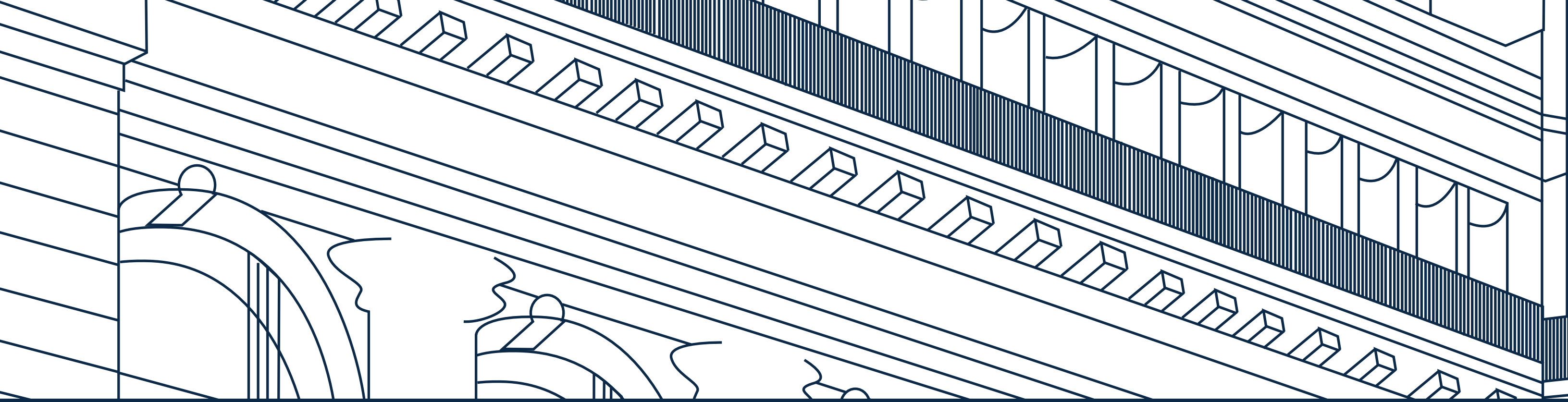

BANCO DE MÉXICO®

Minutes number 109

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on June 27, 2024

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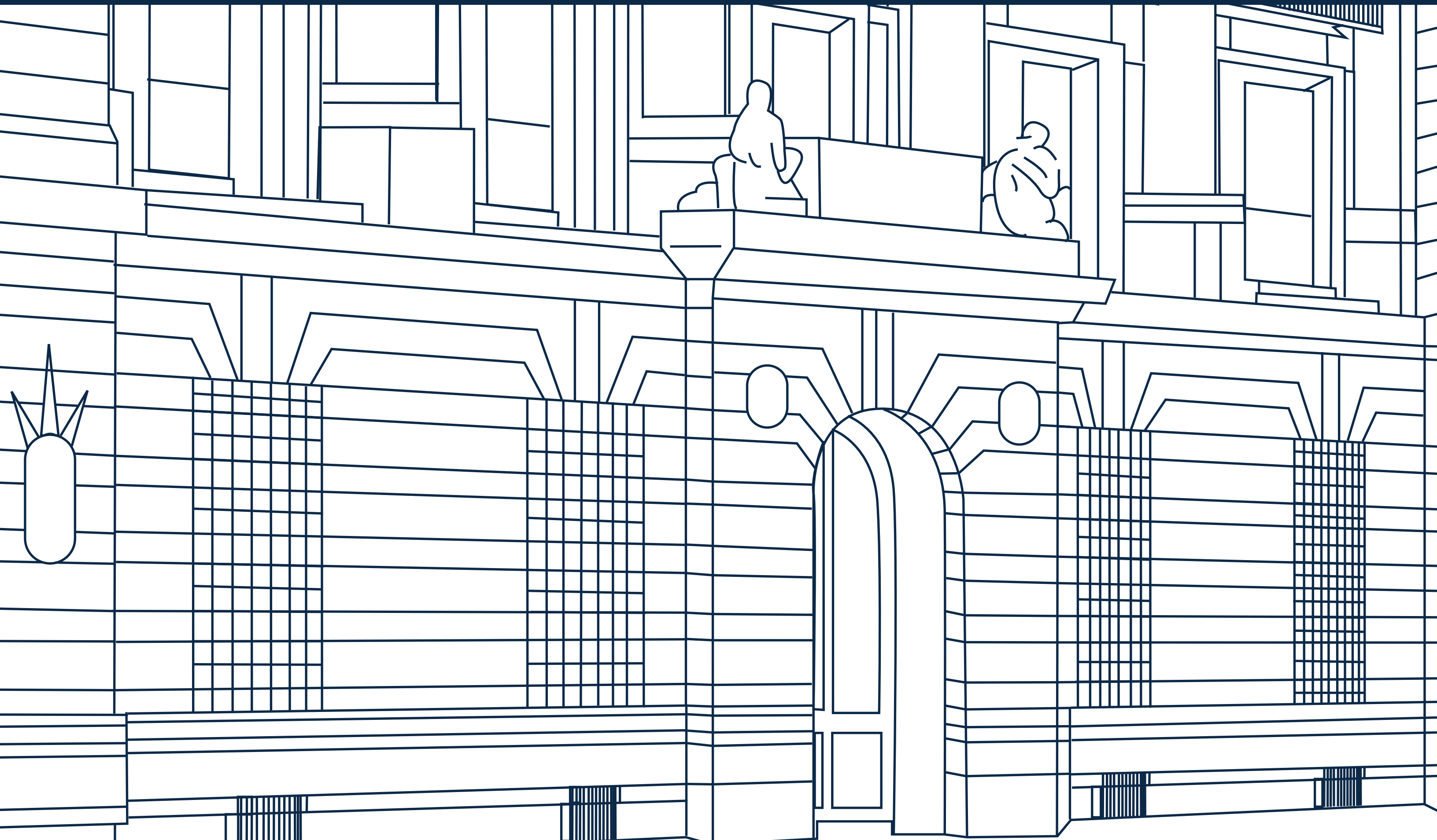

FOREWARNING
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1. PLACE, DATE AND PARTICIPANTS

1.1. Place: Meeting held by virtual means.

1.2. Date of Governing Board meeting: June 26, 2024.

1.3. Participants:
- Victoria Rodríguez, Governor.
- Galia Borja, Deputy Governor.
- Irene Espinosa, Deputy Governor.
- Jonathan Heath, Deputy Governor.
- Omar Mejía, Deputy Governor.
- Gabriel Yorio, Undersecretary of Finance and Public Credit.
- María Elena Méndez, Secretary of the Governing Board.

Prior to this meeting, preliminary work by Banco de México's staff analyzing the economic and financial environment as well as the developments in inflation and the determinants and outlook for inflation, was conducted and presented to the Governing Board (see Annex).

2. ANALYSIS AND RATIONALE BEHIND THE GOVERNING BOARD'S VOTING

International environment

Some members expect world economic activity to have continued increasing during the second quarter of 2024, although at a slower pace than in the previous quarter. **One** member argued that the sound global economic performance expected for this year would be driven by a stronger growth in advanced economies, while a more generalized weakening is expected in emerging economies. Among global growth risks, he/she mentioned that several of them persist, including those stemming from the expectation of higher interest rates for a longer period, the high levels of fiscal deficits in a large number of economies, the political uncertainty associated with various electoral processes, particularly in the United States, and geopolitical tensions. Regarding the US economy, he/she underlined the soundness of domestic demand as a result of the boost provided by private consumption. He/she considered that the US labor market continues showing resilience. **Another** member noted some of the factors behind this resilience, the fading of which could affect economic activity in the future. He/she argued that fiscal support together with unconventional monetary stimulus measures to mitigate the effects of the pandemic contributed, on the one hand, to generate excess savings and an improvement in households' financial position, mainly in the United States, which supported private consumption. On the other hand, he/she noted that limited refinancing needs were observed in the corporate sector, which took place under relatively favorable credit conditions. However, he/she added that currently the outlook is different, given the less sound financial situation of firms and households. Regarding households, he/she stated that in the United States, for example, excess savings and leverage are already at their pre-pandemic trend levels, while real disposable income has moderated its growth. Thus, he/she indicated that, although consumption of services in that economy continues showing dynamism, consumption of goods has somewhat declined, which reflects consumers that are more aware of the signs of moderation in the labor market. As for firms, he/she pointed out that greater refinancing needs are expected, which, according to forecasts, will be at higher rates. Finally, he/she stated that, in his/her opinion, in light of the fading of these factors that once supported economic resilience, a more efficient pass-through of restrictive monetary policy stances is expected. **Some** members expect a moderation of the US economy in the next quarters. **One** member expressed that this could be more evident in that country's industrial activity.

Most members highlighted that the disinflation process has continued worldwide. Some members pointed out that headline inflation has continued decreasing in most advanced economies. **The majority indicated that this was due to lower pressures on food prices. Some** members added that it was also due to a reduction in goods inflation. Nevertheless, **some** members considered that the recent progress in disinflation has been moderate. **Most members highlighted that there is some heterogeneity in the behavior of inflation across economies. Some** members indicated that US inflation decreased between April and May. **One** member noted that in the euro area, annual headline inflation rose during the same period due to an increase in the core component and a rebound in energy inflation. **Another** member stated that some emerging economies registered increases in headline inflation due to higher pressures on energy prices and, in some cases, due to a rise in food prices. **One** member added that services inflation resistance to decline is a global phenomenon with low correlation to the cyclical phase of different economies. **Most members agreed that the disinflation process is expected to continue.** However, **some** members pointed out that inflation is still anticipated to remain above central banks' targets. **One** member indicated that there is a prevailing expectation that in some economies convergence to the inflation target will be postponed again until early 2025.

The majority noted that some central banks of advanced economies left their reference rates unchanged, while others lowered them. Some members stated that most of them maintained a cautious tone. **One** member pointed out that these institutions emphasized a greater data dependence in their future decisions. **Another** member indicated that, despite the heterogeneity in the monetary cycles of different economies, the discussion in most central banks has focused on avoiding the adoption of an overly restrictive monetary policy stance. **All members mentioned that the Federal Reserve left the federal funds rate unchanged for the seventh consecutive occasion. Some** members noted that its policy statement acknowledged modest progress towards the inflation target in recent months. **One** member pointed out that the statement reiterated that risks to achieving its employment and price stability goals have moved towards better balance. However, **some** members highlighted its restrictive tone. **Most members underlined that the chairman of said institution stated that there is still uncertainty as to whether inflation is steadily moving to the 2% target. One** member added that said chairman stated that evidence clearly shows that the monetary policy stance is restrictive and is having the expected effects. **Most members expressed that the European Central Bank lowered its interest rates at its June meeting after having left them unchanged for nine months. Some** members specified that this rate cut was accompanied by an upward revision of their inflation forecasts. **One** member added that said central bank indicated that it will maintain a restrictive monetary policy stance as long as necessary to achieve convergence of inflation to its target. **Most members pointed out that the Bank of Canada also made its first policy rate cut in June. One** member noted that this central bank argued that it has greater confidence that inflation is on a trajectory towards its target. **Another** member indicated that various monetary authorities in Latin America and Eastern Europe continued lowering their reference rates.

All members noted that the Federal Reserve's economic projections included a lower number of rate cuts anticipated for this year. Most members added that slightly higher rates are also expected for 2025 compared to previous projections. Some members expressed that the median of projections for the long-term interest rate increased. **One** member pointed out that this change was from 2.6 to 2.8%. He/she considered that the greater dispersion among members' projections for the long-term interest rate reflects greater uncertainty as to where the US economy might converge. In this regard, he/she ruled out implications for monetary policy in the short term. Regarding emerging economies, **another** member pointed out that in most of them the expectation that reference rates will remain high for a longer period has strengthened.

Most members noted that international financial markets exhibited some volatility, although end-to-end variations were mixed and moderate. Some members added that the release of higher-than-anticipated US inflation and employment figures led to an adjustment in expectations about the path of the federal funds rate. **One** member mentioned that in light of better-than-expected figures US government bond yields declined slightly. **Another** member highlighted that the evolution of geopolitical tensions also contributed to said volatility. **One** member commented that since the previous decision, fixed-income markets have exhibited mixed movements. **Another** member expressed that fixed-income markets performed differently across regions. **Some members noted that stock market indices registered gains. One** member pointed out that developed countries registered increases, while emerging ones registered losses. **Another** member argued that the materialization of adverse events related to electoral processes, geopolitical conflicts, and global economic growth could intensify international financial volatility, with negative effects particularly for emerging economies.

Economic activity in Mexico

The majority pointed out that, at the beginning of the second quarter of 2024, Mexico's economic activity continued exhibiting the weakness observed since the end of 2023. Some members pointed out that the IGAE registered a contraction in April. **One** member stated that this result was caused by decreases in the three main sectors of economic activity. **Another** member mentioned that annual growth rates showed an expansion in the secondary and tertiary IGAE sectors and a contraction in the primary one. **Most members asserted that recent readings indicate a lower-than-expected dynamism. One** member warned that this, together with the timely indicator for May, suggests that the economic slowdown has extended, contrary to what had been anticipated. **Another** member added that this slowdown contrasts with the previous expectation that economic activity would be at high levels in the first half of the year. Nevertheless, **one** member expressed that INEGI estimates an expansion in May that could offset the fall in April. He/she added that various indicators of production, demand and employment show mixed signals, which, together with greater uncertainty associated with the country's political transition, make it difficult to anticipate the economy's performance for this year and the next one.

Regarding the performance of the productive sectors, the majority noted that IGAE data of April indicate that industrial production decreased at a monthly rate due to a greater sluggishness in manufacturing. Most members argued that construction has expanded at lower monthly rates than those registered in previous months. One member mentioned that there is some weakness in railway, oil and petrochemical construction works. **Some** members also mentioned the weakness in the mining sector. Likewise, **one** member pointed out the weakness of the electricity sector. **Some** members noted that the services sector remains heterogeneous in its different subsectors. **One** member indicated that due to the fall in some of these subsectors, the progress made in previous months has reversed, and thus total services remain at the same levels as those observed at the end of 2023. **Another** member stated that the tertiary sector as a whole seems to be affected by the weakness of secondary activities, especially those more related to industrial use, such as commercial activities. Meanwhile, he/she noted that timely estimates suggest that the weakness in the primary sector could extend throughout the quarter. **One** member pointed out that, nevertheless, considering the annual variation of economic activity data for the first quarter, a 1.9% growth rate is observed.

Regarding domestic demand, most members indicated that private consumption has remained strong. One member considered that this has been mainly associated with the dynamism of consumption of imported goods, while that of domestic goods and services has been lower. **Another** member pointed out that in its annual variation the consumption of domestic goods rose 3.3% in March, its highest growth in eighteen months. Regarding forward-looking indicators, **some** members mentioned that those related to consumption of services suggest a slowdown. However, **one** member argued that the risks of the recent exchange rate depreciation and its effects on consumption capacity attributed to remittances should be considered. **Some** members expressed that investment reactivated slightly in March. **One** member stated that the growth registered in that month was supported by construction and domestic machinery and equipment. He/she added that in that same month gross capital formation maintained a strong expansion of 10.9% in annual terms, although this figure is lower than those observed during most of 2023. **Some** members commented that private investment spending has grown at lower rates. **One** member reiterated that its deceleration is noticeable with respect to the first half of 2023.

Most members noted that external demand exhibited sluggishness. Some members pointed out that automotive manufacturing exports have shown weakness. **One** member noted a similar behavior in the non-automotive ones. **Another** member considered that the latter have changed marginally. **One** member mentioned that automotive exports grew at an annual rate of 19.7%, while non-automotive exports contracted 2.8%. He/she added that, therefore, in their annual variation, manufacturing exports grew 4.2%.

Some members commented that, looking ahead, economic growth is expected to be lower than previously anticipated. They considered that the balance of risks to economic activity has become biased to the downside. **One** member stated that there is the risk that private investment will continue losing dynamism, considering the tight financial conditions and the environment of greater uncertainty generated by financial volatility in Mexico, as well as by the upcoming electoral process in the United States. He/she added that while a low contribution to economic growth from external demand is expected over the next quarters, the latter could decelerate more than anticipated if the weakness prevailing in the US manufacturing sector worsens. He/she noted that this could extend the low dynamism of domestic manufacturing production, limiting the positive spillover effects that this sector tends to have on other sectors of the economy.

Regarding the output gap estimated with GDP data, **one** member pointed out that it decreased in the first quarter of 2024, although it remained in positive territory. **Another** member noted that said gap is expected to close faster than previously anticipated. **Some** members commented that it is expected to be in negative territory as of the last quarter of 2024. **One** member mentioned that the point estimate of the output gap calculated with IGAE data up to April is already in negative territory, although without being statistically different from zero. He/she added that, although slack measures are unobservable factors and their estimation is subject to uncertainty, it cannot be ignored that timely data indicate that the economy has had three consecutive quarters of marked weakness. **Some** members indicated that the cyclical conditions of the economy will be a relevant factor in the price formation process.

All members noted that the labor market continued showing strength, although most members mentioned that it has shown some signs of moderation. Some members highlighted the high labor force participation rate and the fact that the unemployment rate remains at historic lows. **One** member indicated that formal employment in the manufacturing and construction industries has lost momentum. **Some** members noted that, despite its relative slowdown, the wage bill continues growing at levels higher than those prior to the pandemic. **One** member expressed that the expectation of significant wage increases in 2025 persist. **Another** member highlighted the high level of nominal annual variation of the daily wage of IMSS-insured workers, as well as contractual wage revisions in public and private firms. He/she mentioned that wage increases are much higher than productivity increases. However, **one** member pointed out that nominal and real wage growth rates have declined. Meanwhile**, some** members commented that formal job creation has grown at a slower pace and that, given the prospect of a slowdown in economic activity, this trend is likely to become more pronounced.

Inflation in Mexico

Most members indicated that annual headline inflation rose from 4.65% in April to 4.78% in the first fortnight of June. They pointed out that this was due to an increase in non-core inflation. Some members highlighted that headline inflation has trended upwards since March. **One** member commented on the scant progress in disinflation since more than half a year ago. **Another** member considered that, although headline inflation has remained on an upward trend in recent readings, various metrics suggest that this is mainly due to a change in relative prices rather than to generalized price increases.

Most members underlined that core inflation continued decreasing from 4.37 to 4.17% between April and the first fortnight of June. Some members pointed out that it has decreased for sixteen consecutive months. **One** member highlighted that the seasonally adjusted annualized monthly variations of this component have fallen to levels close to 3%. **Some** members emphasized that this component reflects the medium-term trend of inflation. **Most members agreed that its downward trend is mainly explained by the reduction in merchandise inflation, while all members pointed out that services inflation does not yet show a clear downward trend.**

Delving into the behavior of merchandise inflation, **some** members pointed out that it has decreased for eighteen consecutive months. **One** member noted that its most recent reading is below its historical average. **Another** member stated that it decreased from 3.67 to 3.33% between April and the first fortnight of June. Regarding its components, food merchandise inflation went from 4.79 to 4.28%, while that of non-food merchandise fell from 2.34 to 2.18%. **Another** member highlighted that the annual inflation of non-food merchandise has been below 3% for the last five months. He/she added that monthly variations of food merchandise prices have been below their historical average so far this year.

Some members stated that services inflation continues being affected by cost-related pressures and a lagged pass-through to consumers. **One** member expressed that although this is a global problem it is not possible to anticipate that the easing pressures on this component abroad will have a similar outcome in Mexico. He/she mentioned that its performance is influenced by domestic conditions such as the resilience of consumption, despite some mixed signals from its determinants, expectations of significant wage increases in 2025, a tight labor market, and the high growth of the wage bill, despite its relative deceleration. **Another** member added that signs of moderation are beginning to be observed in some items, and various metrics point to a better performance.

Some members mentioned that services inflation remains above 5%. **One** member pointed out that it registered 5.19% in the first fortnight of June. **Another** member noted that it shows generalized pressures in all its items and, in some of them, it exhibits rates that are twice as high as the inflation target. **One** member stated that practically half of the CPI items that make up this subcomponent register seasonally adjusted annualized monthly variations above 5%. However, **another** member indicated that the proportion of the basket of services with annualized monthly variations above 5% has decreased. He/she highlighted that the annualized monthly variations show an improvement in inflation at the margin. He/she pointed out that while the average of these variations in the last twelve months is 5.21%, the corresponding for the last six and three months is 5.05 and 4.42%, respectively. Likewise, **one** member indicated that the annual inflation of services other than housing and education was 6.05% in the first fortnight of June, the lowest figure registered in two and a half years. **Another** member stated that it has decreased from the peak levels of 7.5% registered at the beginning of 2023. He/she pointed out that the monthly inflation rate of this item has been moderating. He/she specified that the average of the last twelve months is 6.06%, while the average of the last six and three months is 5.56 and 4.03%, respectively.

Most members pointed out that non-core inflation increased from 5.54 to 6.73% between April and the first fortnight of June. All members agreed that this was driven by the higher annual variations in the prices of agricultural and livestock products and energy. One member noted that the annual inflation of agricultural and livestock products increased from 7.35 to 8.99% during the same period, while that of energy products rose from 4.38 to 5.52%. **Another** member argued that non-core inflation continues growing above its historical average of around 6%. He/she pointed out that there have been significant increases in the inflation of agricultural and livestock products since March and an upward trend in energy prices since mid-2023. **Some** members emphasized that non-core inflation is very volatile and tends to face short-lived shocks. **One** member expressed that monetary policy has little impact on this component. **Another** member estimated that it is necessary to remain alert to the increases that this component has exhibited since mid-2023.

Most members mentioned that headline inflation expectations for the end of 2024 were revised upwards. Some members commented that those for the next twelve months declined. **Most members stated that those for the end of 2025, as well as those for the medium and long terms, have remained stable. One** member indicated that analysts' expectations are above the central bank's intermediate targets for 2024 and 2025. Regarding expectations drawn from market instruments, **another** member noted that those for the 1 to 5-year average and for the 6 to 10-year average increased slightly. **One** member highlighted that breakeven inflation implicit in government securities curves exhibited mixed changes during the period, although it remains at levels similar to the previous policy decision, above 400 basis points.

Most members noted that the forecasts for headline and core inflation were revised slightly in some quarters. One member pointed out that this adjustment was due, in part, to the impact of the exchange rate depreciation on merchandise inflation, which tends to be more clearly affected by the Mexican peso exchange rate. **Another** member highlighted that the impact of the depreciation on merchandise prices would be reflected with a certain lag and the degree of the pass-through will depend on the timing of the exchange rate adjustment and the behavior of other inflationary determinants. **The majority underlined that, although the depreciation of the Mexican peso impacts inflation forecasts upwards, its effects are partly offset by those associated with the greater weakness exhibited by economic activity. One** member considered that the lower economic activity would allow the decline in headline inflation to resume shortly. He/she pointed out that the adjustment was also explained by the greater persistence expected in housing and education inflation, as well as by the greater variations in agricultural and livestock products' prices. **Most members mentioned that headline inflation is still expected to converge to the 3% target in the fourth quarter of 2025.**

Most members considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. One member stated that the upward bias became more pronounced and that a more uncertain inflationary outlook is now currently faced. He/she indicated that since the balance of risks is determined with a forward-looking approach, less weight should be given to the already observed decline in inflation from its peak, and more weight should be granted to the fact that progress in disinflation has paused since October 2023 and is at risk of reverting. **Another** member expressed that the shock associated with the slowdown in economic activity will last longer than the volatility shock associated with idiosyncratic factors, and thus the former will play a more relevant role in inflation dynamics.

The majority held that there is the risk of a greater currency depreciation, which could exert pressure on inflation. One member pointed out that the intensity and duration of adjustments in financial markets are uncertain and could hinder the convergence of inflation to the target within the planning horizon. He/she anticipates that risk aversion and its consequences on domestic financial markets will persist. He/she considered that, in addition to tight international financial conditions, the electoral process in the United States could generate bouts of volatility. However, **another** member deemed it possible that part of the exchange rate shock may be temporary or may moderate to some extent, which could imply a lower exchange rate pass-through. **The majority added that the expected economic slowdown could mitigate the risk of the exchange rate pass-through. One** member highlighted that studies on the Mexican economy show that the coefficient of the exchange rate pass-through to inflation is lower under greater slack conditions. He/she argued that the anchoring of inflation expectations has significantly reduced the pass-through over the last two decades. **Another** member pointed out that, although the pass-through of the depreciation to costs has been low in recent years, the nature and magnitude of the exchange rate shock, its duration and slack conditions, among other factors, will be decisive in its inflationary effects. Meanwhile, **one** member argued that a recent study shows that in both advanced and emerging economies the magnitude of the exchange rate pass-through depends on the nature of the shock that contributed to the currency depreciation. He/she pointed out that, according to said study, in the case of Mexico, the pass-through is greater when the nature of the shock is idiosyncratic, with demand-related shocks and risk premium shocks having the largest effects.

Most members highlighted as an upward risk the persistence of core inflation, especially of its services component. One member considered that the persistence of services inflation could continue due to the lag in the relative price readjustment and because cost increases have not yet fully passed on to consumer prices. He/she warned that merchandise inflation could decline less, potentially halting the deceleration of the core component. He/she added that the decline in food merchandise inflation could reverse direction once the favorable shocks to this component dissipate and the comparison base effect becomes more relevant. He/she deemed that non-food merchandise inflation is reaching low levels that are difficult to sustain. He/she warned about the risk that non-food merchandise inflation, as it converges to its mean, may no longer offset the persistence of services inflation, initiating an upward trend in core inflation.

Among additional upward risks, the majority warned about the possibility of greater cost-related pressures of various nature. They highlighted pressures associated with climate-related impacts. One member mentioned the challenges that could arise from the fiscal boost during 2024. **Another** member indicated that the 2025 Economic Package will be crucial for understanding the fiscal framework, spending-related pressures, and support measures for Pemex. Meanwhile, he/she recalled that the risk of non-core inflation remaining above the central bank's projections, at levels consistent with its historical averages, prevails. **One** member emphasized the risks associated with an intensification of the geopolitical conflicts.

Some members stated that some of the mentioned risks could be offset by a lower-than-anticipated economic activity. **One** member estimated that greater slack, in addition to offsetting the potential effects of currency depreciation, will contribute to a decline in services inflation. He/she stated that the easing of slack conditions has increased and is likely to last longer than the volatility shock.

Macrofinancial environment

Some members noted that during the weeks following the last monetary policy meeting, domestic financial markets exhibited a stable behavior. However, **one** member mentioned that markets faced an adverse environment in May in light of the expectation of smaller reference rate cuts in advanced economies. **The majority mentioned that idiosyncratic factors generated significant volatility in domestic markets in early June. All members underlined that trading conditions experienced significant disruptions. They emphasized that the Mexican peso depreciated considerably. One** member specified that after having been below 17 pesos per dollar in May, in June the exchange rate reached levels similar to those observed in the early months of 2023, although still below those registered in 2022. **Another** member highlighted that the Mexican peso briefly reached a level of 19 pesos per dollar, making it the emerging economy currency with the highest depreciation on certain trading days. **Some** members added that the currency exhibited a broad trading range. **One** member indicated that, in his/her opinion, the Mexican peso returned to levels close to its fundamentals, thus correcting the overvaluation observed in the past year. **Some** members argued that this behavior of the Mexican peso was due to a lower appetite for local assets and the liquidation of long Mexican peso positions, mainly in short-term foreign exchange derivatives. **One** member specified that this was partly due to the unwinding of carry trade positions following the decline in the volatility-adjusted interest rate spread. He/she emphasized that volatility and the skew implied in the options market increased significantly, reaching year-high levels. He/she underlined that, consistent with the above, there has been an increase in the demand for hedging in view of possible subsequent depreciation episodes. **Another** member pointed out that, in the medium term, expectations continue signaling a bias towards depreciation. **One** member considered that, in light of the deterioration in trading conditions, the proper functioning of the foreign exchange market should be monitored, and underlined that this does not imply that there is a specific target level. **The majority pointed out that part of the exchange rate adjustment has reversed in recent days. One** member added that recently the Mexican peso exchange rate has performed in line with other similar currencies.

All members noted that interest rates on medium- and long-term government bonds increased significantly, associated with the referred idiosyncratic factors. Some members mentioned a deterioration in market conditions and historical highs in some nodes of the nominal yield curve. **One** member added that broad trading ranges were observed. **Another** member pointed out that a certain reversal in said rates has been observed in recent days. **One** member mentioned that a more restrictive stance of the US Federal Reserve and expectations of less reference rate cuts for the remainder of the year, along with idiosyncratic factors, have contributed to the increase in the interest rate spread of Mexican bonds. He/she added that, despite the above, this spread appears less attractive after adjusting for the volatility of the Mexican peso, although it remains at levels higher than most comparable emerging currencies. **Another** member stated that in recent weeks there was a capital outflow mainly of *M-Bonos* held by non-residents. He/she mentioned that the interest rate derivatives market exhibited a similar behavior to that of government bonds, with significant increases and high volatility. He/she argued that part of the movements is explained by closing positions, as well as by demand for currency hedging in view of changes in interest rates. He/she indicated that the implied expectations for the trajectory of the reference rate in TIIE swaps discount with a higher probability that the next reference rate cut will occur only until the November policy decision, and that the reference rate will close the year at 10.60%. He/she emphasized that this contrasts with the median of expectations of private sector analysts, who anticipate the next reference rate adjustment in August and a year-end rate of 10.25%. He/she added that, in both cases, there has been a correction in monetary policy expectations.

The majority highlighted that sovereign risk premia increased. One member stated that the risk premium is still at levels higher than those observed before the election in June. He/she warned that, in the medium term, expectations of a higher risk premium prevail. However, **another** member commented that increases in risk premia have been limited compared to other stress episodes. **Most members pointed out that the stock market performed unfavorably due to the lower risk appetite observed domestically.**

One member considered that, looking ahead, incoming information can help mitigate uncertainty and contribute to the further stabilization of domestic financial markets. He/she stated that a number of factors can contribute to the above, such as the sound macroeconomic fundamentals, particularly compared to other emerging economies. He/she highlighted fiscal discipline, sustainable external accounts, a well-capitalized Mexican banking system with no currency imbalances, a developed financial derivatives market that allows economic agents to hedge the exchange rate risk, and adequate levels of international reserves. He/she noted that two primary pillars of the country's macroeconomic policy framework are an autonomous central bank with a price stability mandate and a flexible exchange rate regime. **Some** members underlined that, under this regime, the exchange rate acts as a shock absorber, helping the economy to adjust in an orderly manner.

Most members highlighted that total financing in the economy continued increasing. One member attributed said growth to the domestic component. He/she added that domestic financing to the private sector exhibited solid growth in April, although it continued decelerating. **Some** members indicated that commercial bank credit maintained its dynamism. They specified that financing to businesses and for consumption registered high rates of expansion. However, **one** member highlighted that these segments have shown some moderation. He/she warned that, looking ahead, the evolution of credit to firms should be monitored, as the economic slowdown could be reflected in both demand- and supply-side adverse factors for credit. **Another** member mentioned that delinquency levels remain low and stable.

Monetary policy

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It stated that the challenges and risks on both sides of the balance call for continuing conducting monetary policy prudently. With the presence of all its members, the Board decided by majority to maintain the target for the overnight interbank interest rate at 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in the forecast horizon.

Looking ahead, the Board foresees that the inflationary environment may allow for discussing reference rate adjustments. It will take into account the prospects that global shocks will continue dissipating and the effects of a weaker-than-anticipated economic activity. It will consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on 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.

One member stated that this is one of the most complex decisions of the monetary cycle as the economy experiences two shocks acting in opposite directions on inflation. He/she pointed out that, on the one hand, there is a period of volatility associated with idiosyncratic factors, while, on the other hand, the risk of a greater-than-expected easing of slack conditions has gained relevance, the latter factor lasting longer. He/she expressed that an adjustment in the monetary restriction is consistent with risks to the outlook, given the highly restrictive policy stance and the progress in disinflation. Among these risks, he/she highlighted the risk of a higher depreciation. He/she stated that, while volatility should be monitored, the conduction of monetary policy should address it to the extent that it affects inflation. He/she added that, given the expectation of greater slack conditions, the pass-through to prices could be lower, as suggested by the evidence of Mexico, and would also contribute to reduce services inflation. Therefore, he/she considered that, as a result, the risk associated with the economic slowdown gains more importance due to its implications for inflation dynamics. He/she expressed that a gradual approach allows to take actions responsibly, addressing all inflation determinants within monetary policy’s horizon. He/she argued that failing to address changes in the inflation outlook in a timely manner, such as the current intensification of risks to the downside, could imply larger adjustments in the future, making the conduction and communication of monetary policy more challenging. He/she considered it inappropriate to adopt a highly data-dependent stance, as this would be equivalent to incorporating only part of the information and conducting monetary policy with lags, which would imply unnecessary costs. He/she added that an optimal conduction of monetary policy should de forward-looking, considering both the observed and the expected inflation determinants. He/she underlined that making additional adjustments to the reference rate does not imply abandoning a restrictive policy stance, which will remain necessary throughout the forecast horizon, given the challenges that prevail. He/she indicated that the challenge lies in defining the pace of such adjustments, taking into account the behavior of inflation with respect to intermediate targets, the performance of its determinants, the prevailing risks, and assigning weight to the outlook for the inflation environment.

Another member expressed that, since the last monetary policy meeting, the challenges of persistence and of a slowdown in the disinflation process have continued. He/she added that currently there is also an unforeseen shock of financial volatility generated by idiosyncratic factors, which represents an additional obstacle to achieving the convergence of inflation to the target within the planning horizon. He/she mentioned the risk that the monetary restriction might be insufficient to achieve such convergence if the reference rate is reduced or if inflation expectations increase. He/she considered that, therefore, the outlook for the conduction of monetary policy has become more complex. In this regard, he/she underlined headline inflation’s upward trend, the mixed changes in inflation expectations between April and May, the adjustment in inflation forecasts, and a labor market that remains tight.

He/she expressed that the strength of consumption and, to a lesser extent, of investment, as well as the fiscal policy outlook, would imply a lesser-than-anticipated deterioration for economic activity for the remainder of 2024. He/she considered that all of the above, coupled with a balance of risks for inflation biased to the upside, indicates that monetary policy should continue being conducted cautiously. He/she estimated that, given the current environment of high uncertainty and financial volatility, a reference rate cut would come as a surprise to most market participants and could increase exchange rate volatility and raise inflation expectations. For this reason, he/she considered that a risk management approach should be prioritized in an environment of increasing uncertainty, fueled by idiosyncratic and external shocks. He/she argued that refraining from modifying the target rate will help maintain inflation expectations anchored and strengthen Banco de México's credibility and its commitment to the primary mandate of price stability. He/she expressed that the central bank's communication should place emphasis on a cautious and data-dependent approach.

One member mentioned that, since the last monetary policy decision, the international outlook has had few changes, while domestically, two shocks have been observed of different nature, magnitude, and duration that, for the moment, have tended to offset each other. He/she mentioned that one of them is associated with the increased uncertainty that led to financial volatility during the period, while the other one refers to the Mexican economy decelerating at a faster-than-anticipated pace, in a context in which high dynamism was anticipated for the first half of the year. He/she pointed out that the financial volatility registered this month has led to an environment of greater uncertainty compared to previous decisions, although in recent days volatility has moderated, in line with Mexico's solid macroeconomic fundamentals. In this regard, he/she argued that uncertainty shocks have implications for both the real and financial sectors. He/she expressed that, in both sectors, economic agents postpone making decisions as they await more precise information and proceed cautiously, being less reactive to changes in the economic environment, including reference rate adjustments. He/she added that, in environments of lesser certainty, the reference rate may have a lesser effect on long-term bond rates if risk premia adjust in the opposite direction, thereby complicating transmission along the yield curve. He/she emphasized that, while the monetary policy stance is undoubtedly restrictive, given the uncertainty surrounding certain inflation determinants, it is appropriate on this occasion to extend the pause in order to continue assessing both the disinflation process and the monetary policy transmission mechanism. He/she expressed that if their behavior is as expected and if macroeconomic conditions, including aggregate demand, contribute to fostering a more favorable price dynamic, it would be appropriate to resume the downward adjustments in order to pursue a more efficient balance in the conduction of monetary policy. He/she stated that this decision seeks to manage both upward and downward risks to inflation and to foster an orderly adjustment of markets and the overall economy, in compliance with the constitutional mandate.

Another member estimated it is not necessary to lower the reference rate before there is greater certainty that inflation, specifically core inflation, including its services subcomponent, show a downward trend and displays a clear convergence to the 3% target. Similarly, he/she considered that the target rate should be consistent with the deterioration in market trading conditions and with the expectation of high rates due to greater domestic risk premia. He/she pointed out that external monetary conditions and the rate differential are beginning to gain relevance in determining the monetary policy stance. He/she deemed that a high and prolonged restrictive stance is required given its lagged effects on aggregate demand and the low effectiveness of its transmission mechanisms. He/she noted that bank credit, despite certain moderation, and monetary aggregates in real terms maintain a vigorous dynamic, indicating that the effects of the monetary policy stance have not yet fully materialized. He/she added that, in view of the observed depreciation, the exchange rate channel may cease to contain certain pressures, despite the low pass-through of the foreign exchange depreciation. He/she considered that a strategy of occasional and gradual data-dependent calibrations to the monetary policy stance is adequate. He/she noted that further fine-tuning requires a downward trend in services inflation, a substantial improvement in inflationary expectations, and that convergence to the projected inflation target by the end of 2025 materializes. He/she pointed out that any eventual adjustments would be implemented in order to maintain the ex-ante real interest rate in a 7-7.5% range. He/she highlighted that, since the March decision, such rate has increased by 12 basis points, thus laying towards the middle of said range. He/she underlined the importance of monitoring the effects of inflationary and exchange rate pressures on inflation expectations. He/she asserted that the anchoring of inflation expectations at 3% must be ensured, and that, since they remain above the central bank forecasts, changes in slack conditions or the tightening of financial conditions should continue to be of secondary consideration. He/she expressed that, in the face of increased uncertainty, utmost caution must be used regarding the signals provided to the public. He/she pointed out that keeping the reference rate unchanged shows caution and sends the message that the central bank is not satisfied with the inflation dynamics. He/she stated that the direction of future adjustments will represent an even stronger signal than the level of the reference rate by itself.

One member pointed out that in early June an episode of volatility occurred in domestic financial markets, which implied a notable depreciation of the Mexican peso. He/she emphasized that, nevertheless, the impact of said depreciation on the central bank's inflation forecasts was partly offset by the effects corresponding to expectations of a weaker Mexican economic activity than previously anticipated. He/she added that the forecast of these pressures takes place in a context where headline inflation, the measure over which the central bank's target is set, has been increasing for several months due to the behavior of the non-core component. He/she estimated that, taking into account all elements of the macroeconomic and financial environment combined, it is prudent to maintain the reference rate at 11% on this occasion. He/she emphasized that this decision, which implies extending the pause in reference rate adjustments, does not mean that the possibility of lowering the reference rate in future meetings is no longer considered. He/she recalled that, despite the fluctuations exhibited by headline inflation this year, it remains at levels visibly lower than the highs registered during this inflationary episode. He/she also mentioned that, since the last monetary policy meeting, core inflation, which better reflects the trend in inflation, has continued decreasing. He/she stated that the current inflationary environment is undoubtedly less adverse than that of 2022 and early 2023. He/she added that disinflation is projected to continue throughout the forecast horizon. In this context, he/she highlighted that the central bank is at a stage where progress in disinflation and the prevailing degree of monetary restriction allow to discuss possible reference rate cuts and, in his/her opinion, this will be undertaken in upcoming monetary policy meetings. He/she stated that moderation of inflationary pressures will be considered in light of the expectation that global shocks will continue to dissipate and in view of prospects of a weaker-than-anticipated economic activity. He/she underlined that the incidence of both the restrictive monetary policy stance that has been maintained and that prevailing in the future on inflation throughout the horizon in which monetary policy operates will be considered.

3. MONETARY POLICY DECISION

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It stated that the challenges and risks on both sides of the balance call for continuing conducting monetary policy prudently. With the presence of all its members, the Board decided by majority to maintain the target for the overnight interbank interest rate at 11.00%. With this decision, the monetary policy stance remains restrictive and will continue being conducive to the convergence of inflation to the 3% target in the forecast horizon.

Looking ahead, the Board foresees that the inflationary environment may allow for discussing reference rate adjustments. It will take into account the prospects that global shocks will continue dissipating and the effects of a weaker-than-anticipated economic activity. It will consider the incidence of both the restrictive policy stance that has been maintained and that prevailing in the future on 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.

4. VOTING

Voting in favor of the decision were Victoria Rodríguez, Galia Borja, Irene Espinosa, and Jonathan Heath. Omar Mejía voted in favor of lowering the target for the overnight interbank interest rate by 25 basis points to 10.75%.

5. DISSIDENT OPINIONS / VOTES

Vote. Omar Mejía

The inflation outlook faces two opposing shocks, whose effects tend to counter each other: a depreciation resulting from idiosyncratic events and evidence of a greater-than-expected economic weakness. I anticipate that the easing of slack conditions will last longer and thus will play a more relevant role in inflation dynamics throughout the horizon. In addition, there are specific instruments to ensure the well-functioning of markets, and monetary policy must react accordingly to their impact on our central baseline scenario, which, given the impact of both shocks combined, does not display relevant changes and allows to continue adjusting our monetary policy stance, which should be set to enable the convergence of inflation, ensuring an orderly adjustment of the economy and markets. I deem it responsible to reflect in depth about the appropriate level of monetary restriction in the current context, characterized by the evident progress in the inflation outlook and prospects of greater slack conditions. For this reason, it is also appropriate to conduct monetary policy with a prospective approach and refrain from overweighing the evolution of non-core inflation, over which monetary policy has little incidence. In view of the above, I believe it is appropriate to make an adjustment to the monetary restriction.

ANNEX*

The information in this Annex was prepared for this meeting by the staff of Banco de México's Directorate General of Economic Research and Directorate General of Central Bank Operations. It does not necessarily reflect the considerations of the members of the Governing Board as to the monetary policy decision.

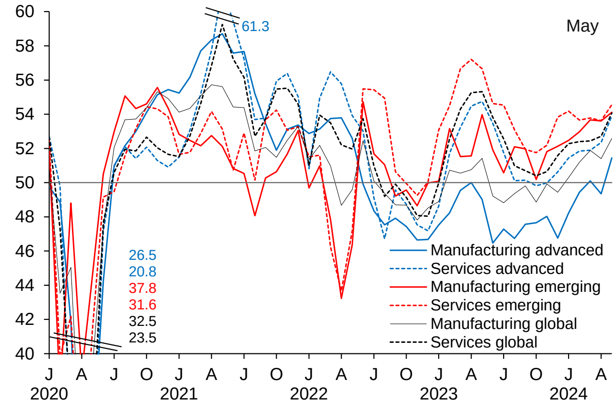
A.1. External conditions

A.1.1. World economic activity

World economic activity is expected to continue expanding during the second quarter of 2024, albeit at a slower pace than in the previous quarter. The latter is associated with a lower growth in emerging economies, after having registered a robust performance during the first quarter. Advanced economies would have registered a slight recovery in economic activity, although the pace of growth is expected to be different across countries. Purchasing Managers' Indices point to an increase in the services sector and in manufacturing activity at the global level during the second quarter of the year (Chart 1). Some world trade indicators exhibited modest growth in April relative to the first quarter of the year. Among global risks the following stand out: the intensification of geopolitical turmoil, the protraction of inflationary pressures, tight financial conditions, and, to a lesser extent, the challenges to financial stability.

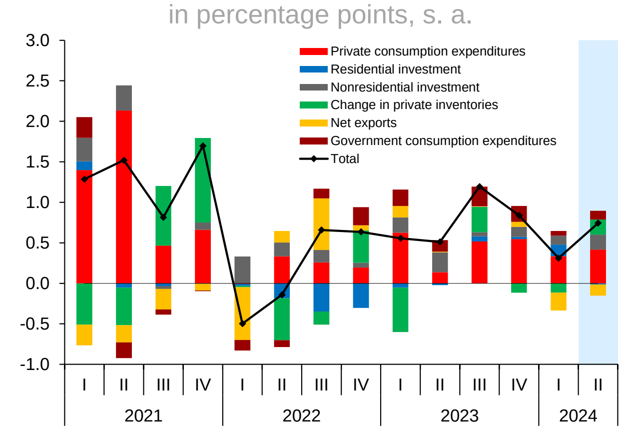
In the United States, although economic activity moderated in the first quarter of 2024 compared to the last quarter of 2023, domestic demand was solid. In particular, GDP grew at a seasonally adjusted quarterly rate of 0.3%, after having increased 0.8% in the previous quarter (Chart 2).[1] Recent indicators suggest that the US economy remained resilient during the second quarter of 2024. This performance would reflect positive contributions from private consumption, nonresidential investment, government spending, and inventory accumulation.

Chart 1
Purchasing Managers' Index: production component for advanced, emerging and global economies
Diffusion index, s. a.1/



s. a. / Seasonally adjusted figures.
1/ The index varies between 0 and 100 points. A reading above 50 points indicates an expansion and below 50 indicates a contraction. A reading equal to 50 points indicates no change.
Note: Figures in the chart correspond to respective minimum levels of each indicator, in the same order as the labels.
Source: IHS Markit.

Chart 2
US: real GDP and components
Quarterly percentage rate and contribution in percentage points, s. a.



s. a. / Seasonally adjusted figures.
Note: The shaded area refers to Atlanta Federal Reserve's GDPNow forecasts as of June 20.
Source: BEA and Federal Reserve Bank of Atlanta.

* Note: In the electronic version of this document the data to generate all the charts and the table can be obtained by clicking on them, except for those that are not produced or elaborated by Banco de México.

[1] Expressed as a seasonally adjusted quarterly rate, the change in US GDP was 1.3% in the first quarter of 2024 and 3.4% in the fourth quarter of 2023.

US industrial production increased at a seasonally adjusted monthly rate of 0.9% in May, after having stagnated in April. Manufacturing production expanded 0.9% in May, mainly as a result of positive contributions from the chemical industry, the food merchandise and beverages industry, and from the manufacturing of metal products. The mining sector grew 0.3%, while electricity and gas generation rose 1.6%. Purchasing Managers' Indices point to a slower pace of growth in manufacturing in June.

The US labor market remained tight, despite the moderation shown by various indicators. The non-farm payroll expanded more than expected, from 165 thousand new positions in April to 272 thousand in May. Although they remain at low levels, initial claims for unemployment insurance have slightly trended upwards recently, registering 238 thousand new claims in the week ending June 15. The unemployment rate increased marginally from 3.9% in April to 4.0% in May, its highest level since January 2022. Although the number of new vacancies remains above pre-pandemic levels, it declined from 8.4 million in March to 8.1 million in April. The annual rate of change in average hourly wages rose slightly from 4.1% in April to 4.2% in May.[2]

After five quarters of having been practically stagnant, economic activity in the euro area grew at a seasonally adjusted quarterly rate of 0.3% in the first quarter of 2024.[3] Similar growth is expected for the second quarter of the year. Economic performance during the first quarter is mainly attributed to the positive contribution of net exports. The labor market in this region remained robust. The unemployment rate decreased from 6.5% in March to 6.4% in April, reaching new historic lows. The latter took place in a context in which the labor participation rate has been increasing.

Regarding the rest of the major advanced economies, they are expected to register an expansion in the second quarter of 2024, although with differences in terms of growth rates. In particular, Japan's economic activity is expected to recover, after having contracted in the previous quarter. Labor markets in this group of economies remained tight, despite the moderation of some indicators.

Most of the major emerging economies, mainly in Latin America and Emerging Asia, are expected to show lower dynamism in the second quarter of the year compared to the previous quarter. In the particular case of China, some economic activity indicators point to slower growth between April and June, after GDP grew at a seasonally adjusted quarterly rate of 1.6% in the first quarter of the year.[4] In April and May, retail sales and industrial production registered a moderation in their growth rate compared to the performance observed at the beginning of the year. The Chinese economy continues facing difficulties due to the weakness of its real estate sector and the low confidence of economic agents, despite the various stimuli implemented by the country’s authorities to boost growth.

Since Mexico's last monetary policy decision, international commodity prices registered a mixed behavior. Oil prices performed differently throughout the period. During the first four weeks, prices decreased due to a lower perception of the risk associated with the geopolitical conflict in the Middle East, as well as due to the agreement reached on June 2 between the members of the Organization of the Petroleum Exporting Countries and allied countries (OPEC+) to gradually increase their supply starting in the fourth quarter of 2024. Towards the second week of June, a reversal of this trend was observed due to the expectation of a higher global demand during the summer. As for natural gas reference prices, they trended upwards. Prices increased due to higher global demand and lower production in Norway and Australia associated with the maintenance of gas processing infrastructure. There were additional upward pressures caused by geopolitical tensions in Europe. Grain prices performed differently during the period. In May, they rose due to adverse weather conditions, such as floods in Brazil and frosts in Russia and Ukraine, as well as supply concerns associated with geopolitical tensions between the latter two countries. Nevertheless, at the beginning of June, this trend reversed, partly due to larger grain harvests in the United States. Industrial metals prices trended downwards, although with some volatility. At the beginning of the period, prices rose due to expectations of a recovery in global manufacturing activity. However, this trend reversed by the end of May due to expectations of a lower demand from

[2] Average hourly earnings of production and nonsupervisory employees.

[3] Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 1.3% in the first quarter of 2024.

[4] Expressed as an annual rate, China's GDP growth was 5.3% in the first quarter of 2024.

China and higher inventory levels worldwide. Precious metal prices remained at high levels, similar to those observed around Mexico's last monetary policy decision, although they registered some volatility in light of the publication of various global economic indicators, particularly from the United States.

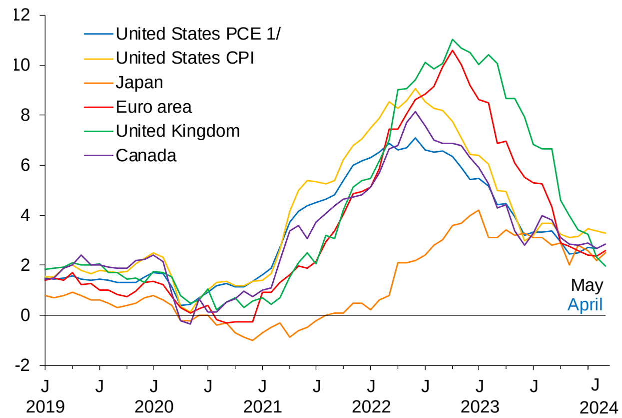
A.1.2. Monetary policy and international financial markets

In several of the main advanced economies, annual headline inflation decreased due to lower pressures on food prices and, to a lesser extent, on the core component. However, the pace of inflation reduction has varied across economies, and, in some cases, inflation has rebounded (Chart 3). In most of these economies, inflation remains above the targets of their respective central banks.

In particular, in the United States, annual headline inflation measured by the consumer price index decreased from 3.4% in April to 3.3% in May. This reduction reflected the fall in food inflation and core inflation. The latter decreased from 3.6 to 3.4% during the same period. This was partially offset by higher pressures on energy prices. The monthly variation of the core component decreased in May due to lower pressures on services prices. The Personal Consumption Expenditure Price Index (PCEPI) decreased slightly from 2.70% in March to 2.65% in April, while its core component went from 2.81 to 2.75% between the same months.

Analysts' inflation forecasts for most main advanced economies foresee a moderation in headline inflation throughout 2024 from its current levels. However, it would remain at levels above the targets of their respective central banks during this year. Longer-term inflation expectations for these economies drawn from financial instruments were revised slightly downwards recently with respect to expectations registered in the second week of May.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



1/ The personal consumption expenditures price index is used.
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat, Bank of Japan, the UK Office for National Statistics, and Statistics Canada.

In several emerging economies, annual headline inflation increased in its most recent reading. This was partly attributed to higher pressures on energy prices and, in some cases, to a rise in food inflation. Thus, in most of these economies, headline inflation remained above the point targets of their respective central banks, although in several of them inflation was within the variability range considered by each central bank. Core inflation decreased in most of the main emerging economies.

In this context, since Mexico's last monetary policy decision, the central banks of the major advanced and emerging economies adjusted their monetary policy stances in a heterogeneous manner, depending on the evolution of inflation and of other economic indicators in each country.

In the major advanced economies, most central banks continued to gradually reduce their securities' holdings and a large number of them kept their reference rates unchanged, including the US Federal Reserve. Some of them pointed to the need for greater confidence that inflation is returning to target before easing their monetary policy stances. Some central banks in advanced economies, however, lowered their reference rates. The European Central Bank and the Bank of Canada announced their first interest rate cuts, after having kept their reference rates unchanged in several previous decisions.[5]

[5] At its June meeting, the Bank of Canada announced a cut of 25 basis points to its reference rate, after having left it unchanged for six consecutive decisions. Its Governing Council stated that recent data increased its confidence that inflation will continue converging to its target and considered that its monetary policy did not need to be so restrictive. However, it noted that risks to the inflationary outlook prevail.

Although it left its monetary policy rate unchanged in June, the Bank of Japan stated that in its next decision it will disclose a plan to reduce the amount of its government bond purchases.[6]

At its June meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the seventh consecutive decision. Thus, it remains between 5.25 and 5.50%. Said central bank reiterated that, when considering any adjustment to the target range for the federal funds rate, the Federal Open Market Committee (FOMC) will carefully evaluate new information, the evolution of the economic outlook, and the balance of risks. It indicated again that the FOMC considers that risks associated with meeting its employment and inflation goals have moved toward better balance. It mentioned again that the Committee does not expect that it would be appropriate to reduce the target range for the federal funds rate before it has greater confidence that inflation is moving sustainably toward the 2% target. However, it emphasized that it is prepared to adjust its monetary policy stance in the event of risks that may prevent it from meeting its goals. In addition, said central bank continued reducing the size of its balance sheet, although at a slower pace.

During the press conference of the June decision, the chairman of the Federal Reserve reiterated that so far this year, inflation data have not generated greater confidence among FOMC members that inflation is converging toward 2%. However, he noted that most recent inflation readings have been more favorable than at the beginning of the year and that there has been modest progress toward the inflation target. He indicated that, if the economy remains strong and inflation persists, the Committee is prepared to maintain the current target range for as long as appropriate. In contrast, if the labor market weakens unexpectedly or inflation falls faster than anticipated, it is also ready to respond.

Regarding the adjustments to the Committee's projections, between March and June, the median headline inflation measured by the personal consumption expenditure price index was revised upwards from 2.4 to 2.6% for the end of 2024, from 2.2 to 2.3% for 2025, and was left unchanged at 2.0% for 2026. The Committee revised upwards its expectation for the federal funds rate for the end of 2024 from 4.6 to 5.1%, for the end of 2025 from 3.9 to 4.1%, and kept it unchanged at 3.1% for the end of 2026. Most recent expectations drawn from financial instruments suggest that the federal funds rate would be around 4.90% at the end of 2024 and close to 3.99% at the end of 2025.

At its June meeting, the European Central Bank cut its reference rates by 25 basis points (bps), after having left them unchanged for five consecutive decisions. Thus, its refinancing, key lending and key deposit rates stand at 4.25, 4.5 and 3.75%, respectively. Its Governing Council noted that, based on the updated assessment of the inflation outlook, the core inflation dynamics and the strength of monetary policy transmission, it was appropriate to moderate the degree of monetary policy tightening. However, it reiterated that it will keep the reference rates at sufficiently restrictive levels for as long as necessary in order to ensure that inflation returns to its target in a timely manner. It again indicated that it will maintain a data-dependent approach to determine the appropriate duration and degree of such tightening and that it was not committing to a particular monetary policy path.

At the press conference, the president of said institution pointed out that, despite having revised upwards their inflation forecasts, the decision was taken because their confidence in the downward trajectory of inflation has been increasing in the last few months. However, she stated that additional data is needed to confirm that they are on a disinflation path. She also mentioned that it cannot be confirmed that they are in a rate reduction phase, but that there is a high probability that this will be the case, although it will depend on data. She highlighted that there is a high uncertainty about the speed and time that this phase will take. Regarding its Pandemic Emergency Purchase Program (PEPP), the Governing Council confirmed that it will reduce its securities' holdings acquired under the program by an average of EUR 7.5 billion per month during the second half of the year.

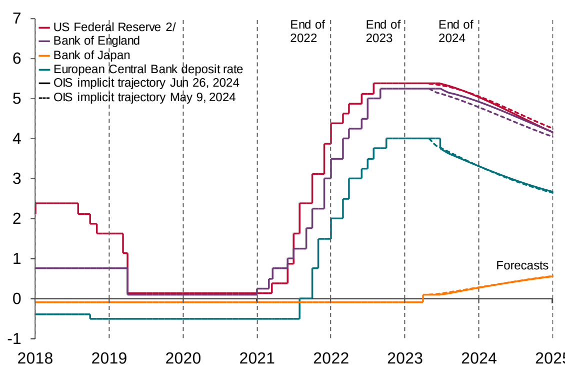
Since Mexico's last monetary policy decision, the central banks of the main emerging economies made different decisions regarding their reference rates, according to the specific economic circumstances of their countries. Some central banks, mainly those of Latin America and Eastern Europe, continued lowering their rates in their most recent decisions, albeit in less magnitude. The central banks of Peru

[6] The Bank of Japan announced that it will reduce the amount of its government bond purchases (JGBs) to ensure that long-term interest rates are more freely determined in the financial markets. It will gather feedback from market participants and, at its next monetary policy meeting, will decide on a detailed plan for reducing the amount of its purchase over the next one to two years approximately.

and Brazil left their reference rates unchanged in their June decision, after having previously lowered them. Some central banks in Southeast Asia decided not to adjust their reference rates, including the central bank of China.

Regarding future actions, the central banks indicated that, in general, their decisions will continue depending on the incoming information stemming from these indicators. Some of these institutions anticipate that reference rates will remain at restrictive levels for some time and communicated that they are prepared to make additional adjustments, if necessary, to bring inflation back to target. Regarding market expectations for monetary policy rates in the main advanced economies, based on the latest available information, interest rates implicit in interest rate swap curves (OIS) showed limited changes (Chart 4). Thus, the implied trajectories for the major advanced economies foresee, in general, reference rate cuts of at least 25 bps during the fourth quarter of 2024.

Chart 4
Reference rates and trajectories implied in OIS curves[1/]
Percent

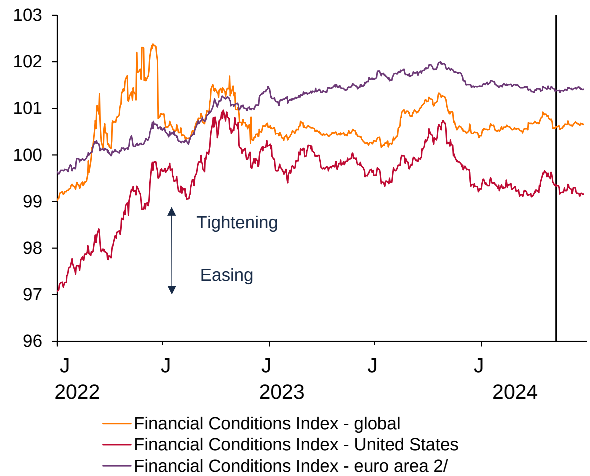


1/ OIS: Fixed floating interest rate swap where the fixed interest rate is associated with the effective overnight reference rate.
2/ For the observed reference rate of the U.S., the average interest rate of the target range of the federal funds rate (5.00%- 5.25%) is used.
Source: Bloomberg.

International financial conditions have shown limited movements since the beginning of May 2024 (Chart 5). Markets reacted to mixed data on inflation and economic activity, mainly in the United States, and thus the financial conditions index did not exhibit a clear trend during the period. The US dollar showed a tendency to appreciate as a result of the Federal Reserve's more cautious tone since the second half of June, which contrasts with the recent reference rate cuts by other central banks in advanced economies.

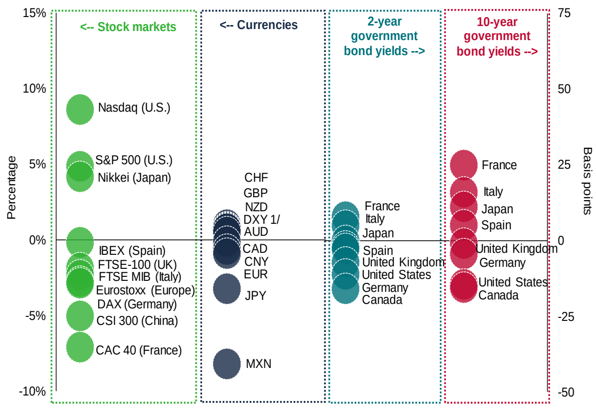
In line with the evolution of financial conditions, medium- and long-term rates declined slightly in most of the main advanced economies (Chart 6). In emerging economies, increases in longer-term interest rates were observed in some regions (Chart 7). Most stock markets in advanced economies registered losses, while those in emerging economies showed mixed changes, with declines in Latin America standing out. In the foreign exchange markets, the US dollar appreciated against the currencies of emerging and advanced countries. Lastly, since Mexico's last monetary policy decision, net capital inflows into emerging economies in both equity and fixed-income assets have been registered.

Chart 5
Financial Conditions Index[1/]
Units



1/ The financial conditions index is constructed considering the effect of five variables on economic activity: the reference interest rate, the 10-year government bond, the spread of investment grade bonds over the government debt bond with equivalent maturity, the ratio of a stock index with 10-year average earnings per share, and the trade weighted exchange rate.
2/ In the case of the euro area, the spread between the sovereign bonds of France, Italy, Spain, the Netherlands, Belgium, Austria, Portugal and Finland over the German 10-year bond is also considered. The vertical black line indicates the last calendarized monetary policy meeting of Banco de México.
Source: Bloomberg and Goldman Sachs.

Chart 6
Change in selected financial indicators from May 9 to June 26, 2024



1/ DXY: a weighted average estimated by the Intercontinental Exchange (ICE) of the nominal exchange rate of the main six currencies operated globally with the following weights: EUR: 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%.
Source: Bloomberg.

Chart 7
Selected emerging economies: financial assets performance as of May 3, 2024
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-6.40%	-7.61%	42	40	13
	Brazil	-6.38%	-5.58%	79	47	26
	Chile	0.10%	-1.07%	-99	5	-3
	Colombia	-5.16%	-1.46%	-20	27	20
	Peru	-2.06%	2.75%	-25	6	-1
Emerging Europe	Russia	4.02%	-9.25%	117	137	N.A.
	Poland	0.40%	2.40%	-2	10	-3
	Turkey	-1.75%	4.81%	-200	34	-16
	Czechia	0.43%	0.75%	0	8	-3
	Hungary	-1.43%	3.50%	-36	3	-2
Asia	China	-0.23%	-3.44%	-17	-6	3
	Malaysia	0.54%	0.05%	-6	-8	1
	India	-0.05%	4.51%	-16	-17	-2
	Philippines	-2.51%	-6.91%	-24	-24	5
	Thailand	0.29%	-4.64%	0	-6	1
	Indonesia	-1.93%	-3.57%	-13	-2	5
Africa	South Africa	1.63%	4.37%	-72	-91	-20

Note: An upward adjustment indicates currency appreciation. Interest rates correspond to swap rates at the specified terms, except for Hungary, where government securities with 3-year maturities were used as a reference. For the Philippines, a 2-year swap rate was used, and for Russia, 2-year and 3-year swap rates were used. The latest CDS data for Russia is as of June 1, 2022.
Source: Bloomberg.

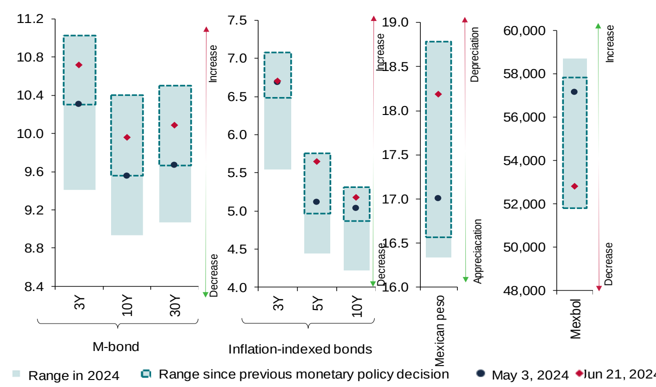
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

Since the previous monetary policy decision in Mexico, domestic financial markets exhibited significant volatility due to idiosyncratic factors. The Mexican peso depreciated notably against the US dollar, while medium- and long-term interest rates increased considerably (Chart 8). More recently, trading conditions in Mexican markets have somewhat normalized.

The Mexican peso traded in a range of 2.48 pesos, between 16.52 and 19.00 pesos per US dollar since the last monetary policy decision (Chart 9). In its most recent reading, it depreciated 6.40% with respect to the date of the previous monetary policy decision. This occurred in an environment characterized by high volatility, a deterioration in trading conditions, and a decrease in Mexican peso positions, although a certain improvement was observed lately.

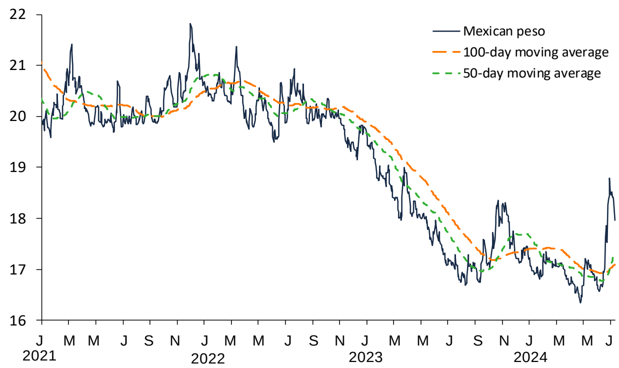
Chart 8
Mexican markets' performance
Percent, MXN/USD and index



Source: Bloomberg and *Proveedor Integral de Precios* (PIP).

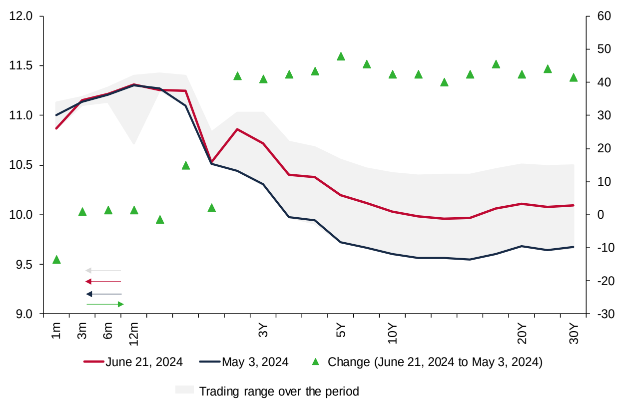
Interest rates on government securities increased between 40 and 48 basis points in the long-term segment of the curve, reaching all-time highs for some maturities (Chart 10). Real rate instruments registered increases in the medium and long terms. In this context, breakeven inflation implicit in spreads between nominal and real rates of market instruments exhibited high volatility and differentiated variations by term (Chart 11). The fixed-income market also exhibited a deterioration in its trading conditions, which partially reversed in the days leading up to Mexico's monetary policy decision.

Chart 9
Mexican peso exchange rate
MXN/USD



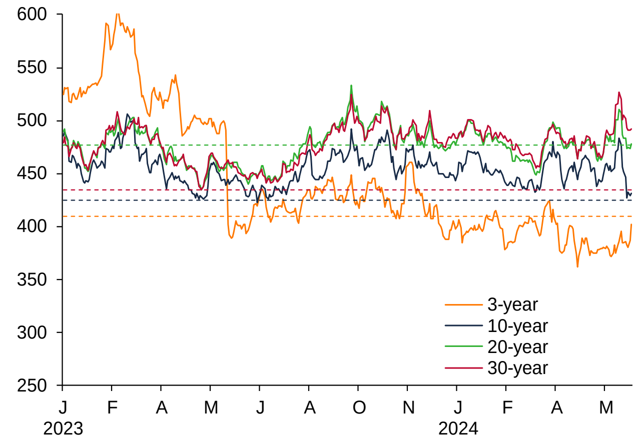
Source: Banco de México.

Chart 10
Nominal yield curve of government securities
Percent, basis points



Source: *Proveedor Integral de Precios* (PIP).

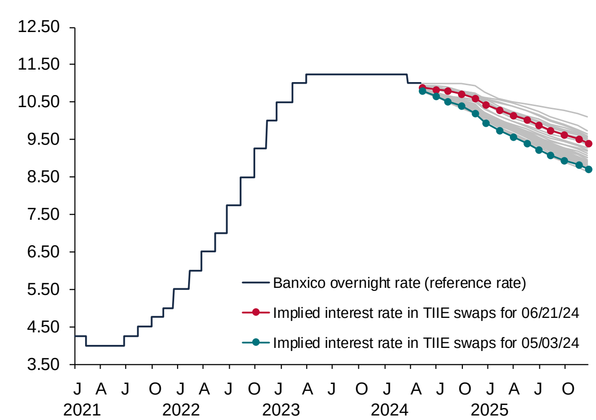
Chart 11
Breakeven inflation and inflation risk implied in government securities' yields
Basis points



1/ Horizontal lines refer to the respective averages observed from September 2008 to date.
Source: *Proveedor Integral de Precios* (PIP).

Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swap curve does not incorporate any movement in the decision of June 2024 and shows a level of 10.66% and of 9.61% for the target rate for the end of 2024 and 2025, respectively (Chart 12). The analysts surveyed by Citibanamex are divided as to the date when a reference rate adjustment will take place, with a similar number of participants expecting the next rate cut to occur in the decision of June, August, or September. They estimate the rate will end the year at 10.25%.

Chart 12
Interbank funding rate implied in TIIE swaps
Percent

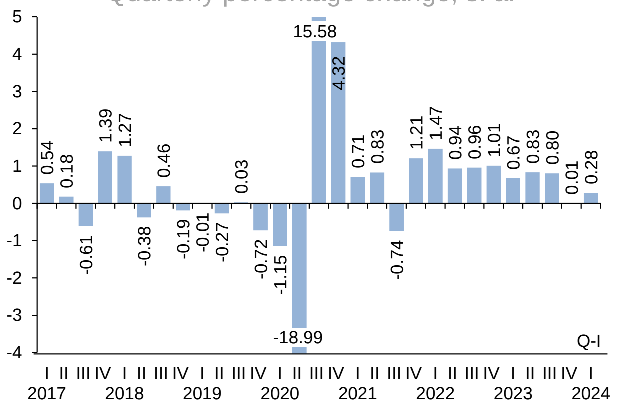


Note: Gray lines represent the range since the last monetary policy decision.
Source: *Proveedor Integral de Precios* (PIP).

A.2.2. Economic activity in Mexico

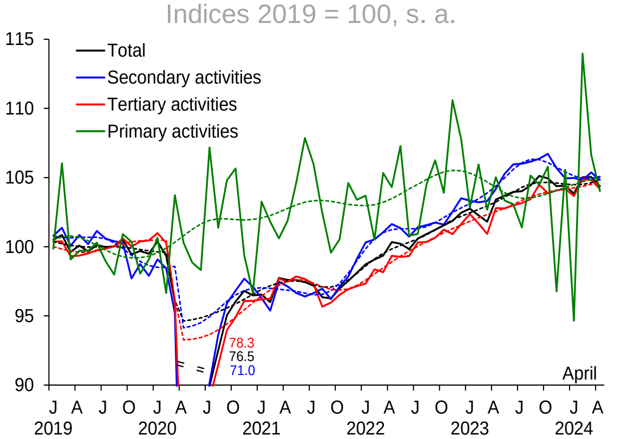
At the beginning of the second quarter of 2024, productive activity continued showing the weakness it had exhibited since the end of 2023. In particular, during the first quarter of 2024, GDP registered a seasonally adjusted quarterly variation of 0.28% (Chart 13). Subsequently, economic activity slowed down in April, as a result of widespread contractions in the three major sectors of productive activity (Chart 14).

Chart 13
Gross Domestic Product
Quarterly percentage change, s. a.



s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

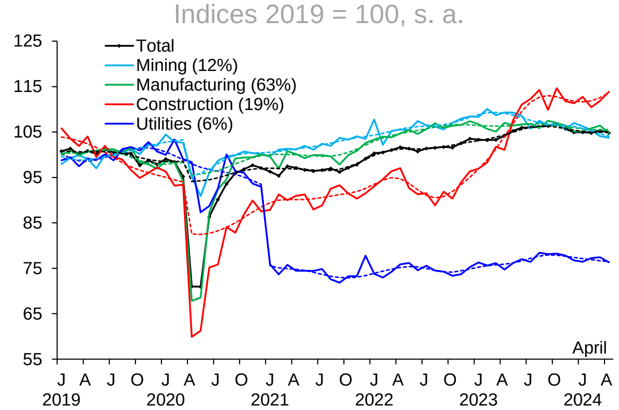
Chart 14
Global Indicator of Economic Activity
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

At the beginning of the second quarter, industrial activity remained sluggish (Chart 15). Manufacturing remained weak, while construction exhibited low dynamism. Services, on the other hand, have been showing a loss of dynamism. In April, they declined markedly, although with heterogeneity among its sectors. In a context of droughts across various regions of Mexico, agricultural activity declined for the second consecutive month, after having reactivated in February.

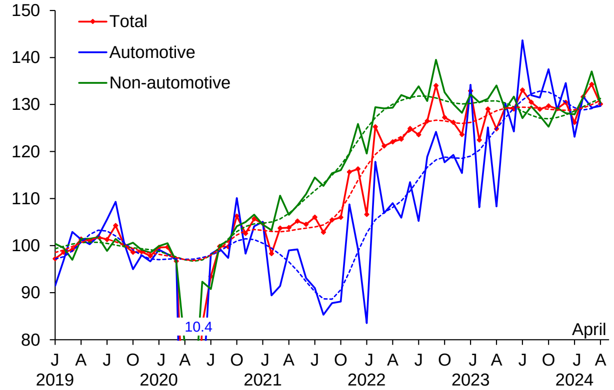
Chart 15
Industrial activity 1/
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding external demand, manufacturing exports remained sluggish at the beginning of the second quarter of 2024 (Chart 16). Automotive exports exhibited low dynamism, while non-automotive exports contracted. As for domestic demand, private consumption continued trending upwards at the end of the first quarter. Consumption of imported goods increased, albeit at a moderate pace compared to the previous months. Consumption of domestic goods rebounded, after exhibiting weakness over the previous months. In contrast, consumption of services declined at the margin. Meanwhile, gross fixed investment recovered moderately compared to the weak performance registered at the end of 2023. At the end of the first quarter, spending on investment both in construction and in machinery and equipment increased, albeit with a loss of dynamism with respect to the first quarters of 2023.

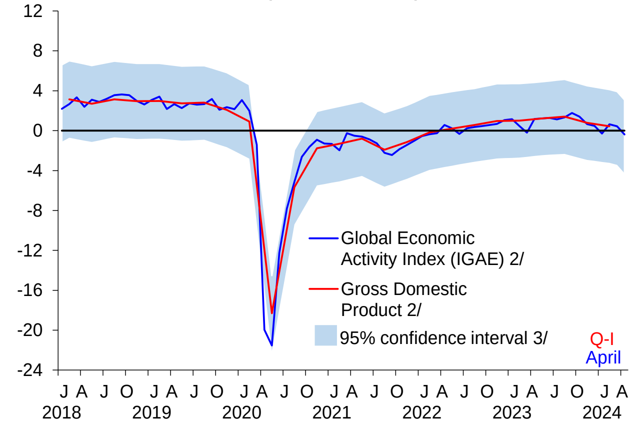
Chart 16
Manufacturing exports
Indices 2019 = 100, s. a.



s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line.
Source: Prepared by Banco de México with data from the Tax Administration Service (SAT, for its Spanish acronym), the Ministry of the Economy (SE, for its Spanish acronym), Banco de México, the National Institute of Statistics and Geography (INEGI, for its Spanish acronym). Mexico's Merchandise Trade Balance. The National System of Statistical and Geographical Information (SNIEG, for its Spanish acronym). Information of national interest.

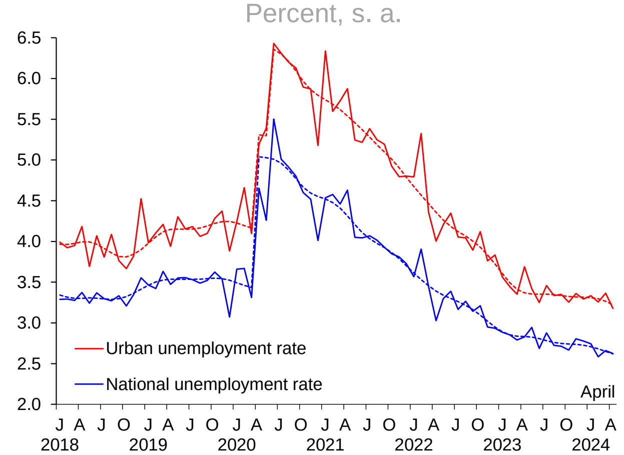
Regarding the cyclical position of the economy, amid the economic slowdown observed in the last quarter of 2023 and the first one of 2024, the point estimate of the output gap decreased (Chart 17). Said estimate is not statistically different from zero. In April 2024, the labor market continued showing strength, albeit with some signs of moderation. The national unemployment rate registered a level similar to the previous month, while the urban unemployment rate decreased at the margin and reached its lowest level on record since 2005 (Chart 18). With information up to May and with seasonally adjusted data, the number of newly created formal IMSS-insured jobs continued trending upwards, although the growth rate of this indicator has been moderating. Finally, in April 2024, unit labor costs in the manufacturing sector remained at relatively high levels (Chart 19).

Chart 17
Output gap estimates 1/
Percent of potential output, s. a



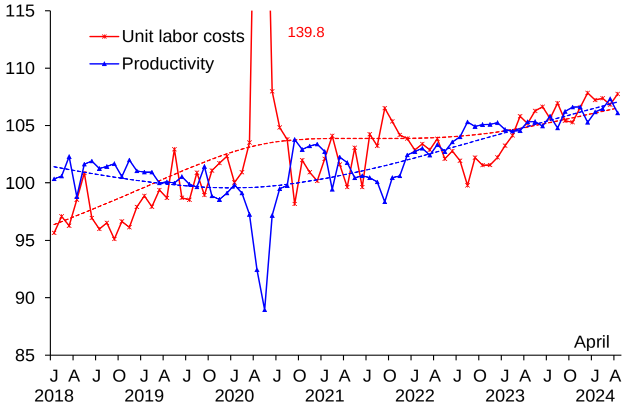
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ GDP flash estimate up to Q1-2024 and IGAE up to April 2024.
3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.

Chart 18
National and urban unemployment rates
Percent, s. a.



s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
Source: INEGI.

Chart 19
Productivity and unit labor costs in the manufacturing sector 1/
Indices 2019 = 100, s. a.



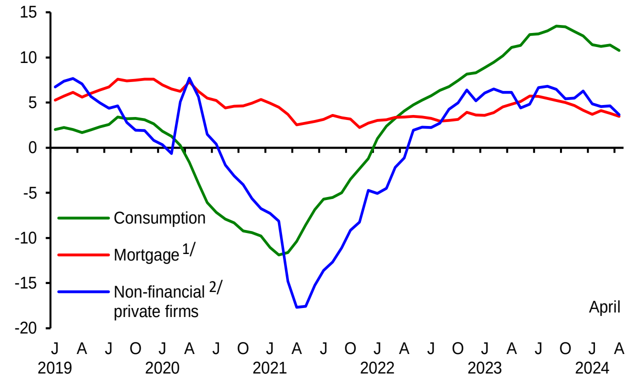
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line.
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly Manufacturing Industry Survey and industrial activity indicators of Mexico's System of National Accounts (*Sistema de Cuentas Nacionales de México*, SCNM), INEGI.

Domestic financing to the private sector continued growing in April 2024, albeit with some moderation compared to the dynamism observed in the second half of 2023. Regarding its components, bank lending portfolio to firms and households grew at rates lower than those at the end of the previous year (Chart 20).

As for the cost of financing, interest rates on bank credit to firms decreased in April 2024, despite remaining at high levels. Meanwhile, credit intermediation margins in this segment decreased slightly and remained at levels similar to those observed prior to the pandemic. Interest rates on mortgages remained at levels similar to those observed prior to the health emergency. Lastly, regarding commercial bank consumer credit, credit card interest rates decreased in February 2024. However, these interest rates continued being at relatively high levels, while interest rates associated with payroll loans have remained relatively stable since August 2021.

As for portfolio quality, in April 2024, delinquency rates of bank credit to the private sector remained at low levels. In the segment of consumption, this indicator decreased slightly, partially reversing the increases observed during the second half of 2023.

Chart 20
Performing credit from commercial banks to the non-financial private sector
Annual percentage change

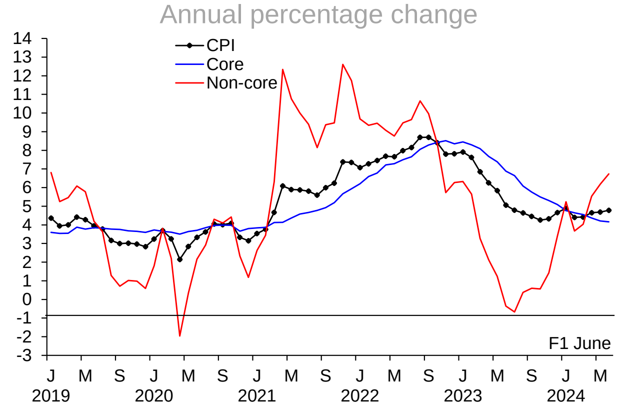


1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation shifted from 4.65% in April to 4.78% in the first fortnight of June 2024. This result reflected the increase in non-core inflation, which was partially offset by the decrease in core inflation (Chart 21 and Table 1).

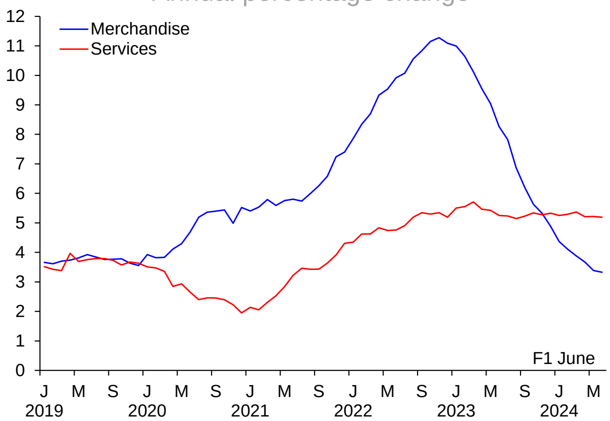
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

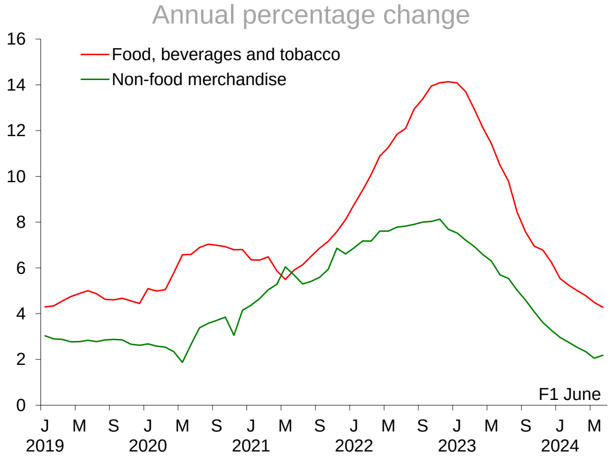
Annual core inflation decreased from 4.37 to 4.17% between April and the first fortnight of June 2024. Regarding its components, during the same period, annual merchandise inflation decreased from 3.67 to 3.33% (Chart 22), affected by the decrease from 4.79 to 4.28% in annual food inflation and from 2.34 to 2.18% in non-food inflation (Chart 23). Between the mentioned periods, annual services inflation remained relatively stable, registering 5.21 and 5.19%, respectively. Thus, services inflation remained at high levels and continued without showing a clear downward trend, affected by pressures related to operating costs, their pass-through to consumer prices, and the recovery in its demand.

Chart 22
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

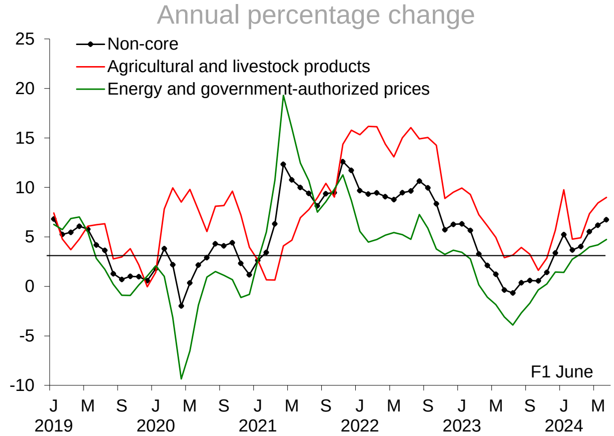
Chart 23
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

Between April and the first fortnight of June 2024, annual non-core inflation increased from 5.54 to 6.73%, driven by the higher annual variations in agricultural and livestock products and energy prices (Chart 24 and Table 1). During that period, annual inflation of agricultural and livestock products increased from 7.35 to 8.99%, influenced by the rise in the annual variation of livestock products from -1.13 to 2.46%. Annual inflation of fruit and vegetables remained at high levels of 18.57 and 17.28% during the referred periods. Meanwhile, annual inflation of energy products increased from 4.38 to 5.52%, largely reflecting the rise in the annual variation of gasoline prices from 4.86 to 5.34%.

Chart 24
Non-core price subindex
Annual percentage change



Source: INEGI.

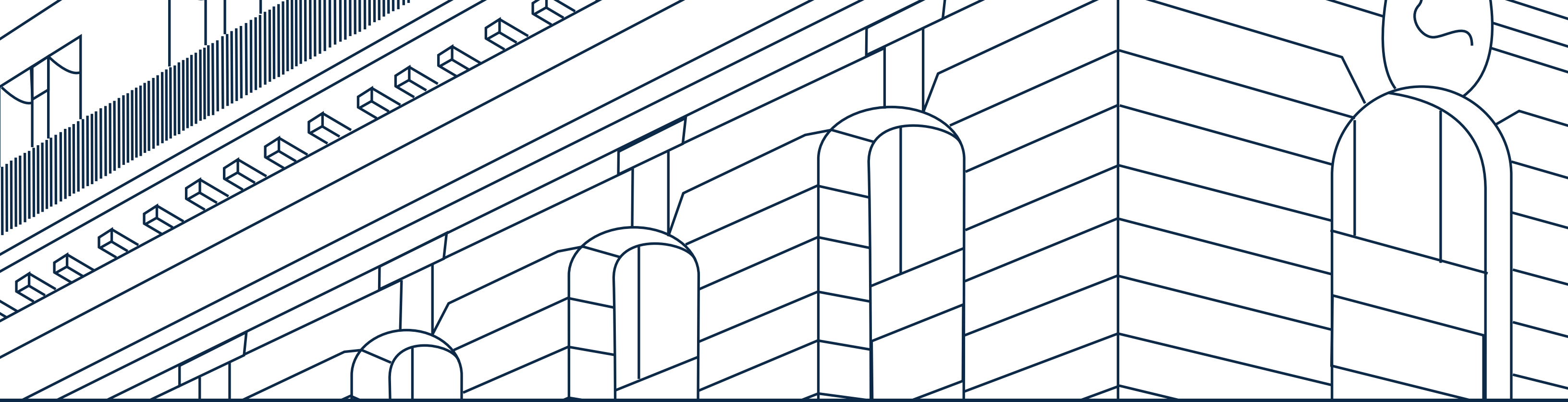
Regarding inflation expectations drawn from the survey conducted by Banco de México among private sector specialists, between April and May 2024, the median of headline inflation for the end of 2024 increased from 4.20 to 4.27%. Regarding its components, the median of the core component decreased slightly from 4.10 to 4.07%. Expectations for headline and core inflation for the end of 2025 remained relatively stable. The median of headline inflation expectations remained at 3.71%, while that of core inflation shifted from 3.72 to 3.70%. At the same time, the median of headline inflation expectations over the next four years adjusted from 3.68 to 3.70%, while that of core inflation expectations decreased from 3.63 to 3.60%. The medians of headline and core inflation expectations for the long term (5 to 8 years) remained stable at around 3.50%. Lastly, breakeven inflation has increased since the previous monetary policy decision. Regarding its components, inflation expectations implied in market instruments and inflation risk premium increased.

The disinflationary process is expected to continue. Although the depreciation of the Mexican peso impacts the inflation forecast upwards, its effects are partly offset by those associated with the greater weakness of economic activity. The forecasts for headline and core inflation are slightly adjusted in some quarters. Headline inflation is still expected to converge to the target in the fourth quarter of 2025. These projections are subject to risks. On the upside: i) persistence of core inflation; ii) greater foreign exchange depreciation; iii) greater cost-related pressures; iv) climate-related impacts, and v) the intensification of geopolitical conflicts. On the downside: i) weaker-than-anticipated economic activity; ii) a lower pass-through effect from some cost-related pressures, and iii) a lower-than-anticipated effect of the exchange rate depreciation on inflation. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.

Table 1
Consumer Price Index and components
Annual percentage change

Item	April 2024	May 2024	1st fortnight June 2024
CPI	**4.65**	**4.69**	**4.78**
Core	**4.37**	**4.21**	**4.17**
Merchandise	**3.67**	**3.38**	**3.33**
Food, beverages and tobacco	4.79	4.49	4.28
Non-food merchandise	2.34	2.05	2.18
Services	**5.21**	**5.22**	**5.19**
Housing	3.73	3.81	3.86
Education (tuitions)	6.36	6.34	6.36
Other services	6.19	6.14	6.05
Non-core	**5.54**	**6.19**	**6.73**
Agricultural and livestock products	**7.35**	**8.44**	**8.99**
Fruits and vegetables	18.57	18.55	17.28
Livestock products	-1.13	0.71	2.46
Energy and government-authorized prices	**3.98**	**4.20**	**4.74**
Energy products	4.38	4.81	5.52
Government-authorized prices	3.08	2.88	3.07

Source: INEGI.



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Document published on July 11, 2024