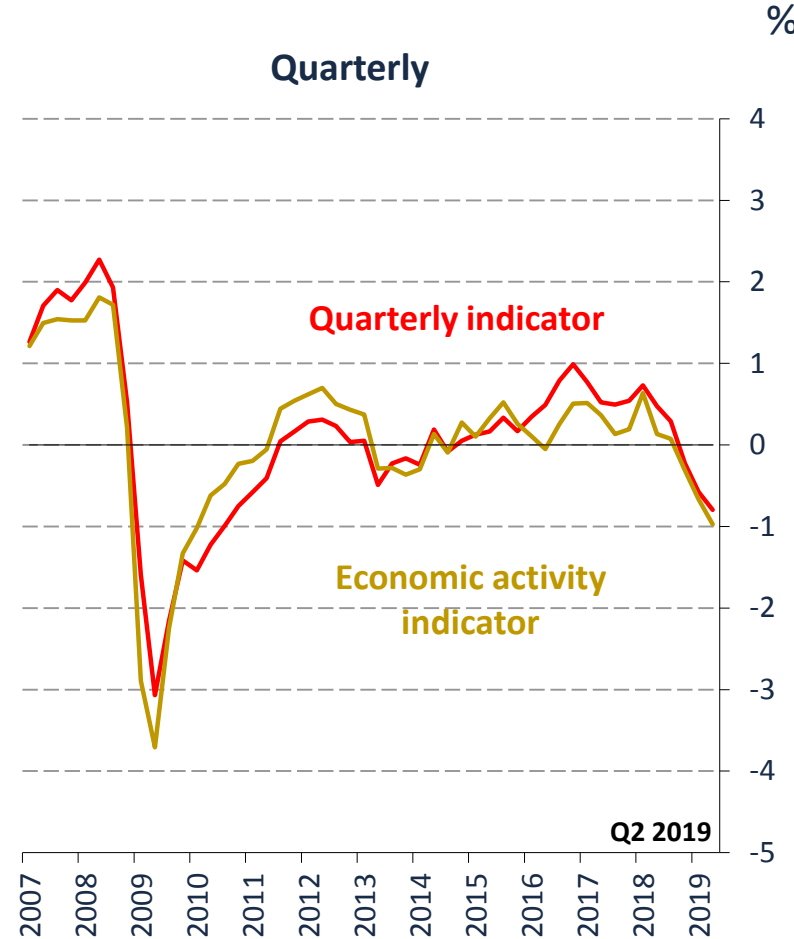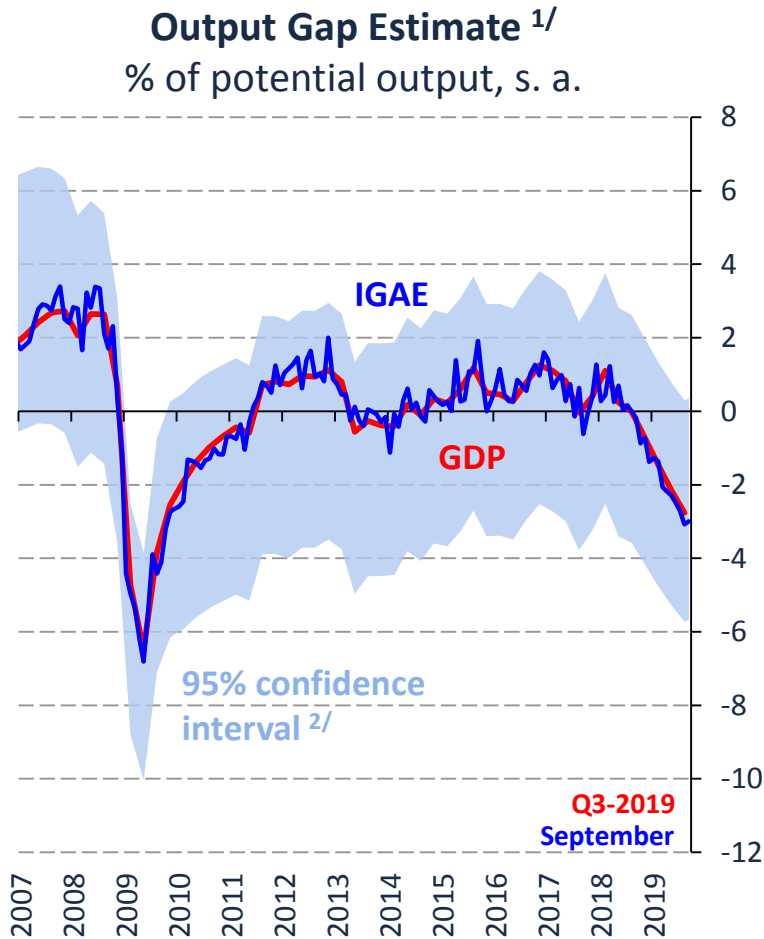1/ During the third quarter of 2019, an average of 20.5 million insured workers were registered in the IMSS. Real wages were deflated with the INPC.
2/ Integrated by the municipalities mentioned in the DOF of December 26, 2018, most of which share boundary with the northern border.
Source: calculations prepared by Banco de México with data from IMSS, STPS and INEGI (ENOE, for its acronym in Spanish).

During Q3-2019, economic slack is estimated to have widened in negative terrain at a greater-than-anticipated pace, consistent with the stagnation of economic activity.

Output Gap Estimate [1]
% of potential output, s. a.

IGAE

GDP

95% confidence interval [2]

Q3-2019 September

Slack Indicators: Main Component by Indicators Frequency [3]
%

Quarterly

Quarterly indicator

Economic activity indicator

Q2 2019

Monthly

Labor market

Consumption

Monthly indicator

Financial conditions

August

Among the factors that business representatives and analysts believe could limit growth are those related to governance. 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 [1,2]
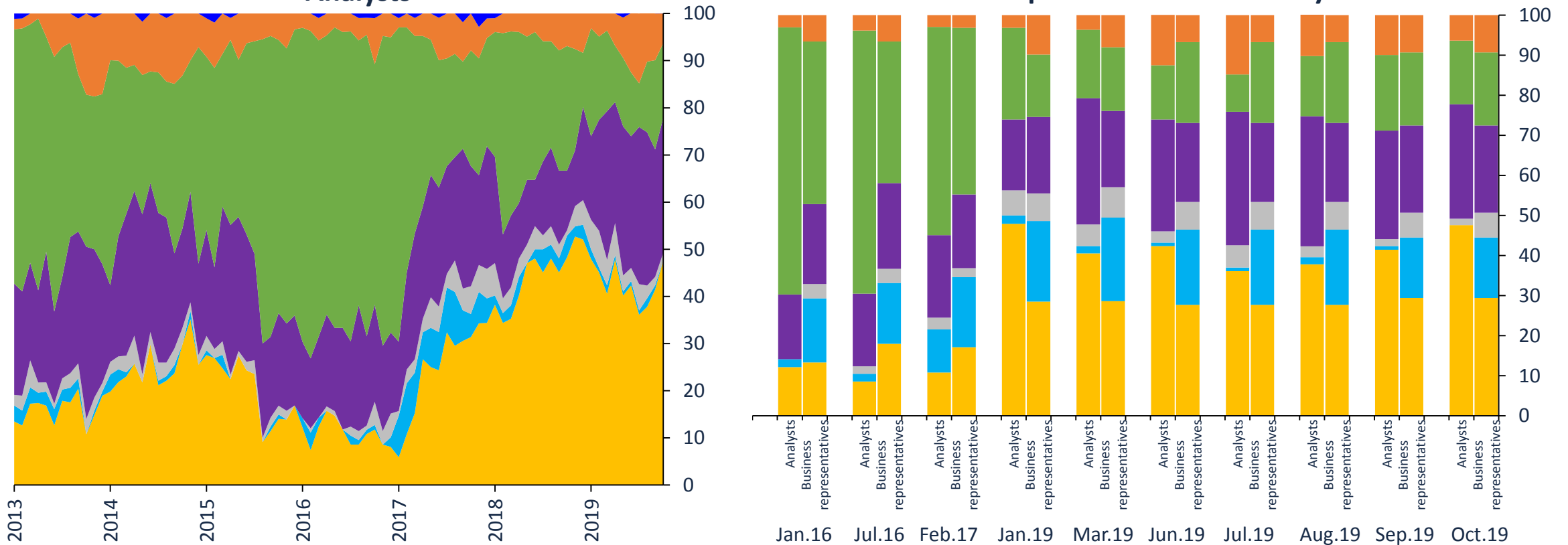
1/ Responses from the Survey of Private Sector Forecasters associated with the question: Which three main factors will limit economic growth in the next six months? 2/ Responses from the Monthly Survey of Regional Economic Activity (EMAER, for its acronym in Spanish) associated with the question: In 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.

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1	External conditions
2	Current situation of the Mexican economy
3	**Inflation**
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In Q3-2019, annual headline inflation trended downwards. Thus, while in Q2-2019 average annual headline inflation was 4.21%, in Q3 it stood out at 3.31%, registering 3.10% in F1-Nov. This behavior can be attributed to the significant fall in non-core annual inflation. Annual core inflation, on the other hand, continued showing persistence, although it has shown a slight decline recently.

Consumer Price Index

Annual % change [1]

Incidences in percentage points [2]
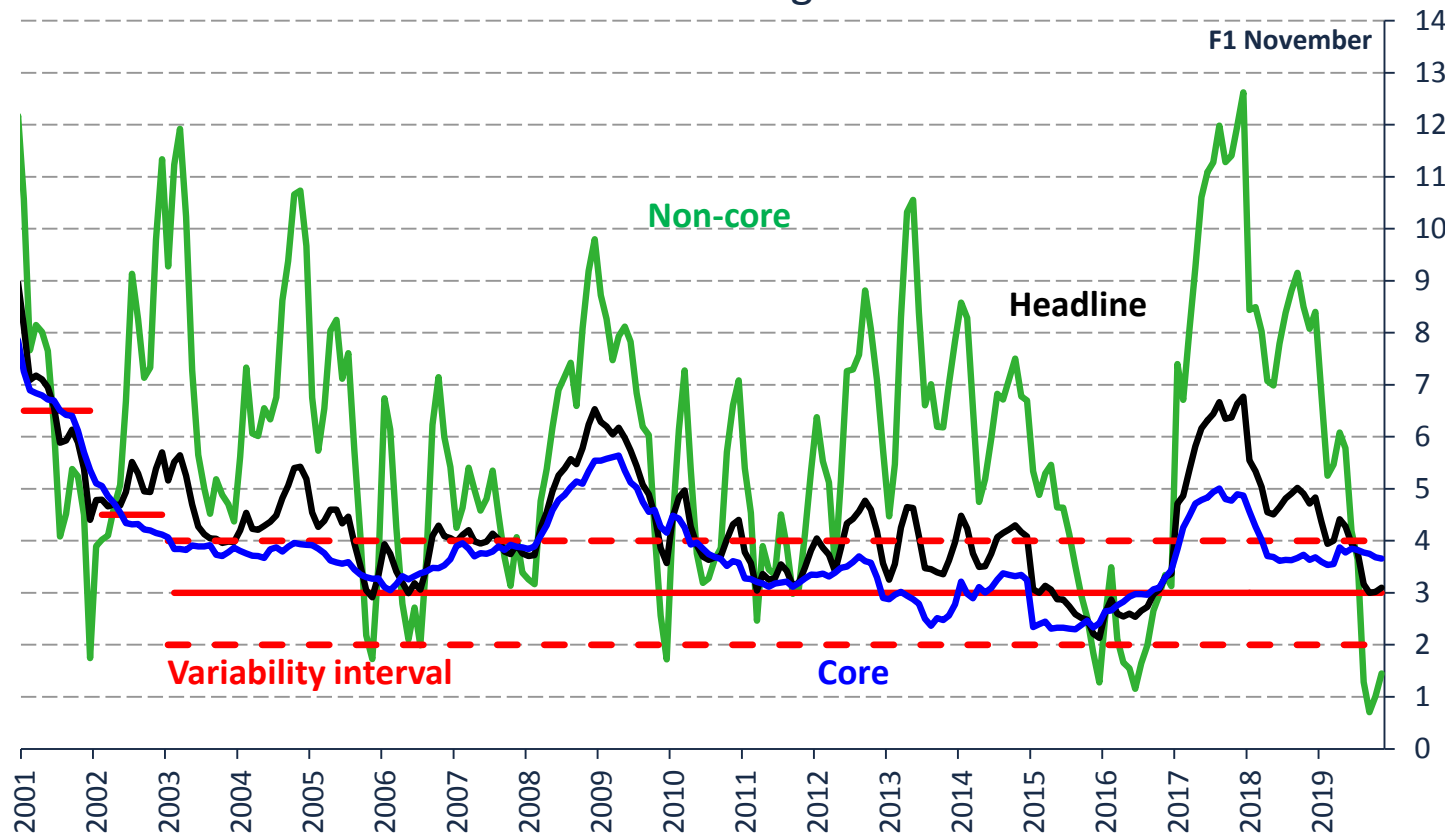
1/ Since 2003, a permanent inflation target of 3%, with a variability interval of +/-1%, was established for headline inflation.
Source: Banco de México and INEGI.
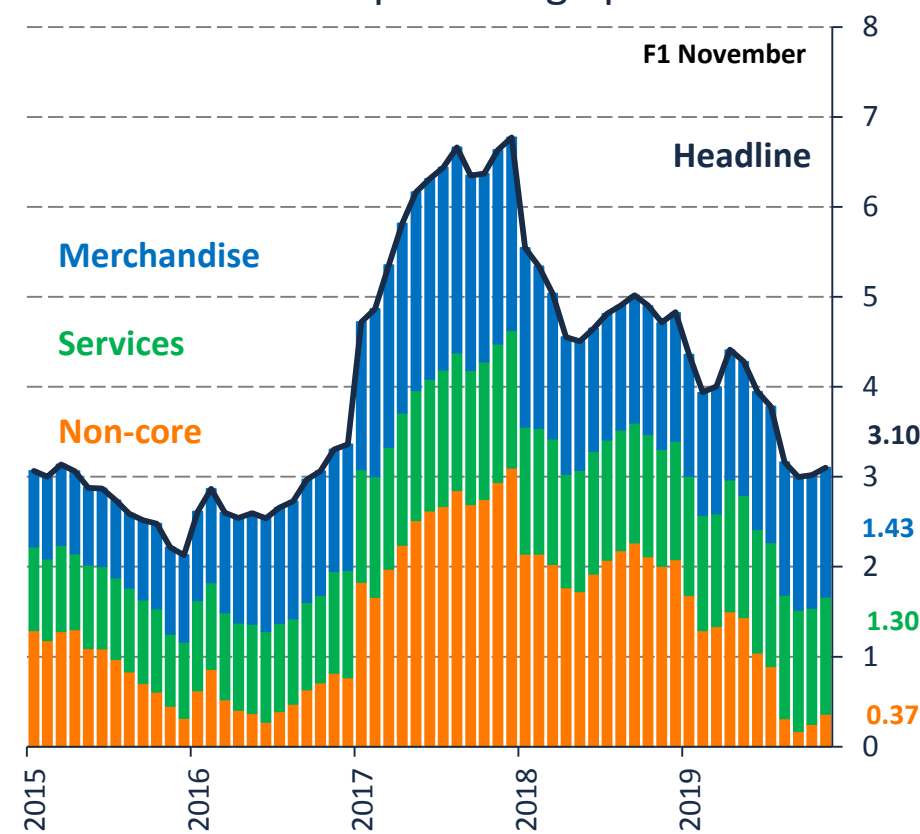
2/ In certain cases, the sum of inflation's components may not add up due to rounding.
Source: Banco de México and INEGI.

Between Q2 and Q3-2019, annual non-core inflation decreased significantly, from an average of 5.35 to 1.87%, while in F1-Nov it lay at 1.45%. Such behavior is due to the lower annual variations registered in the prices of energy products, although those of agricultural and livestock products have also decreased, although in lesser magnitude.

Non-core Price Subindex
Annual incidences in percentage points [1]

Agricultural and Livestock Products Price Index
Annual % change

Selected Energy Price Indexes
Annual % change
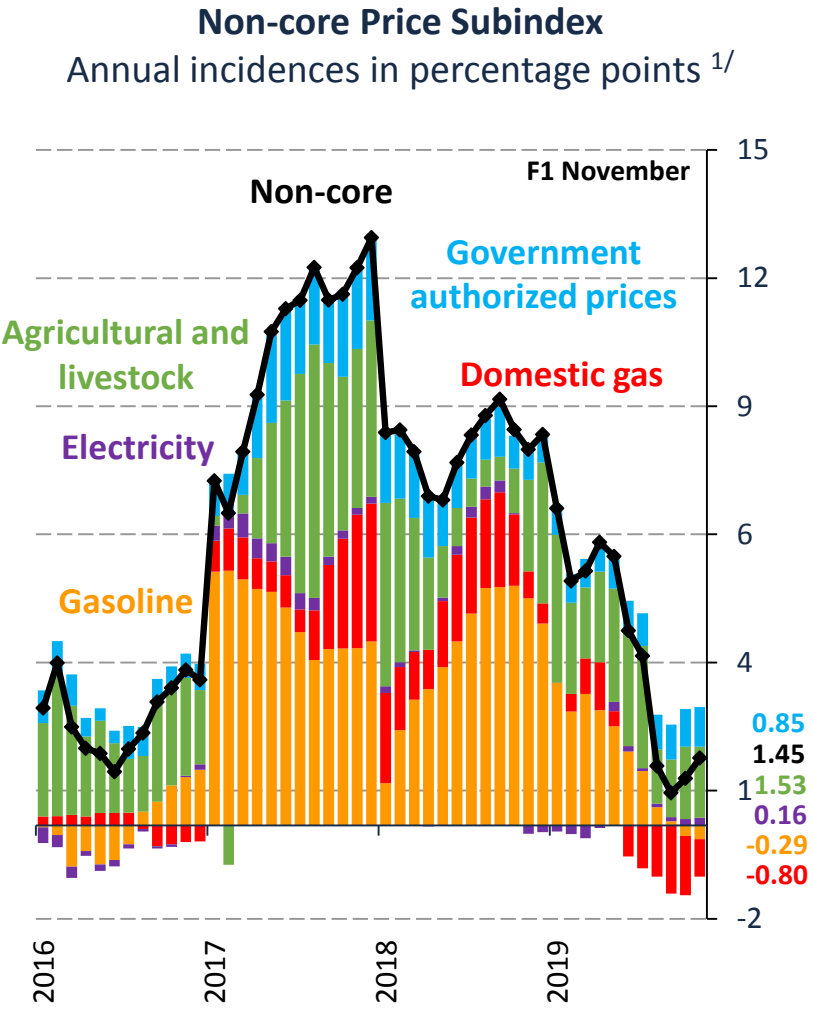
1/ In certain cases, the sum of inflation's components may not add up due to rounding.
Source: Calculated by Banco de México with INEGI data.
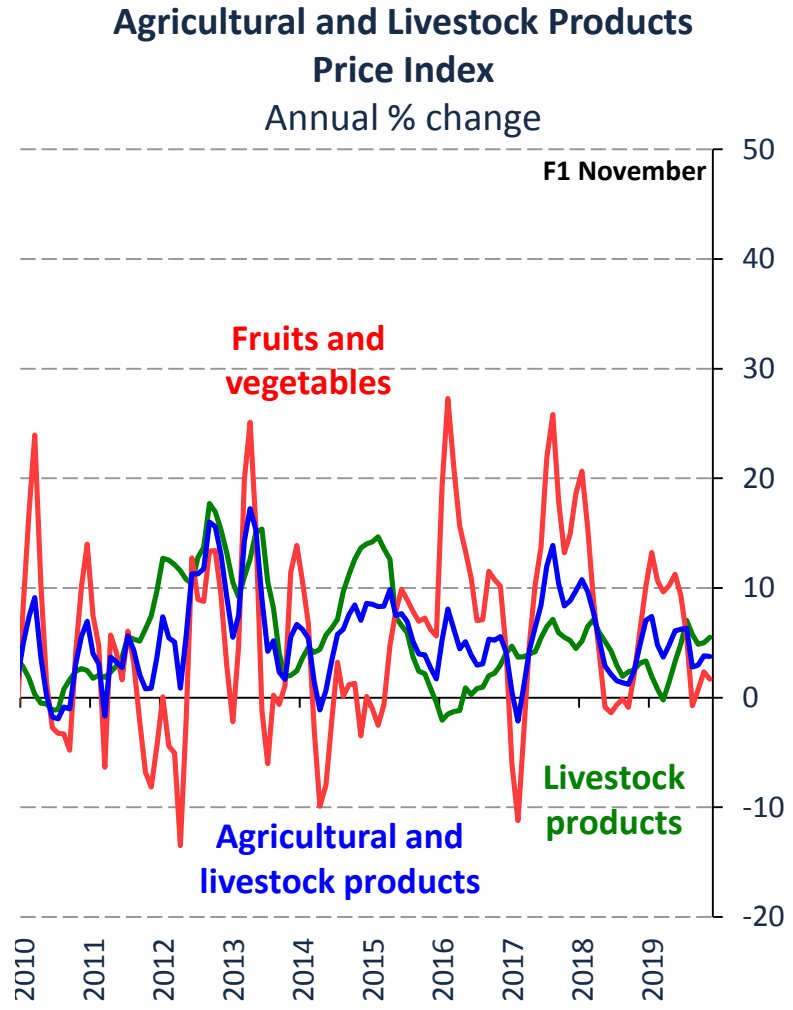
Source: Banco de México and INEGI.
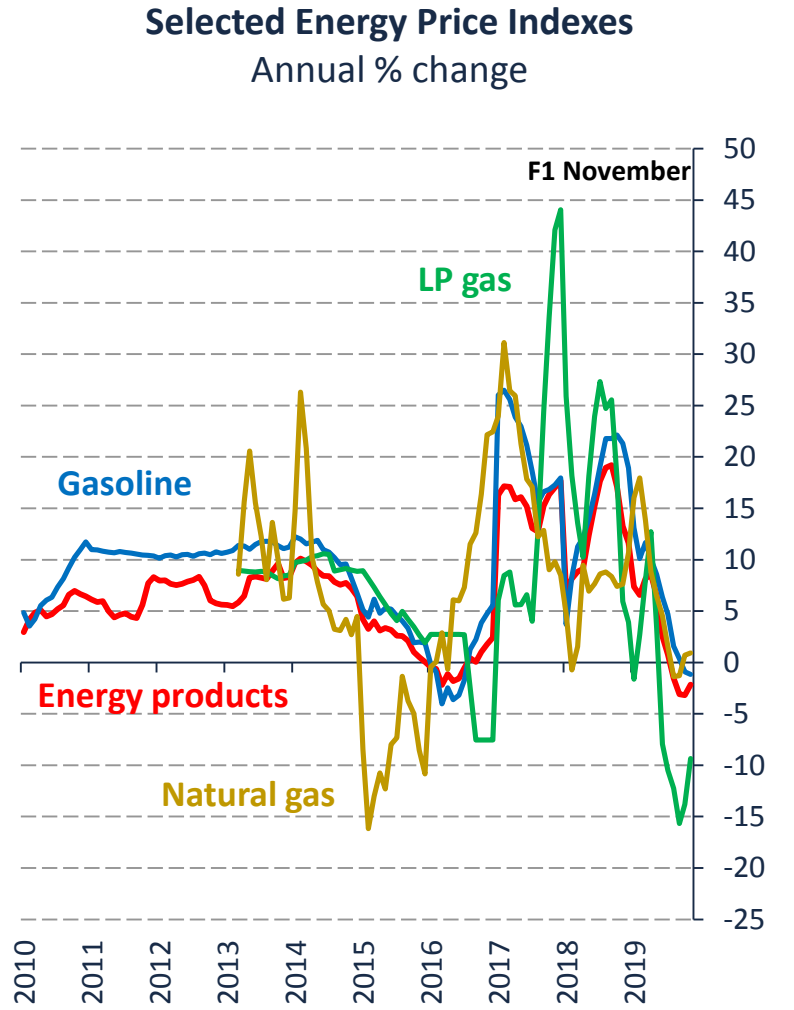
Source: Banco de México and INEGI.

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Annual core inflation continues to show persistence, although throughout Q3-2019, October and F1-Nov it somewhat decreased.

Core Inflation Trend Measures
Annual % change

Core inflation

Trimmed mean indicator[1]

Supercore price subindex

F1 November
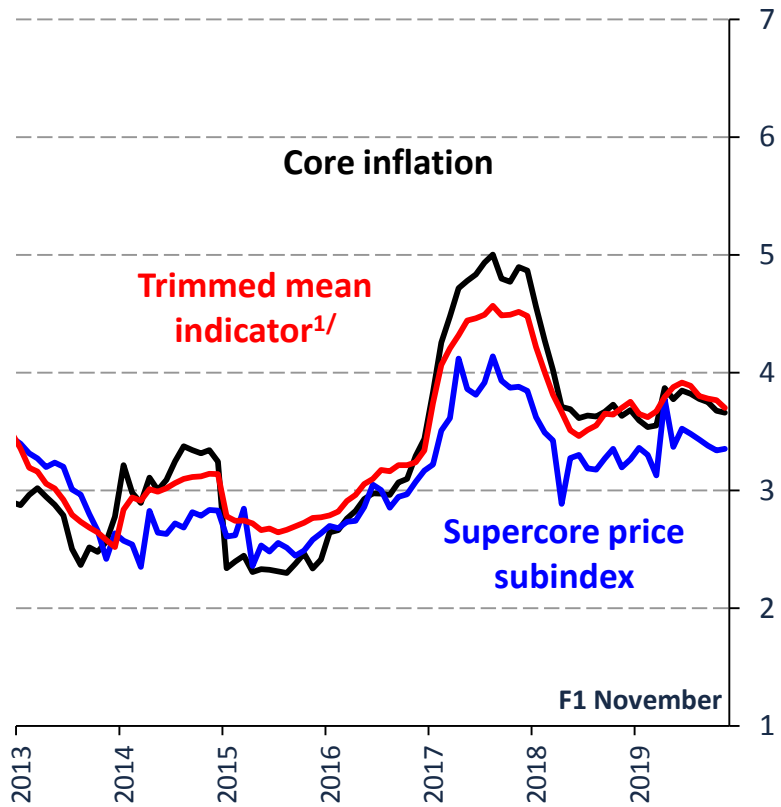
1/ The trimmed mean indicator excludes the contribution of extreme variations in the prices of some generic items to the inflation of a price index. To eliminate the effect of these changes, the following is done: i) monthly seasonally adjusted changes of the generic items of the price index are arranged 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.

Merchandise Price Subindex
Annual % change

Foods, beverages and tobacco

Merchandise

Non-food merchandise

F1 November
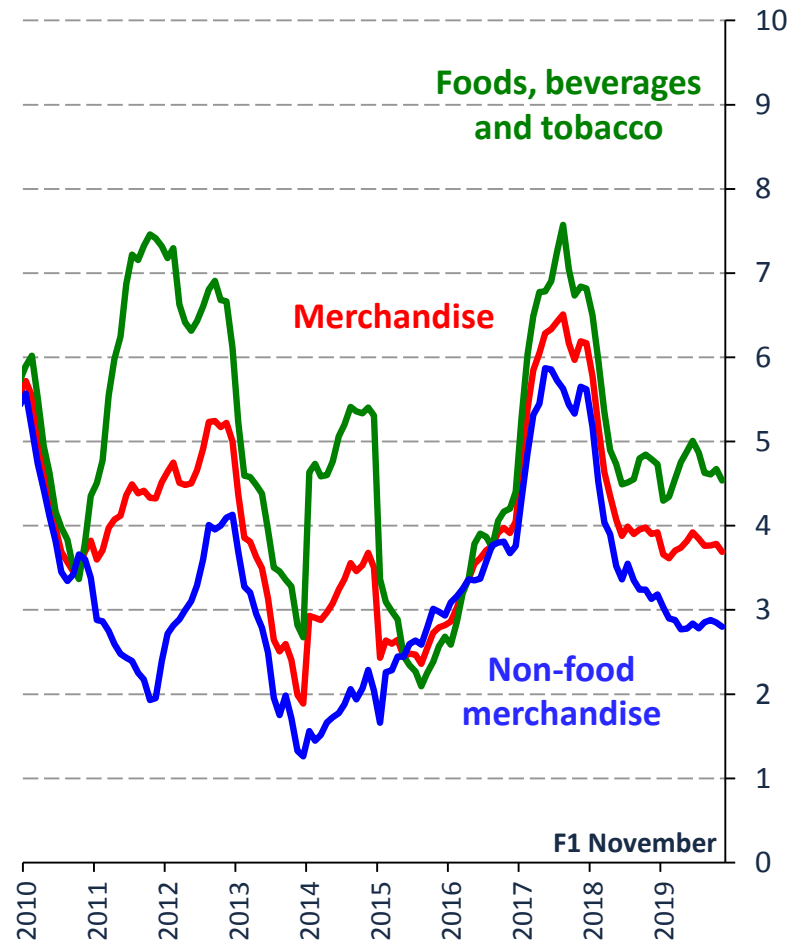
Source: Banco de México and INEGI.

Services Price Subindex
Annual % change
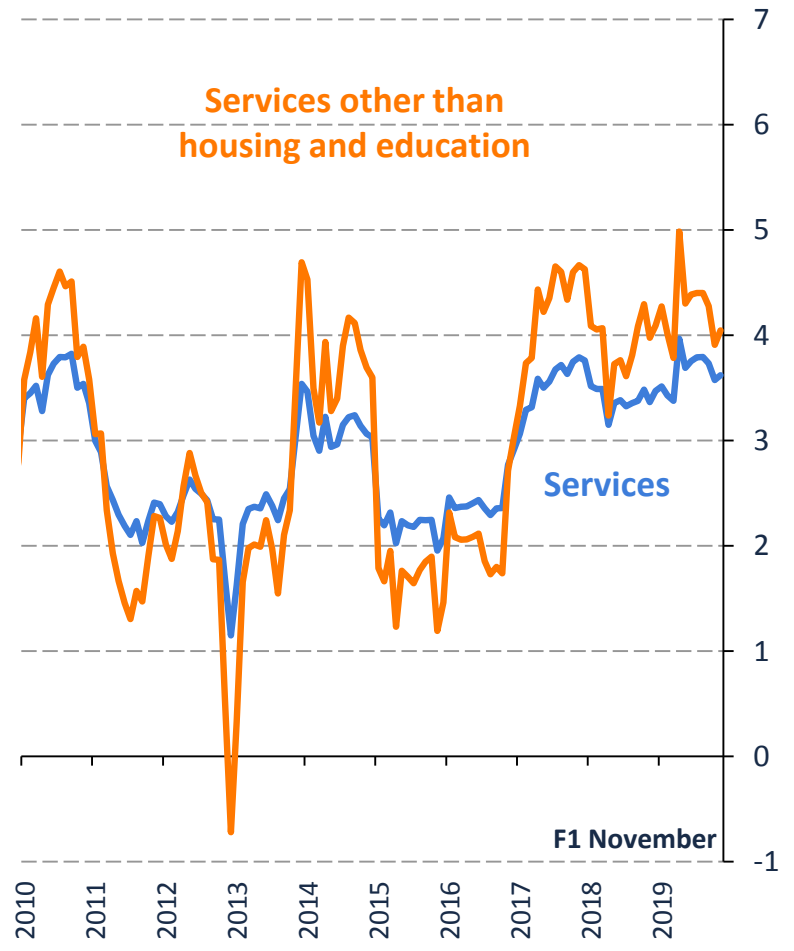
Services other than housing and education

Services

F1 November

Source: Banco de México and INEGI.

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Outline

1	**External conditions**
2	**Current situation of the Mexican economy**
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Monetary policy conduction

August, September and November meetings
Reductions of 25bp in each one to a level of **7.50%**

✓ 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).
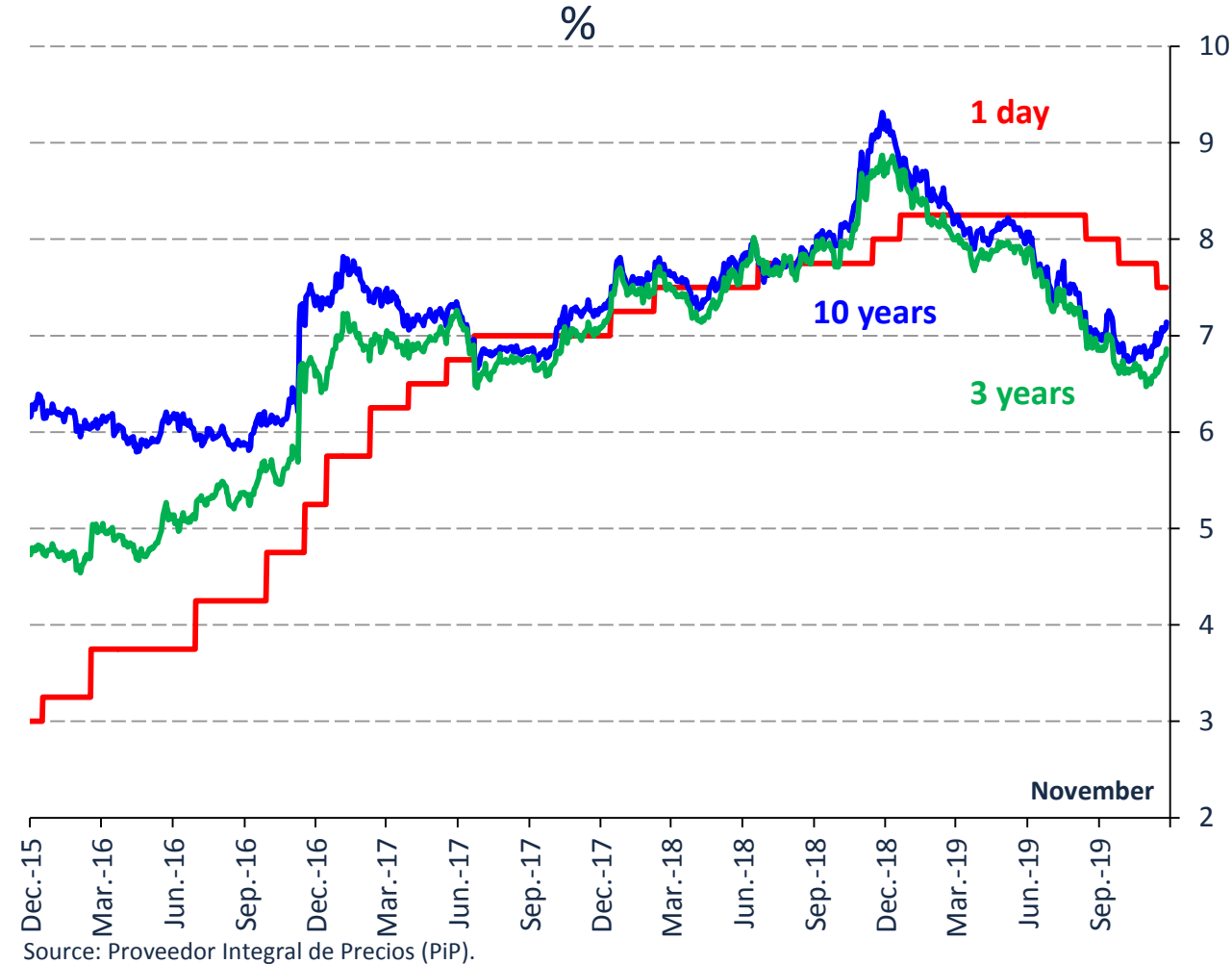
Interest rates in Mexico have reflected the effects of the lower external interest rates, registering decreases in all terms, while short term interest rates were affected mainly by the reduction in the target interest rate.

Interest Rates on Government Securities in Mexico
%
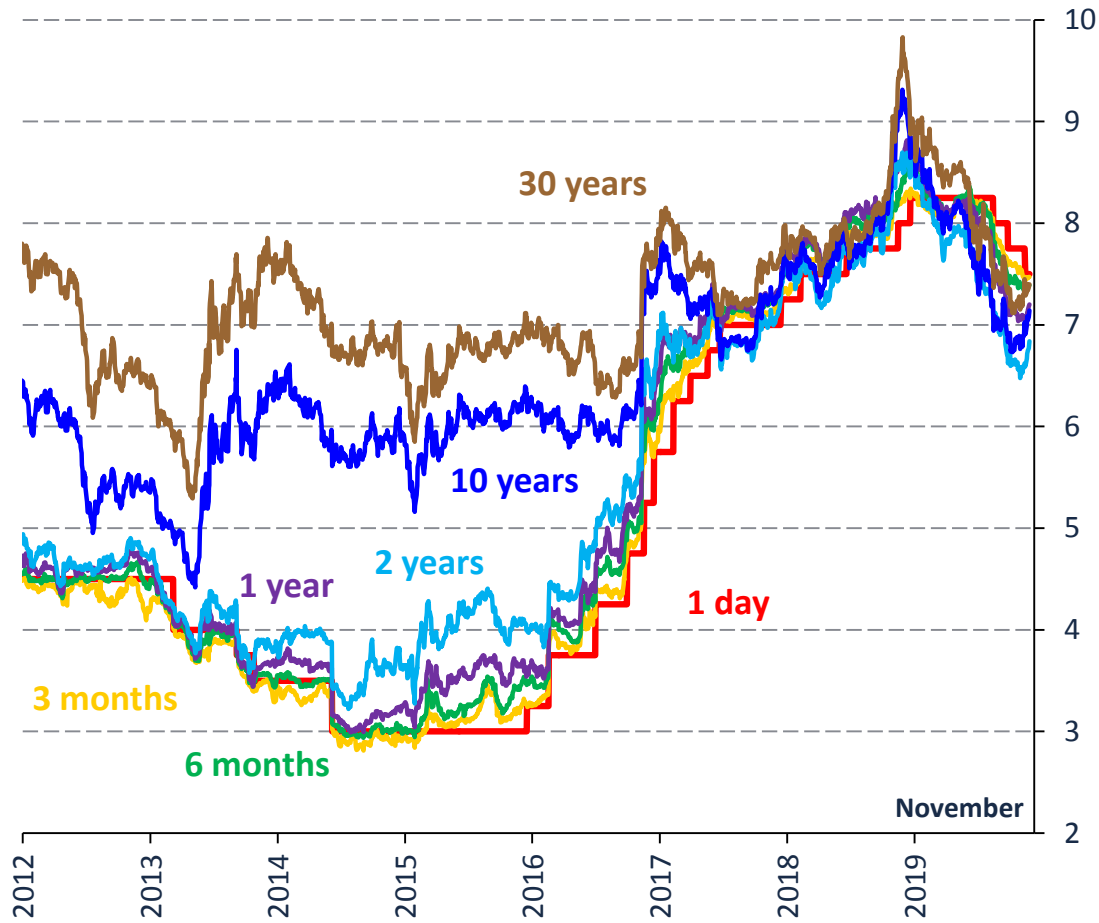
Source: Proveedor Integral de Precios (PiP).

Yield curve
Basis points
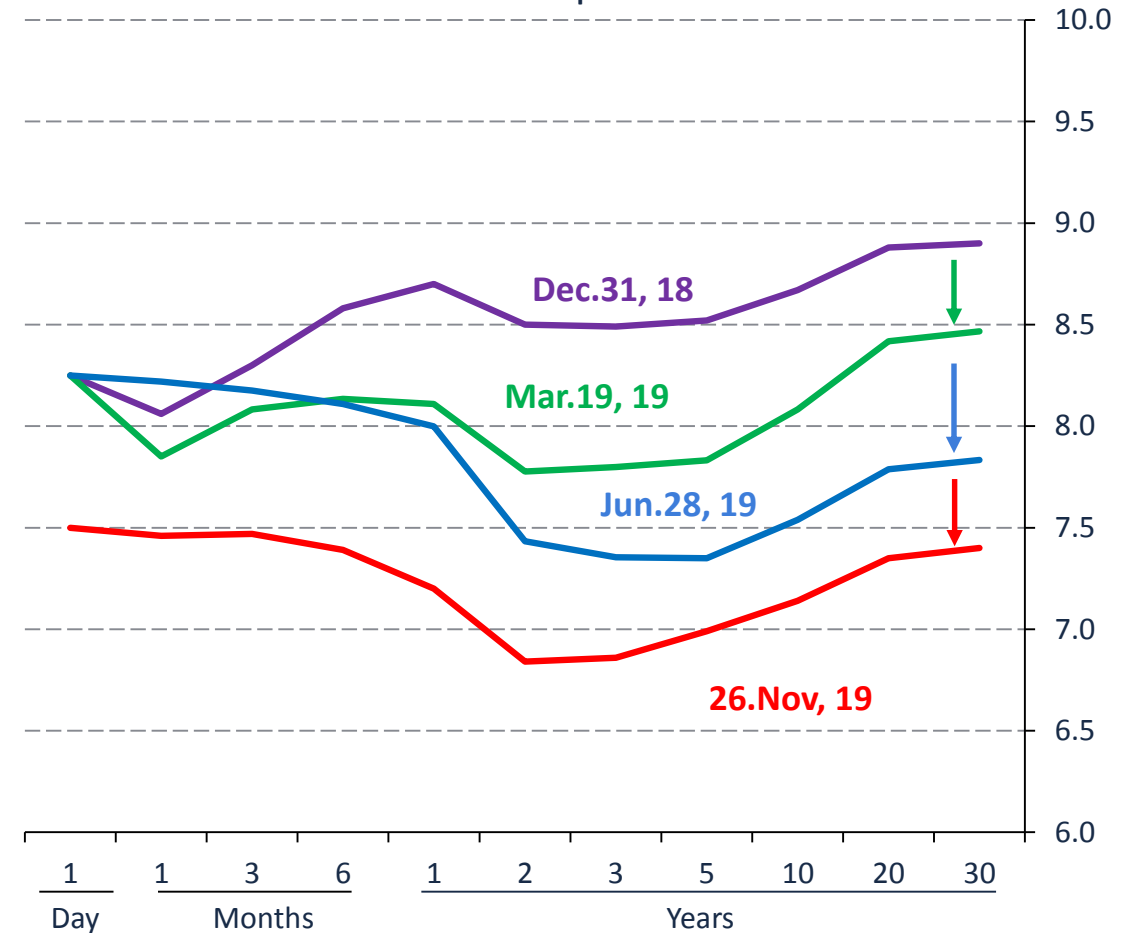
Source: Proveedor Integral de Precios (PiP).

Although the peso depreciated in the first part of Q3-2019 associated with a lower appetite for global risk, this trend has been partially reversed accompanied by lower levels of volatility. The aforementioned is due partly to a greater appetite for risk associated with lesser trade tensions between China and the United States.

Nominal Exchange Rate [1]
Pesos per dollar

Analysts' expectations 2019 Banxico survey 19.72
Analysts' expectations 2019 Citibanamex survey 19.70
Analysts' expectations 2020 Banxico 20.17
Analysts' expectations 2020 Banxico 20.40

Observed exchange rate

19.52

November

1/ Observed exchange rate refers to the daily FIX Exchange Rate. Figures aside analysts' expectations correspond to averages of Banco de México survey for October and the Citibanamex survey for November 20, 2019.
Source: Banco de México and Citibanamex.

Volatility Implied in Exchange Rate Options
%

1 week

1 month   6 months

18 months

9 months   November

Source: Bloomberg

Short-term inflation expectations drawn from surveys have followed the latest information, while longer term ones have remained relatively stable, although at levels higher than 3%. Meanwhile, break-even inflation and inflationary risk drawn from market instruments decreased.

Inflation Expectations
Median, %

For the end of 2019 and 2020

— Headline
--- Core

2020
2019

October
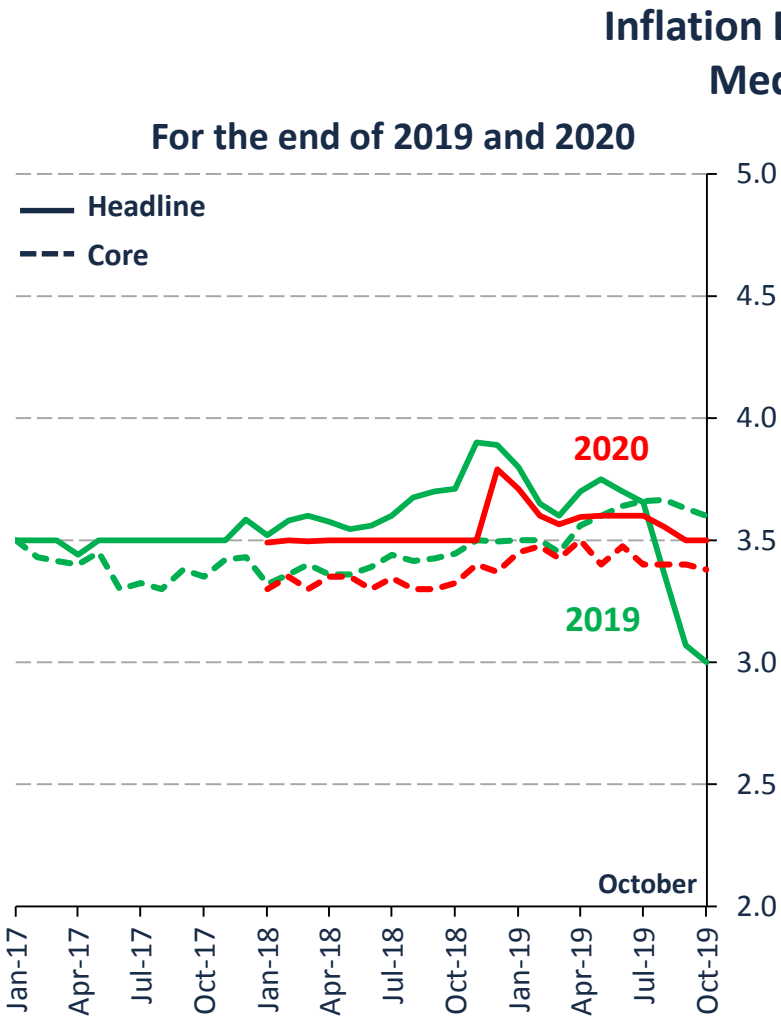
Source: Banco de México's Survey of Private Sector Forecasters.

Headline Inflation (Different Terms)

Variability interval (upper limit)

Citibanamex following 3-8 years

Next 5-8 years

Next 4 years

Inflation target

October
November

Source: Banco de México's Survey (monthly periodicity) and Citibanamex Survey (biweekly periodicity).

Break-even Inflation and Inflation Risk Implied in Bonds

Break-even inflation implied in 10-year bonds

20-day moving average

November
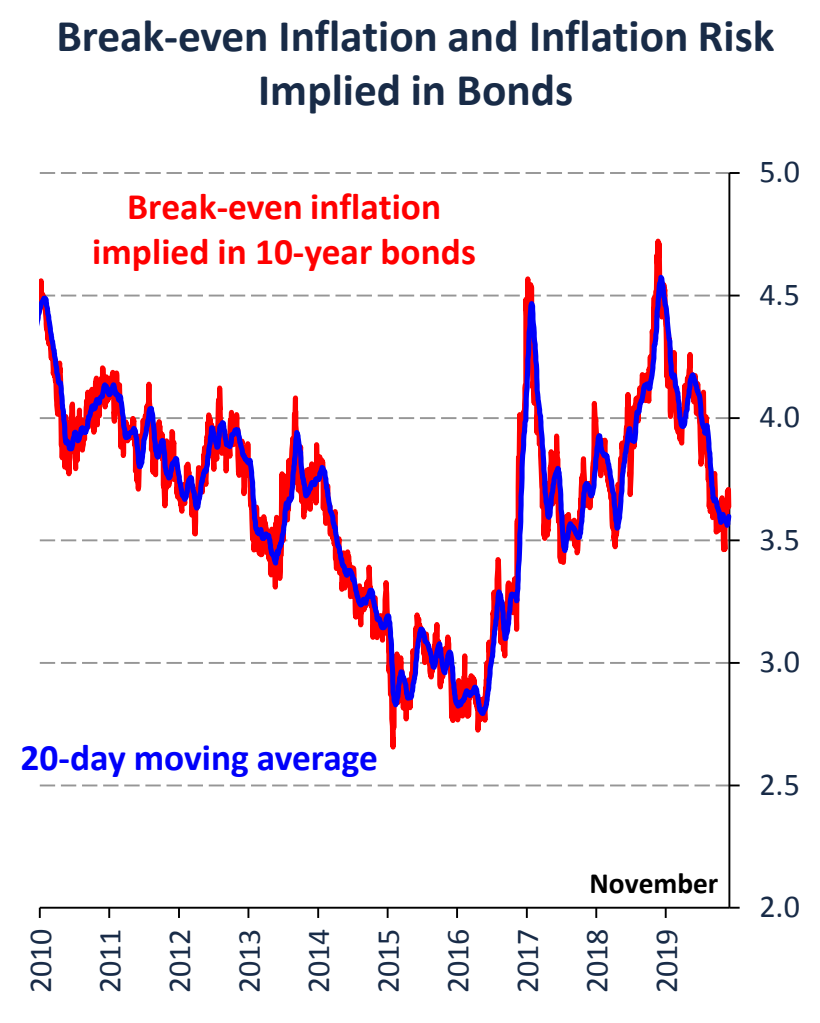
Source: Banco de México estimates with Valmer and PiP data.

Outline

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Economic Activity Forecasts: The economy is expected to start showing higher growth rates as of next year, although the recovery has been delayed with respect to forecasts of the previous Report.

Fan Chart: GDP Growth
Annual %, s. a.
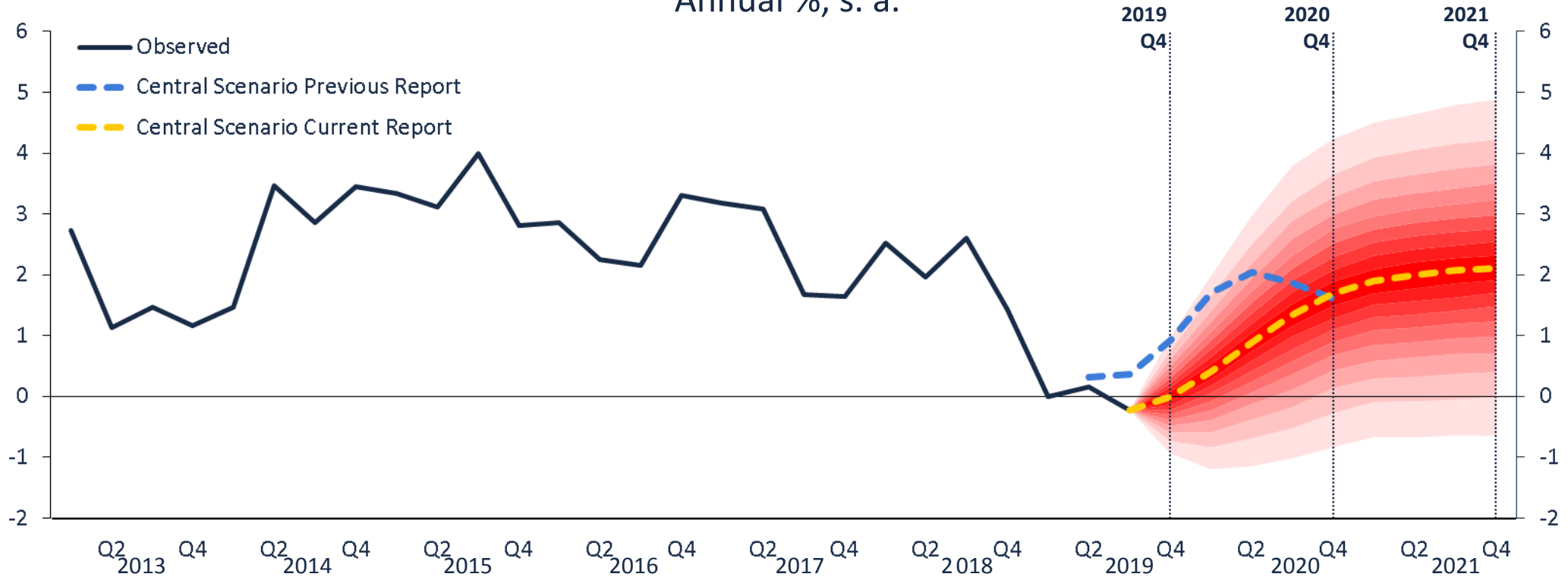
s. a. / Seasonally adjusted series. Source: INEGI and Banco de México.

GDP Growth
%

Report	QR Apr-Jun 2019	QR Jul-Sep2019
2019	0.2 - 0.7	-0.2 a 0.2
2020	1.5 - 2.5	0.8 - 1.8
2021	--	1.3 - 2.3

Increase in Number of IMSS-insured Jobs
Thousands

Report	QR Apr-Jun 2019	QR Jul-Sep 2019
2019	450 - 550	300 - 370
2020	590 - 690	500 - 600
2021	--	510 - 610

Current Account Deficit
% of GDP

Report	QR Apr-Jun 2019	QR Jul-Sep 2019
2019	1.2	0.5
2020	1.6	1.4
2021	--	1.7

Risks to the Growth Outlook within the Forecast Horizon
In an environment of marked uncertainty, as a result of the elements of both external and domestic risk, the balance of risks to economic activity in Mexico remains biased to the downside.

Downward risks
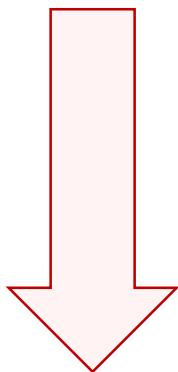
- Escalation of trade tensions.

- Delays in the ratification of the USMCA in the United States and Canada.

- Volatility episodes in international financial markets.

- Greater-than-expected slowdown of global economy and trade.

- Greater persistence of the weakness in aggregate demand components.

- Deterioration of the sovereign and Pemex's credit ratings.

- Smaller-than-expected public spending in 2020.

Upward risks
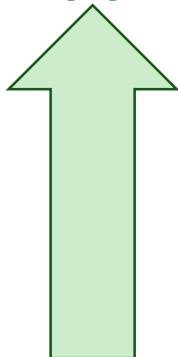
- That the USMCA is formalized.

- Greater-than-anticipated industrial production in the U.S.

- Greater-than-expected dynamism of aggregate demand.

Annual headline inflation is still anticipated to remain at levels close to 3%, although it is estimated to increase slightly during Q1 2020.

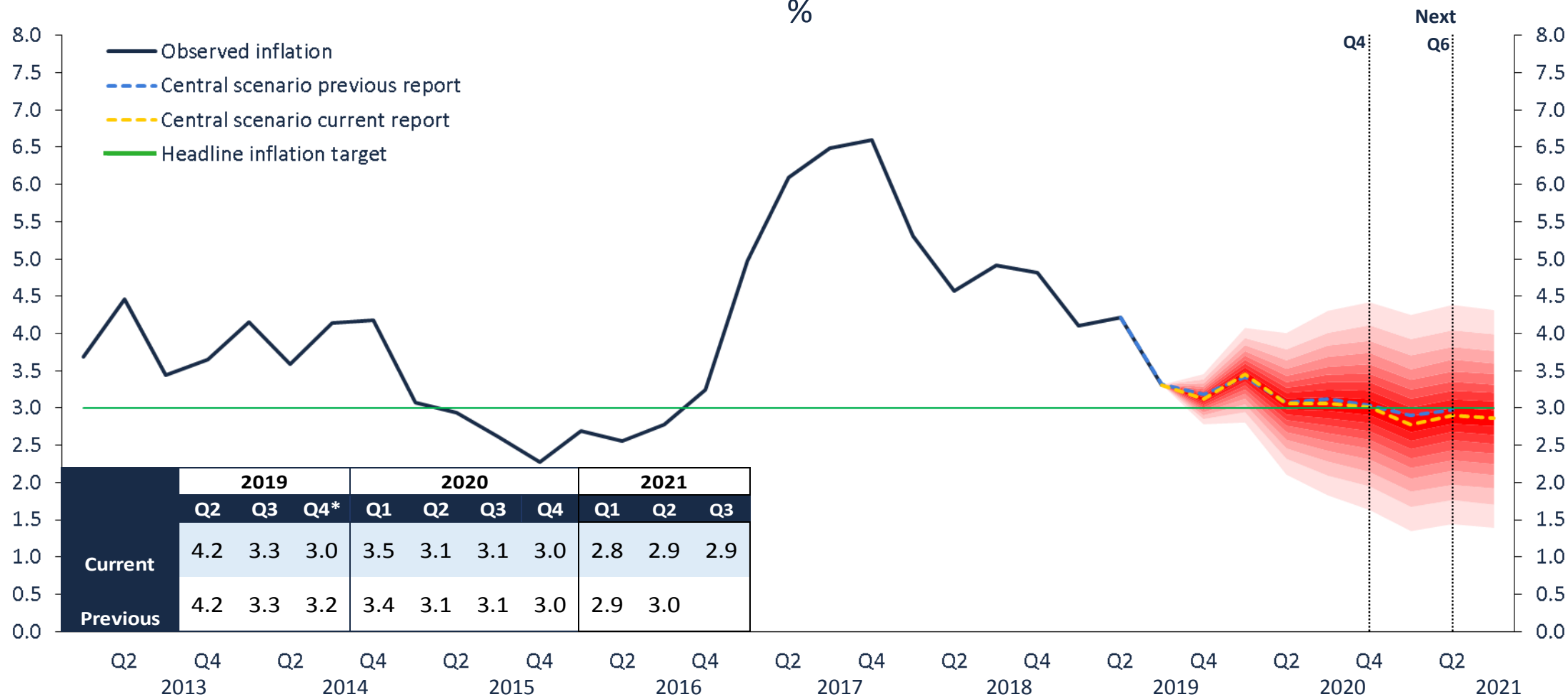**Fan Chart**
Annual Headline Inflation [1]
%

	2019			**2020**				**2021**		
	Q2	Q3	Q4*	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Current	4.2	3.3	3.0	3.5	3.1	3.1	3.0	2.8	2.9	2.9
Previous	4.2	3.3	3.2	3.4	3.1	3.1	3.0	2.9	3.0	

1/ Quarterly average of annual headline inflation. The next four and six quarters are indicated as of 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.

In regards to annual core inflation, it is expected to lie at levels close to 3% starting from Q3 2020.

Fan Chart
Annual Core Inflation [1]
%

|	2019			2020				2021		
	Q2	**Q3**	**Q4***	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Current	3.8	3.8	3.6	3.6	3.2	3.1	2.9	2.8	2.9	2.9
Previous	3.8	3.7	3.5	3.4	3.1	3.0	2.9	2.9	3.0	

1/ Quarterly average of annual core inflation. The next four and six quarters are indicated as of 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.

Risks to the Inflation Outlook
In this context, uncertainty persists regarding the risks that could divert inflation from its expected trajectory.

Upward risks
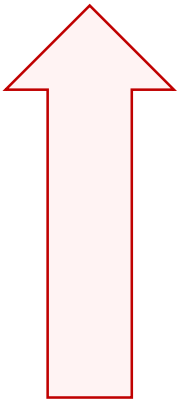
- That core inflation continues to show persistence.
- Wage increases above productivity gains, which could generate cost pressures.
- That the peso exchange rate comes under pressure from external and domestic factors.
- Threat of tariff imposition by the United States and compensatory measures, although this risk has diminished.
- That public finances deteriorate.
- Increases in agricultural and livestock prices or in energy prices greater than anticipated.

Downward risks
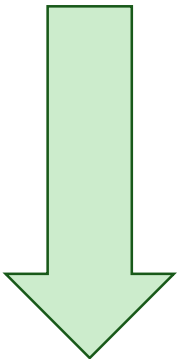
- That the peso exchange rate appreciates, possibly associated with a context of greater risk appetite in international financial markets, or in case the trade agreement with the U.S. and Canada is ratified.
- That slack conditions or that their effect on core inflation is greater than expected.
- That lower price changes in some goods included in the non-core subindex are observed.

Final remarks

- On November 25, the International Monetary Fund (IMF) announced the approval of the Foreign Exchange Commission's request **to renew the Flexible Credit Line** for another two years for nearly 61 billion dollars. The IMF highlighted that **the country has continued to implement sound economic policies and policy frameworks**, and that it also has strong economic fundamentals that have allowed it to successfully navigate in a complex external environment.

- It is necessary to **incentivize investment** by fostering an environment of certainty and strengthening the business climate, supported by a sound and resilient macroeconomic framework founded on fiscal discipline, price stability and financial stability.

- It is necessary to encourage **greater competition**, provide the **necessary incentives to favor value creation** over rent seeking, and **increase the efficiency** with which the economy operates. It is key to strengthen the **rule of law** by fighting insecurity, corruption and impunity, and to guarantee legal certainty.

Annex – Boxes

1 Considerations on the Possible Effects of US Trade Tensions and Monetary Policy on the World Economy

2 Latent Indicator of Economic Activity based on a Signs Extraction Model (SEM)

3 Estimates of Price and Quantity Effects on the Evolution of Non-oil Trade Balance Dynamics in Mexico

4 M1 and its Economic Activity Forecast Potential

5 Role of Imports on the Evolution of Merchandise Inflation

6 Relevance of Central Bank Independence and the Price Stability Mandate

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