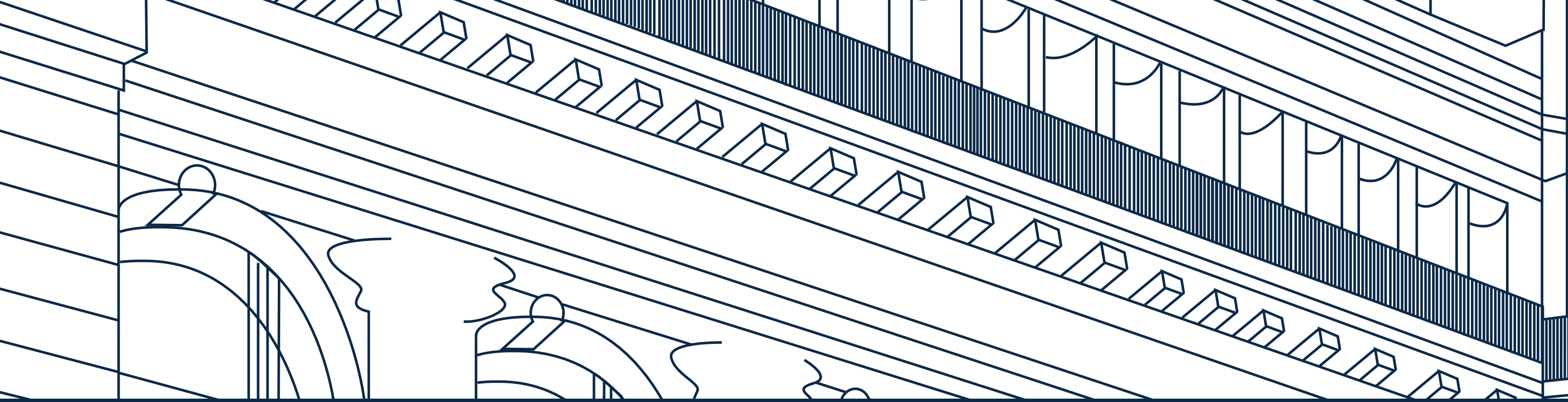

BANCO DE MÉXICO®

Minutes number 110

Meeting of Banco de México's Governing Board on the occasion of the monetary policy decision announced on August 8, 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: August 7, 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 noted that global economic activity is expected to have moderated during the second quarter of 2024 compared to the previous one. **Some** members argued that, nevertheless, the dynamism of economic activity is expected to have remained heterogeneous across countries. They highlighted the prospects of lower growth in emerging economies and higher growth in advanced economies compared to the previous quarter. In this regard, **one** member noted that the United States registered higher-than-anticipated growth in the second quarter. **Another** member specified that economic activity in China exhibited low dynamism. **One** member indicated that world economic growth is expected to be slightly lower in 2024 than in 2023. **Another** member pointed out that in the remainder of 2024, world economic growth faces the risk of a more pronounced slowdown due to the lagged effects of interest rates remaining high for a longer period than expected. He/she added that geopolitical risks also prevail, associated with the potential escalation of conflicts in the Middle East and with increased trade tensions.

Delving into the US economy, **some** members agreed that, although growth was greater than expected, industrial activity in that country remains weak, mainly in its manufacturing sector. With respect to consumption, **one** member highlighted that the dynamism of services moderated, while that of goods was mainly driven by the consumption of vehicles, which had registered negative variations since the second quarter of 2023. He/she specified that, nevertheless, in their annual comparison, these continued registering a contraction. **Most members noted that recent indicators suggest a reduction in the US labor market dynamism. Some** members pointed out that the unemployment rate increased. **One** member mentioned that wage growth slowed down. **Another** member pointed out that the non-farm payroll exhibited lower-than-expected growth, and that the number of job vacancies continued to decline. **Some** members considered that the publication of lower job creation figures generated concerns about the possibility of a "hard landing" in that economy. **One** member noted that a cooling labor market, coupled with slower growth in disposable income and signs of a less sound financial position of households, could affect consumption dynamics.

Most members stated that in a large number of advanced economies headline inflation continued decreasing. Some members attributed this, mainly, to lower pressures on food prices and to a decline in core inflation. However, **one** member considered that this component continues showing persistence at the global level. **Another** member stated that the disinflation process continues showing heterogeneity, with a marked decrease in the goods subindex and resistance to decline in the services subindex. In the particular case of the United States, **one** member pointed out that annual headline inflation, measured by the personal consumption expenditure deflator, declined in June. He/she stated that since May, the monthly variations of the core component have been lower than those recorded in the first quarter. He/she argued that the rise in the unemployment rate and the slowdown in wage growth can be expected to contribute to a further decline in inflation in that country. **Another** member indicated that, looking ahead, disinflation is anticipated to continue in advanced economies.

Regarding inflation in emerging countries, **some** members highlighted the rebound in headline inflation in some of them in recent readings. **One** member pointed out that this was due to increases in energy prices and in certain food prices. However, **some** members noted that core inflation in these economies continues decreasing steadily. **One** member added that in several emerging economies inflation is already within the variability range of their monetary authorities.

Most members mentioned that the US Federal Reserve left the target range for the federal funds rate unchanged. They pointed out that said institution recognized a more favorable outlook for inflation. Some members indicated that its statement highlighted that the labor market is less tight. **One** member added that the Federal Reserve emphasized that the risks to achieving its employment and price stability goals continue to move towards a better balance and that the committee remains vigilant to the risks on both sides of its mandate. **The majority underlined that its chairman mentioned that in view of the evolution of inflation and the labor market, a reduction in the reference rate could be on the table at the September meeting. One** member mentioned that analysts expect three 25-basis-point cuts in 2024, although a high degree of uncertainty prevails in this regard.

Regarding monetary policy decisions of other central banks, most members underlined that the Bank of Japan raised its reference rate unexpectedly. One member noted that, with this adjustment, its reference rate reached its highest level since 2008. **Another** member added that this is the second increase so far this year. **One** member mentioned that said central bank plans to halve its monthly purchases of Japanese government bonds starting in 2026. Meanwhile, **some** members commented that the European Central Bank kept its interest rate unchanged after having reduced it in the previous policy decision. **Some** members mentioned that both the Bank of Canada and the Bank of England lowered their reference rates. **One** member pointed out that in the case of the Bank of Canada, this is the second consecutive reference rate cut. He/she explained that said institute underlined that, although inflation continues above its target and the services component remains high, some measurements of core inflation have exhibited a positive performance recently. He/she added that in the case of the Bank of England, its monetary policy statement pointed out that risks persist, that inflation could rebound above its target and that the monetary policy stance will remain restrictive for as long as necessary. **Another** member anticipated that the rate-cutting cycle by central banks in advanced economies will continue during the rest of the year, although this could happen intermittently. **One** member commented that, despite some heterogeneity in monetary policy cycles, going forward, central banks will acknowledge the need to avoid excessively restrictive monetary policy stances in view of progress in disinflation.

Most members pointed out that international financial markets have recently been volatile. They considered that certain employment data suggesting a lesser dynamism of the labor market in the United States as well as the surprise increase in the reference rate in Japan, contributed to the above. Some members stated that the latter led to a significant appreciation of the yen and to a notorious depreciation in currencies typically used in carry trade positions with said currency, which tended to unwind. Regarding the recent US labor market data, **some** members expressed that these contributed to widespread reductions in government bond yields globally. **Some** members highlighted the decline in the main stock market indices, particularly in the technology sector, given prospects of a greater-than-expected slowdown in the US economy. **One** member added that capital flows to emerging economies had a divergent behavior by asset class, with outflows in fixed-income assets and historically high inflows in equity assets. He/she mentioned the flows to China by local state-owned funds.

Economic activity in Mexico

The majority underlined that, according to the GDP flash estimate for the second quarter of 2024, productive activity registered low growth and continued showing the weakness it has exhibited since the end of last year. Some members pointed out that the deceleration in economic activity was greater than anticipated. **One** member stated that during the last three quarters growth has been below expectations. **Another** member specified that GDP registered an annual growth of 1.1%. **One** member indicated that it was 0.2% at a seasonally adjusted quarterly rate. **Another** member commented that such weak performance occurred in a context in which growth of the US economy surprised to the upside. **Some** members noted that the second quarter of 2024 marks three consecutive quarters of economic weakness. **Some** members detailed that in the last three readings the economy exhibited quarterly variations below 0.5%, specifically 0.3 and 0.2% in the two most recent ones. **One** member added that these results have been observed after the economy grew at a quarterly rate close to 1% for eight consecutive quarters.

Regarding the behavior of Mexico's economic activity by sector, most members highlighted that secondary activities continue showing sluggishness. One member commented that in the second quarter of 2024 these expanded at an annual rate of 0.5%. **Another** member added that, although these activities reactivated somewhat during that quarter, they are still below the levels of October 2023. **The majority mentioned that the low performance of this sector is largely due to the weakness in manufacturing. One** member pointed out that manufacturing fell at a monthly rate of 1.8% in May. **Another** member detailed that manufacturing associated with transportation equipment has not been able to reverse the contraction it registered at the end of 2023. **Meanwhile, the majority stressed that timely data indicate a loss of dynamism in the tertiary sector. One** member mentioned that in the second quarter of the year this sector expanded at an annual rate of 1.7%. **Another** member pointed out that moderate growth in this sector mainly derives from lower commercial activity, which accounts for around one third of this component. He/she added that a high degree of heterogeneity prevails in the behavior of the subsectors that constitute this sector. Finally, **some** members noted the contraction of the primary sector during the second quarter of the year.

Regarding domestic demand, most members underlined that investment continued reactivating somewhat. One member stated that gross fixed investment increased at an annual rate of 5.6% in May. **Some** members pointed out that it has been mainly driven by the construction sector. However, **one** member emphasized the weakening of investment in machinery and equipment. In addition, **some** members pointed out that, excluding the behavior of imports of capital goods, investment has been contracting for two quarters.

Some members pointed out that consumption maintains its dynamism. **One** member added that total consumption grew at an annual rate of 2.8% and remains at high levels. **Another** member noted that the latest information indicates that aggregate demand grew at an annualized quarterly rate close to 6% in the first quarter, mainly driven by household consumption. **Some** members highlighted that consumption has exhibited signs of moderation. **One** member noted that, while the indicator of private consumption in the domestic market had still expanded in a dynamic manner in the first quarter of the year at an annualized quarterly rate of 7.5%, in the second quarter it contracted around 1.9% with April and May data. **Another** member pointed out that private consumption shows a lower dynamism in both domestic goods and services. He/she added that consumption of imported goods registers high levels, although they are already declining. **One** member commented that estimates of consumption directed to the domestic market exhibit a slowdown.

Regarding the external sector, **one** member pointed out that as of the second quarter of the year, the value of automotive manufacturing exports reactivated moderately and remained at high levels. He/she added that the value of non-automotive exports showed some sluggishness and a lateral trend. **Another** member estimated that the behavior of imports, in terms of both private consumption and investment, is related to the appreciation of the real exchange rate, which demonstrates the transmission of the monetary restriction to the economy through the exchange rate channel.

Some members noted that, looking ahead, although forecasts suggest that economic activity will continue expanding, said growth would be modest. **One** member added that he/she expects a pace of growth below its historical average throughout the forecast horizon. He/she also mentioned that, in this regard, the economy seems to be transitioning towards a low growth path. **Another** member considered that the balance of risks to economic activity is biased to the downside. He/she deemed that the main risk to the downside is the materialization of lower-than-expected growth in the US economy. He/she emphasized that the risks associated with geopolitical conflicts and commercial tensions stand out, as well as those related to various electoral processes and their possible results, mainly in the United States. He/she mentioned that all these factors contribute to the increased risk of lower-than-expected growth in private investment in Mexico. **One** member added the greater uncertainty regarding the performance of the global economy and volatility in financial markets derived from idiosyncratic and global factors.

Regarding the cyclical position of the economy, **most** members mentioned that the point estimate of the output gap has been narrowing. **One** member indicated that it is essentially at zero. **Some** members highlighted that it would be persistently negative throughout 2025. **One** member expressed that the output gap estimates are generally not statistically different from zero. He/she pointed out that, additionally, when the sector that includes outsourcing services is excluded from the gap estimate, the gap increases by a couple of percentage points. **Another** member stated that the slack indicator based on principal components remained in positive territory. **One** member specified that this indicator decreased slightly. He/she added that, although the indicator more closely related to the labor market is positive, the indicator related to consumption is close to zero. **Another** member said that the seemingly looser slack conditions should not be expected to promptly contribute to the reduction of inflation. He/she mentioned that, despite the downward revisions to growth forecasts, these do not yet point to a contraction that would lead to a full-fledged easing of slack conditions. Meanwhile, **one** member warned that, although slack measures entail a high degree of uncertainty, one cannot fail to recognize that hard data indicate that the economy has already exhibited three consecutive quarters of weakness. He/she considered that in the face of a notable downward bias in the balance of risks to growth, the cyclical conditions of the economy will be a relevant element in the price formation process.

Most members underlined that some labor market indicators show signs of moderation. Some members mentioned that despite the above the labor market continues showing strength. **Most members highlighted the slowdown in formal employment creation. One** member pointed out that this slowdown has been taking place since mid-2023. **Another** member noted that the annual growth of the employed population is trending downwards. **Some** members mentioned the decline in the labor force participation rate and a slight increase in the unemployment rate in their latest readings. **One** member detailed that for the first time in 12 months the labor participation declined below 60% in June. He/she added that unemployment and underemployment increased with respect to the previous month. **Another** member indicated that unemployment rates, nonetheless, remain near their historic lows. **Some** members noted some reduction in wage growth rates. However, **one** member mentioned that said rates remain high. He/she specified that, based on figures as of June, the nominal annual variation of the daily wage of IMSS-insured workers registered 9.5%, while the moving average of contractual wage revisions for public and private firms recorded 4.1% and 9.3%, respectively. **Another** member considered that, looking ahead, the strength of the labor market is expected to further diminish, considering a growth of economic activity lower than expected some months ago.

Inflation in Mexico

Most members agreed that the fading shocks associated with the pandemic and the geopolitical conflict in Ukraine, as well as the monetary policy stance adopted, have allowed for a significant progress in disinflation in Mexico since the most critical moments of the current inflationary episode. Nevertheless, they acknowledged that the inflationary environment remains complex. One member expressed that an unfavorable inflationary dynamic has developed in recent months. **Another** member recalled that it was already anticipated that the disinflation process would not be linear.

All members pointed out that since the last monetary policy decision, annual headline inflation continued increasing, registering 5.57% in July. Most members noted the increase it has exhibited since October 2023, when it stood at 4.26%. Some members considered that the upward trajectory of headline inflation has been more evident since March 2024. **All members acknowledged that its increases were exclusively due to the upward trend of the non-core component, given that core inflation has remained on a downward trend. One** member stated that on few occasions was it possible to identify the concentration of inflationary shocks in a single inflation component with such clarity. **Another** member pointed out that of the 131 basis points by which headline inflation has increased since October 2023, non-core inflation has contributed with 235 basis points, while core inflation has contributed downward with 104 basis points. **In this context, most members argued that relative price adjustments rather than generalized increases are being observed. Some** members specified that indicators that better represent the medium-term trend of headline inflation do not suggest that generalized price increases are taking place. **One** member pointed out that the trimmed mean indicator of headline inflation, which excludes extreme upward and downward figures, registered 4.3% in July.

Most members highlighted that core inflation continued decreasing and registered 4.05% in July. Some members pointed out that this level is the lowest since March 2021, before Banco de México began its hiking cycle. **One** member emphasized that its seasonally adjusted and annualized monthly rate was 3.53% in July 2024. **Some** members observed that, based on figures from July, this component accumulated eighteen consecutive months of reductions. However, **one** member warned that since then it has declined at a slower rate. **Another** member stated that it has shown a very significant decline compared to other disinflation periods. **One** member mentioned that the fall in core inflation is particularly relevant, since this component better reflects the medium-term trend of headline inflation.

The majority pointed out that the downward trend in core inflation is due to the behavior of merchandise inflation. One member argued that the factors that have contributed to the disinflation process have been reflected faster and more notably on merchandise prices than on services prices. **Another** member pointed out that in July annual merchandise inflation was 3.09%, accumulating twenty consecutive months of reductions. **Some** members noted that annual inflation figures for both food and non-food merchandise are at historical lows. **Some** members deemed that these segments are unlikely to decline much further, and therefore, looking ahead, the reduction in core inflation will depend, to a greater extent, on the performance of services inflation.

Most members mentioned that services inflation continues showing persistence. One member noted that in July it stood at 5.22% and has exhibited a lateral trend for over thirteen months. **Another** member stated that it remains above its historical average. **One** member argued that services companies continue making price adjustments stemming from the pandemic shocks, which they had not been able to implement because demand for services recovered slowly. **Some** members forewarned that housing inflation is trending upwards. **One** member added that inflation of education services has not yet reached an inflection point. However, **some** members agreed that, in recent months, some indicators have performed more favorably. They highlighted that, after having attained a maximum inflation of 7.72% in March 2023, the subcomponent of services other than housing and education registered an inflation of 6.01% in July 2024. **One** member emphasized that this figure is the lowest in over two and a half years, except for June 2024 when it was 5.96%. **Another** member noted that, while the seasonally adjusted annualized monthly rates of this subcomponent were above 6% in the first months of the year, the average of the last three months was 4.05%. He/she expressed that, while during 2021 the percentage of the basket of services with price variations greater than 10% accounted for more than 25%, based on more recent data said percentage was 1.8%.

All members mentioned the upward trend in non-core inflation. One member recalled that after having reached a historically low level of -0.67% in July 2023, non-core inflation has been subject to upward pressures by an unfortunate sequence of adverse shocks. **Most members pointed out that in its last reading of July 2024, non-core inflation registered 10.36%. Some** members noted that in this month it again recorded double-digit annual variations comparable to those observed in August 2022. They noted that the sharp monthly variation observed in July is located at the 99th percentile of the empirical distribution of such variations of this component, thus suggesting that its rebound in that month was highly atypical. **Some** members emphasized that this component is characterized by its high volatility. **One** member considered that it is subject to shocks that can cause significant adjustments between each reading, which can be both upward and downward. In this context, he/she stated that inflation of agricultural and livestock products went from 3.16 to 13.72% between July 2023 and July 2024, while inflation of energy products increased from -7.82 to 9.17% in the same period.

Most members underlined that non-core inflation dynamics respond to supply shocks. Some members mentioned the increases in international reference prices for energy goods. **Most members highlighted the incidence of climatic events. One** member noted that adverse weather conditions like those observed recently had not occurred in over a decade. **Some** members highlighted the significant increases in the prices of some fruits and vegetables. **One** member pointed out that more than 50 basis points of annual headline inflation are attributed to just ten CPI items within the fruits and vegetables subcomponent. **Another** member underlined that, when analyzing the deviation of headline inflation from its historical behavior, it is observed that it stands at 157 basis points above its average, 102 points of which are explained by the behavior of agricultural and livestock products.

Regarding inflation expectations drawn from surveys, most members highlighted that longer-term inflation expectations remained relatively stable, although at levels above target. One member indicated that their distribution continues improving. **Regarding short-term expectations, the majority mentioned that those corresponding to headline inflation for the end of 2024 increased. They attributed this to a deterioration in implied expectations for the non-core component. One** member considered that this adjustment reflected the increase in observed inflation. **Most members added that, in contrast, expectations for the core component for the end of 2024 decreased. Regarding expectations for the next twelve months, they noted that those for headline inflation declined.** However, some members pointed out that those for the end of 2025 adjusted slightly upwards. As for expectations drawn from market instruments, **one** member noted that they remained relatively stable. **Another** member stated that breakeven inflation deteriorated due to a reversion of risk premia to their historical average. **Some** members argued that headline inflation expectations drawn from surveys remain above Banco de México's forecasts. **One** member mentioned that this is also reflected in market expectations. **Another** member commented that none of the analysts anticipate that inflation will reach a rate close to 3% by the end of 2025. He/she noted that core inflation expectations are also above the central bank forecasts. He/she added that surveys point to stagnation in the latter component around its current levels.

Most members stated that in view of the supply shocks that have affected non-core inflation, the central bank's forecasts for headline inflation were revised upwards for the short term. They underlined that considering the nature of these shocks, their effects on inflation are anticipated to begin dissipating relatively quickly, and thus headline inflation would resume a downward trajectory. They added that the forecasts for core inflation remain unchanged, and therefore it is expected to continue decreasing. One member pointed out that core inflation is foreseen to be at 3.9% in the last quarter of 2024. **All members noted that headline and core inflation are still expected to converge to 3% in the fourth quarter of 2025. Thus, most members highlighted that, looking ahead, disinflation is expected to continue. Some** members commented that forecasts consider the fading effects of the global shocks, the weakness of domestic economic activity, and the effects of the monetary policy stance.

Most members considered that the balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside. Some members warned of the risk of prolonged high levels of non-core inflation contaminating core inflation. **One** member stated that this risk is not minor, as adverse weather conditions are becoming more frequent with deeper and longer-lasting effects. **Some** members argued that previous inflationary episodes show that increases in the non-core component are usually followed by increases in the core component. **One** member pointed out that this occurred in 2021 and 2022 as well as in 2017. However, he/she noted that, in those cases, alongside the pressures on the non-core component, the economy was also facing other types of shocks that led to increases in the core component, and for that reason it was necessary to implement significant adjustments to the reference rate. In contrast, he/she underlined that the current situation is different, as core inflation has consolidated a clear downward trend for a year and a half and the reference rate is at a much higher level. He/she added that the analysis carried out does not point to any effects on core inflation, despite the pressures on the non-core component being felt since the end of last year. Thus, **some** members argued that the effect on core inflation of the shocks that non-core inflation is currently experiencing would be limited. **Most members noted that the behavior of analysts' expectations suggests that the market consensus does not anticipate any negative effects either. Some** members mentioned that non-core inflation items which have registered the highest price increases, such as various fruits and vegetables, generally are not essential inputs in production processes. They also noted that, given the availability of close substitutes, they have a high price elasticity of demand, and thus economic agents that use them as inputs can, to a certain extent, substitute them for other alternatives.

Some members mentioned the upside risk of persistence in core inflation, particularly in its services component. **Some** members highlighted the risk of further exchange rate depreciation. **One** member indicated that it will be necessary to assess the possible implications of exchange rate adjustments on inflation dynamics. He/she added the possibility of greater cost-related pressures. **Another** member pointed out the risks related to the labor market and to fiscal policy. **Regarding downward risks, most members highlighted the lower-than-anticipated economic activity.** However, **one** member argued that this could be offset by the resilience of aggregate demand supported by a robust labor market and high disposable personal income. **Another** member noted that the economic weakness could help improve services inflation and limit the pass-through on costs.

Macrofinancial environment

Most members commented that after the volatility observed at the beginning of June in light of idiosyncratic factors, in subsequent

weeks financial markets in Mexico performed better. They indicated that the adjustments in financial variables that took place at the beginning of June, associated with idiosyncratic factors, partially reversed. Some members emphasized that trading conditions in both foreign exchange and fixed-income markets improved in July with respect to the previous month. **Most members noted that the yield curve for government bonds decreased, especially in the medium term, in a context of improved trading conditions with respect to June. One** member specifically highlighted the increase in trading volume.

The majority indicated that domestic markets were affected by the volatility recently experienced by international markets at the beginning of August. They highlighted that such volatility was associated with the release of employment data in the United States and with Japan's monetary policy decision. One member added that these events led to the unwinding of carry trade positions of the Mexican peso against the yen. **Some** members pointed out that the evolution of the electoral process in the United States also influenced markets. **In this context, all members highlighted the recent depreciation of the Mexican peso. Some** members mentioned that it traded in a wide range. **One** member noted that in early August the exchange rate reached intraday levels above 20 pesos per dollar. He/she added that trading conditions have not returned to levels prior to the episode of turbulence in June and its metrics have exhibited a bias towards depreciation. **Another** member stated that from June onwards, sovereign credit risk indicators registered increases, albeit smaller than in other stress episodes. He/she pointed out that the foreign exchange market is becoming increasingly deeper, and thus, despite the volatility, interventions in the foreign exchange market have not been necessary. **Some** members commented that additional bouts of volatility cannot be ruled out. **One** member considered that, in an uncertain environment, markets have tended to overreact to economic news. **Some** members argued that, in the case of Mexico, robust macroeconomic fundamentals and a risk-adjusted interest rate spread that continues being among the most attractive, imply that the economy is in a solid position to handle potential challenges.

One member stated that expectations implied by TIIE swaps for the trajectory of the reference rate decreased, with a rate of 10.80% anticipated for this decision. He/she added that a rate of 10.20% is expected for the end of 2024. He/she mentioned that the analysts' consensus is divided as to the date of the next adjustment and expects a reference rate of 10.50% by the end of 2024. He/she pointed out that, although differences persist between markets and surveys, both incorporate graduality and caution in their trajectories. **Another** member stated that despite the sharp monetary restriction, financing to the non-financial private sector continued expanding. He/she specified that it grew at a real annual rate of 2.0% in June, supported by domestic financing. In this regard, he/she emphasized that commercial bank credit to firms, consumer credit and mortgage lending continued trending upwards, with the former two registering especially high expansion rates. Regarding credit risk, he/she indicated that delinquency rates are at low and stable levels.

Monetary policy

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It considered the nature of the shocks that have affected the non-core component and the projection that their effects on headline inflation will dissipate over the next quarters. It took into account core inflation's trajectory and the fact that it is anticipated to continue decreasing. It estimated that, although the outlook for inflation still calls for a restrictive monetary policy stance, its evolution implies that it is adequate to reduce the level of monetary restriction. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 10.75%.

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

One member argued that the analysis of the evolution of the inflationary outlook suggests that conditions are appropriate to lower the level of monetary restriction. He/she emphasized the notable progress in the reduction of core inflation, which better reflects the medium-term trend in inflation, as well as the prospect that this component will continue declining. He/she pointed out that the nature of the shocks that have exerted upward pressure on the non-core component and headline inflation should be considered. He/she reiterated that the effects of said supply shocks tend to dissipate relatively quickly, which would lead headline inflation to resume a downward trajectory in the following months. He/she also stated that, although it is necessary to acknowledge that non-core inflation at double-digit levels has exerted significant pressures on headline inflation, it is also important to consider that this represents a change in relative prices rather than generalized pressures. He/she argued that both domestic and external environments are conducive to a continuous moderation of inflationary pressures. He/she highlighted the disinflation progress at the global level. In this regard, he/she indicated that since Mexico is an economy open to international trade, the country's disinflation benefits from the lower levels of external inflation. He/she added that, domestically, the expected weakness of national economic activity would contribute to mitigate inflation pressures over the planning horizon. Finally, he/she stated that the level of monetary restriction should be consistent with the fading of pressures stemming from the global shocks, which at the time led to a rise in the reference rate for 15 consecutive meetings, accumulating 725 basis points of increases. Considering all of the above, he/she noted that this decision should be communicated in the context of progress in global shocks' fading, and taking into account that the effect of the rebound in non-core inflation on headline inflation is only in the short term, as well as the current level of monetary restriction and that prevailing in the event of an interest rate cut. He/she highlighted that it will be essential to emphasize that, in line with the central bank's commitment to its primary mandate, the monetary policy stance will continue being clearly restrictive and, therefore, will continue acting to ensure that inflation converges to the 3% target. He/she estimated that, looking ahead, the inflationary environment will allow to continue discussing reference rate adjustments. However, he/she acknowledged that a gradual approach will need to be maintained.

Another member commented that both the reversal of shocks associated with the pandemic and geopolitical conflicts as well as a restrictive and timely monetary policy stance by the central bank have allowed for significant progress in the disinflationary process. However, he/she considered that the outlook for the conduct of monetary policy continues to be very complex in light of the unfavorable inflationary dynamics in recent months. He/she highlighted that headline inflation has continued increasing due to a greater and longer-lasting rebound in the non-core component than expected. He/she argued that the supply shocks that have led to this rebound will not necessarily dissipate rapidly, potentially contaminating core inflation. He/she stated that the latter depends, in part, on their effects on inflation expectations, as well as on the monetary policy response. For this reason, he/she warned that it would be risky to begin a downward cycle when non-core inflation is trending significantly upwards. He/she pointed out that the recent slower decline in core inflation has occurred despite the monetary restriction. He/she stated that the forecast of lower inflationary pressures in light of the weakening of economic activity could be offset by the ongoing resilience of aggregate demand. He/she noted that tensions in financial markets due to idiosyncratic and global factors have added to this complex inflationary dynamic. He/she indicated that exchange rate pressures could continue and escalate, which could hinder the disinflationary process even in light of the expected slowdown in economic activity. He/she highlighted that both inflation expectations and the exchange rate have been the two main channels through which monetary restriction has been operating. He/she noted that since the adoption of a floating exchange rate regime, the pass-through effect has diminished, although this does not mean that exchange rate dynamics are not relevant for the trajectory of inflation. He/she argued that the pass-through effect can only remain bounded if markets' confidence in the central bank's commitment to its primary mandate is maintained. He/she considered that this is an additional reason to conduct monetary policy with caution in episodes of high exchange rate volatility such as the current one. He/she argued that in this environment an adjustment in the monetary policy stance should not be rushed and, instead, a risk management approach should be favored.

One member considered that the conduct of monetary policy requires analyzing both the observed data and the expected determinants of inflationary dynamics. With respect to inflation data, he/she pointed out that the recent readings show a differentiated behavior in its components. He/she highlighted the decline in the core component over

18 consecutive months, which is something unseen since the implementation of the inflation-targeting regime and clearly responds to the monetary restriction. He/she mentioned that, in contrast, non-core inflation has continued rising due to different supply shocks. He/she stated that these shocks appear as short-term determinants of inflation; however, since they concentrate in agricultural and livestock product prices, they only have limited indirect effects, provided that expectations remain anchored. He/she also mentioned, among medium-term determinants, the weak economic activity data, which could contribute to better behavior of the services subcomponent. He/she added that two inflation determinants, expectations and the exchange rate, are also the two transmission channels that have performed better in the current cycle and are unlikely to cease contributing to disinflation, provided that an absolute restrictive stance and an adequate relative stance are maintained. He/she emphasized that a long-term determinant is the central bank's unwavering commitment to reducing inflation towards its target, as shown by the level of monetary restriction attained. In this regard, he/she recalled that the real ex-ante rate is more than twice the upper limit of the neutral range and that the nominal rate is almost twice the observed inflation. He/she stated that the difference between the interest rate gap and the inflation gap is one of the highest among the main emerging economies and is the largest if core inflation is considered. He/she argued that the monetary restriction should also be evaluated in terms of its duration, which is nearing two years and which, he/she considered, will extend throughout the planning horizon. He/she indicated that, even after taking into account the reference rate adjustment, there will be a stance adequate and consistent with the expected pressures on inflation. He/she considered that the pauses in May and June allowed to assess both the disinflationary process and the functioning of the transmission channels. He/she indicated that the monetary policy stance should be as efficient as possible in order to consolidate disinflation and ensure an orderly adjustment of the economy and markets. In this regard, he/she stated that it should be emphasized that the task is yet to be concluded and that a vigilant approach should be maintained. He/she commented that it is appropriate to continue with a data-dependent approach in which gradualism prevails. He/she highlighted that, looking ahead, adjustments may even continue to be spaced out and not proportional to the expected decline in inflation for the remainder of the year.

Another member recalled that in the previous monetary policy decision the target rate remained at 11%, in a context of increasing headline inflation, persistence in services inflation, inflation expectations above the central bank's forecasts, and a balance of risks for inflation biased to the upside. He/she mentioned that in the last six weeks, in his/her opinion, data have not improved and suggest an even more complex environment, in which increased uncertainty has not dissipated. He/she warned that, in an environment in which the expectations channel is the most important, there is a lack of credibility in Banco de México's inflation forecast, given that none of the expectations surveys anticipate reaching the 3% target by the end of 2025 and, on the contrary, they foresee higher inflation levels. He/she argued that chronic optimism stemming from an inflation forecast targeting framework that considers a target rate determined under the assumption that the 3% inflation target is attained in a horizon of eight quarters should be avoided. However, he/she pointed out that if this assumption is not imposed, forecast inflation would not be very different from analysts' expectations, which could be reflecting the perception of a monetary policy that has a low incidence. Therefore, he/she stated the need to maintain a firm restrictive policy stance, given an inflation that is off the target range. He/she emphasized that credibility is a central issue, and therefore it is crucial to convey to the public that all possible measures will be taken to meet the inflation target in order for monetary policy to be more effective. He/she estimated that, with inflation risks to the upside, an increasing inflation trajectory, and unfavorable inflation expectations, the monetary policy stance cannot be eased yet. He/she considered that the mixed signals from the Federal Reserve regarding further easing, exchange rate depreciation, and the recent volatility in financial markets, should play a secondary role in the monetary policy decision given their limited progress in curbing inflation. He/she stated that the effects of the external environment on the relative monetary policy stance are yet to be defined. He/she argued that a premature monetary easing could hinder the attainment of the primary objective and that for this reason the monetary policy stance cannot be adjusted at this time. He/she pointed out that both international institutions and multiple academic studies warn about the relevance of avoiding a premature easing. He/she stated that the signal sent by this adjustment would be more relevant than the level of the reference rate itself and that, under the current conditions, lowering the target rate would send the wrong message of being content with rising headline inflation. He/she added that if services inflation does not show any progress, headline inflation is not declining, and inflation expectations are not more aligned with the central bank's targets, it will be difficult to send signals in another direction.

One member stated that the economy continues facing two shocks that have become more intense and have opposite effects on inflation. He/she mentioned that, on the one hand, the exchange rate continued registering volatility and depreciated, while, on the other hand, he/she expects a slightly greater easing of slack conditions than previously anticipated in June. He/she recalled that the pass-through from the exchange rate to prices is low, and that the greater economic slack will help mitigate the risk of a greater pass-through. He/she added that signs of deceleration would indicate that the shock to economic activity will last longer, affecting the entire monetary policy horizon. He/she delved into the information suggested by the central bank's forecast, by reiterating, on the one hand, that the revision to headline inflation is attributed to supply shocks, with the convergence timeline remaining unchanged, and, on the other hand, that core inflation is anticipated to continue decreasing. He/she highlighted that expectations for core inflation for 2024 and for the next twelve months have decreased, which indicates that markets do not perceive that shocks are contaminating core inflation. Regarding the level of monetary restriction, he/she mentioned that, given the behavior of inflation expectations, the 25-basis point reduction in the reference rate in March has resulted in a decrease of only 9 basis points in the real ex-ante interest rate. He/she underlined that its level is almost twice the upper limit of the neutral range, making it highly restrictive under any metric. In view of the shift in the monetary policy outlook in other economies, he/she stated that even with rate cuts, the relative monetary policy stance will continue to be robust. Considering this solid absolute and relative policy stance, he/she rejected the notion that reductions reflect complacency. In this regard, he/she commented that a restrictive stance will continue to be essential and, in this regard, he/she considered that the monetary policy stance has margins. He/she stated that, although at the time it was necessary to take the reference rate to maximum levels, in response to the unprecedented shocks, now the current inflation challenges are of a different nature, given that the higher readings of headline inflation are explained by its non-core component. In this context, he/she emphasized that convergence to the inflation target and an adjustment to the level of monetary restriction are compatible. He/she added that reference rate cuts aligned with the central scenario must not be postponed, as there is the risk of managing monetary policy with a lag, incurring unnecessary costs for the economy. He/she pointed out that monetary policy should be conducted prospectively, considering both the observed and the expected determinants, without overweighting any specific data point. He/she considered that a gradual approach allows for acknowledging progress in the disinflationary process, while continuing to address the prevailing challenges in a responsible manner.

3. MONETARY POLICY DECISION

The Governing Board assessed the behavior of inflation and its determinants, as well as of inflation expectations. It considered the nature of the shocks that have affected the non-core component and the projection that their effects on headline inflation will dissipate over the next quarters. It took into account core inflation's trajectory and the fact that it is anticipated to continue decreasing. It estimated that, although the outlook for inflation still calls for a restrictive monetary policy stance, its evolution implies that it is adequate to reduce the level of monetary restriction. Thus, with the presence of all its members, the Board decided by majority to lower the target for the overnight interbank interest rate by 25 basis points to 10.75%.

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

4. VOTING

Voting in favor of the decision were Victoria Rodríguez, Galia Borja, and Omar Mejía. Irene Espinosa and Jonathan Heath voted in favor of maintaining the target for the overnight interbank interest rate at 11.00%.

5. DISSIDENT OPINIONS / VOTES

Vote. Irene Espinosa

Given the complex inflationary environment, we should avoid rushing into adjusting the monetary policy stance. It is imperative to remain cautious and prioritize a risk management approach, for the benefit of the central bank's credibility. Headline inflation has continued to increase consecutively for five months, reaching levels unseen in more than twelve months and deviating further from the 3% target. Our forecasts have once again been adjusted upwards; core inflation decreases ever more slowly; non-core inflation continues at high levels and will likely remain above our forecasts, while the risk of the core component becoming contaminated is not negligible; inflation expectations remain above our forecasts and do not show any signs of inflexion; and the balance of risks continues biased to the upside. Looking ahead, foreign exchange volatility could intensify due to domestic and external factors. This would jeopardize the disinflationary process, even considering the anticipated slowdown in economic activity. Under the circumstances and risks outlined above, a reference rate cut would undermine the central bank's credibility regarding its commitment with the constitutional mandate of ensuring price stability.

Vote. Jonathan Heath

The decision to ease the monetary policy stance undermines our credibility given that headline inflation has increased in the last five months and is now at 5%. Core inflation is currently at 4.0%, and surveys indicate that it will remain at that level at the end of 2024 and barely reach 3.8% at the end of 2025; that is, they do not anticipate a decline in inflation. Nine institutions even anticipate that in December 2024 core inflation will be higher than its current levels. Our trajectory for core inflation for the next eight quarters is overly optimistic and lacks credibility. Current inflation figures and its medium-term expectations simply do not support this decision. The monetary policy regime that Banco de México adopted many years ago aimed at eliminating fiscal dominance and focusing the Governing Board's efforts on price stability above all. Voting in favor of easing the monetary policy stance at this time, given a high fiscal deficit and a yet-to-be-confirmed weakness of economic activity, while inflation is still far from target, may be interpreted as premature as long as there is no certainty that inflation is on track, as supported by more solid data.

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.

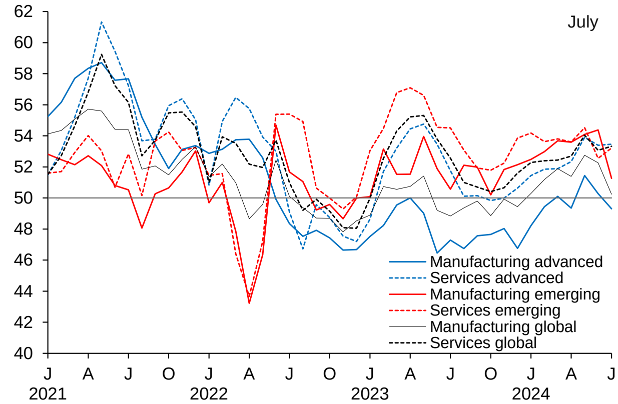
A.1. External conditions

A.1.1. World economic activity

World economic activity is estimated to have grown at a more moderate rate during the second quarter of 2024 as compared to the previous one, albeit with heterogeneous behavior among countries. This reflected, in general, the slower growth of emerging economies, after their robust performance during the first quarter. Advanced economies, on the other hand, are estimated to have expanded at a faster pace than in the previous quarter. Purchasing Managers' Indices for July point to progress in the services sector at the global level (Chart 1). These indices also suggest a deceleration in manufacturing activity in emerging economies and a stagnation of this sector in advanced economies. Recent world trade indicators grew at moderate rates compared to the first quarter. Among global risks the following stand out: the intensification of geopolitical turmoil; the protraction of inflationary pressures; greater volatility in financial markets, and, to a lesser extent, the challenges to financial stability.

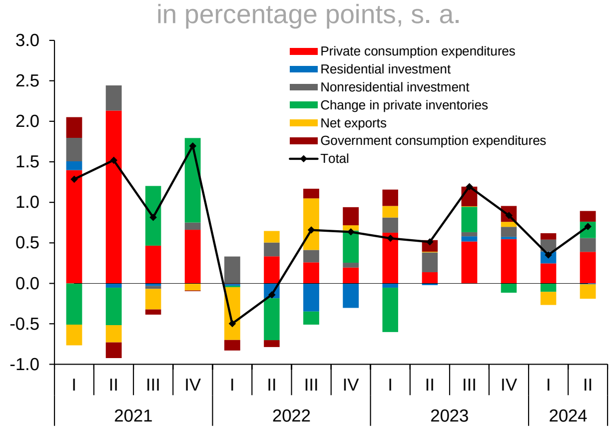
During the second quarter of 2024, the US economy grew at a faster pace than in the previous quarter, supported by a solid domestic demand. GDP grew at a seasonally adjusted quarterly rate of 0.7%, after having increased 0.4% in the first quarter (Chart 2).[1] This performance mainly reflected positive contributions from private consumption, changes in inventories, and non-residential investment.

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.
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.
Source: Bureau of Economic Analysis (BEA).

US industrial production increased at a seasonally adjusted monthly rate of 0.6% in June, after having grown 0.9% in May. The performance of industrial activity in June resulted from a 2.8% increase in the electricity and gas generation sector and to the respective growth of 0.4 and 0.3% in manufacturing

* 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 annualized quarterly rate, the change in the US GDP was 1.4% in the first quarter of 2024 and 2.8% in the second one.

production and the mining sector. Purchasing Managers' Indices point to a stagnation of manufacturing activity in July.

The US labor market has shown more evident signs of easing, moving towards a better balance between labor supply and demand. The non-farm payroll continued to exhibit a moderation in its rate of expansion, registering 114 thousand new positions in July, below the monthly average of the first quarter of 276 thousand new jobs and 179 thousand new jobs registered in June. July's figure is one of the lowest readings in the period of post-pandemic recovery. Initial claims for unemployment insurance have been trending upwards since the end of April, standing at 249 thousand new claims in the week ending July 27. The unemployment rate grew from 4.1% in June to 4.3% in July, its fourth consecutive increase. These increases placed it at its highest level since November 2021. After trending downward since May 2022, the number of job vacancies remained stable at around 8.2 million in May and June, still above pre-pandemic levels. On the other hand, the variation of the employment cost index decreased at a quarterly rate from 1.2% in the first quarter to 0.9% in the second quarter. Lastly, average hourly wages continued decelerating, from an annual variation of 4.0% in June to 3.8% in July.

In the second quarter of the year, economic activity in the euro area grew at a similar pace to that observed in the first one.[2] This was mainly supported by the expansion in the services sector. The labor market in the euro area remained strong. The unemployment rate increased from 6.4% in May to 6.5% in June. Despite the increase at the margin, it remains at historic lows. This took place in a context in which the labor force participation rate has been increasing.

Regarding the rest of the major advanced economies, they are expected to expand in the second quarter of 2024, although with differences in terms of growth rate. Specifically, Japan's economic activity is expected to recover, following the sharp contraction observed in the previous quarter. Labor markets in said group of economies generally exhibited signs of easing. Nevertheless, they remained tight.

Most of the major emerging economies are expected to have shown lower dynamism in the second quarter of the year compared to the previous one, mainly in Emerging Asia and Latin America. This was the case of the Chinese economy. Its economic activity slowed down compared to the first quarter of the year. This was despite the various stimuli implemented by its authorities to boost growth. Its GDP grew at a seasonally adjusted quarterly rate of 0.7%, after having expanded at a rate of 1.5% in the previous quarter.[3] This performance reflected a weaker dynamism of consumption and a still depressed real estate activity, which was partially offset by the strength of exports and manufacturing activity.

Since Mexico's last monetary policy decision, international commodity prices have generally declined. Oil prices decreased throughout most of the period. Although towards the end of June and the beginning of July crude oil prices registered an increase in light of the expectation of a higher demand in the northern hemisphere during summer, they began trending downwards as of the second week of July. The latter was partly due to prospects of lower demand from China. In early August, crude oil prices were subject to additional downward pressures as stock markets fell sharply, reflecting a relatively more negative outlook for the US economy as compared to expectations up to July. Likewise, the geopolitical conflict in the Middle East caused episodes of volatility in crude oil prices. Natural gas prices, in general, were subject to downward pressures due to the expectation of lower demand in the United States, as well as relatively higher inventory levels in that country and in Europe. Nonetheless, prices in Europe were under upward pressures in the last week of July, partly due to the lower gas production in Norway and Australia, as a result of the maintenance of their processing infrastructure as well as of supply concerns related to the conflict in the Middle East. Grain prices decreased mainly as a result of higher harvests in the United States and favorable weather that has generated expectations of increased agricultural production in that country. Industrial metal prices declined as a result of expectations of a lower demand from China and relatively high inventory levels in several countries. Meanwhile, precious metal prices rose in response to expectations that financial conditions would ease sooner than anticipated at the end of the first quarter of the year.

[2] Expressed as a seasonally adjusted quarterly rate, the change in euro area GDP was 0.3% in the first quarter of 2024 and 0.3% in the second quarter. Expressed as a seasonally adjusted annualized quarterly rate, the change in euro area GDP was 1.1% in the first quarter of 2024 and 1.0% in the second quarter of 2024.

[3] Expressed as an annual rate, the GDP growth rate of China was 5.3% in the first quarter of 2024 and 4.7% in the second one.

Thus, the price of gold reached record highs during the third week of July.

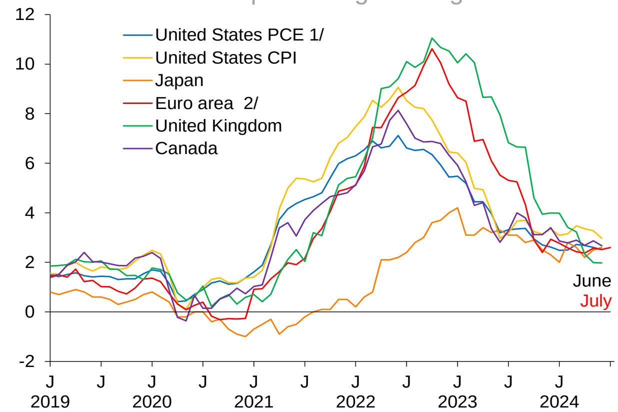
A.1.2. Monetary policy and international financial markets

In most advanced economies, annual headline inflation decreased in its most recent reading, following slight increases in some countries over the previous months (Chart 3). The reduction was generally attributed to lower pressures on food prices and to the core subindex, mostly its goods and, in some cases, energy components. In most advanced economies, headline inflation remained above the central banks' targets. However, in some cases, including the United Kingdom and Canada, it was at its point target or within the variability interval of each central bank.

In the United States, annual headline inflation measured by the personal consumption expenditure deflator decreased from 2.6% in May to 2.5% in June. This reduction reflected the fall in annual inflation of energy products. Core inflation remained practically unchanged at 2.6% during the same period. Nevertheless, since May, the monthly variation of the core component has been below the levels observed in the first quarter, mainly due to lower pressures on services prices. The CPI inflation decreased from 3.3% in May to 3.0% in June, while its core component went from 3.4 to 3.3% between the same months.

Analysts' inflation forecasts foresee a moderation in headline inflation at the end of 2024 compared to the current levels in some of the main advanced economies. Meanwhile, longer-term inflation expectations drawn from financial instruments for some of these economies were revised downwards, especially in recent weeks, with respect to expectations registered in the last week of June. Both short- and long-term inflation expectations remained at levels above the inflation targets in most advanced economies.

Chart 3
Selected advanced economies: headline inflation
Annual percentage change



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

In a large number of emerging economies, annual headline inflation increased in its most recent reading. This occurred, partly, due to higher pressures on energy and food prices. Despite the above, in several cases headline inflation was within the variability range considered by each central bank. Meanwhile, core inflation declined in most of these economies.

In this context, since Mexico's last monetary policy decision, the central banks of the major advanced and emerging economies adjusted their reference rates in a heterogeneous manner, considering the specific circumstances of each country.

In the main advanced economies, most central banks continued to gradually reduce their securities' holdings and some central banks lowered their reference rates. The Bank of Canada cut its interest rate in July for the second consecutive time and the Bank of England announced its first rate cut since 2020. Other central banks kept them unchanged, including the US Federal Reserve. In contrast, the Bank of Japan raised its rate. The latter, together with the lesser dynamism of the US labor market, contributed to the recent volatility in international financial markets.

Specifically, at its July meeting, the US Federal Reserve left the target range for the federal funds rate unchanged for the eighth consecutive decision. Thus, it remained between 5.25 and 5.50%. The Federal Open Market Committee (FOMC) noted that the risks associated with meeting its employment and inflation goals continue moving towards a better balance and that it is attentive to the risks to both parts of its dual mandate. Although it mentioned that there has been some additional progress toward the inflation target, the Committee reiterated that it does not expect it would be appropriate to reduce the target range for the federal funds rate until it has greater confidence that inflation is converging sustainably toward the 2% target. Additionally, the Federal Reserve continued reducing the size of its balance sheet.

During the press conference, the chairman of the Federal Reserve stated that inflation data of the second quarter have generated greater confidence that inflation is converging sustainably toward 2%. He added that the Committee has not made any decisions regarding future meetings and that, although the Committee's general sentiment is that the economy is approaching the point at which it will be appropriate to reduce the reference rate, this will depend on economic indicators. He indicated that, if the data, the evolution of the economic outlook and the balance of risks are consistent with increasing confidence in the sustained downward trajectory of inflation and with a solid labor market, the rate cut could take place at the September policy meeting.

The European Central Bank decided to keep its reference rates unchanged at its July meeting, after having cut them by 25 basis points (bps) in its June decision. Thus, its refinancing, key lending, and key deposit rates stand at 4.25, 4.5, and 3.75%, respectively. Its Governing Council noted that headline inflation will likely remain above target until next year. 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 promptly. The Council reiterated that it will maintain an approach dependent on economic and financial data to determine the appropriate duration and degree of such tightening. It reaffirmed that it was not committing to a specific monetary policy path. Regarding the Pandemic Emergency Program (PEPP), as of July the Governing Council discontinued reinvesting all payments on securities' holdings acquired under the program, reducing the portfolio by an average of EUR 7.5 billion per month, and it plans to discontinue reinvestments at the end of 2024.

At the press conference, the president of the European Central Bank pointed out that, despite being on a disinflationary path, domestic pressures on prices continue to be high, and the interconnection between wages, profits and productivity can generate uncertainty regarding said path. She indicated that the decision to be made at the September meeting is up for debate and will be determined based on all available data.

In contrast, at its July meeting, the Bank of Japan raised its reference rate from a range of 0.0 to 0.1% to around 0.25%, a move that had not been anticipated by analysts. This occurred after the central bank had previously increased it in March and had maintained it at negative levels for over eight years.[4] The Bank of Japan also announced a plan to reduce the amount of Japanese government bond purchases. The Board of that central bank noted that the country's economic activity and prices have evolved in line with its April forecasts. It mentioned the increase in investment, the resilience of private consumption, and wage increases. In this regard, the Board deemed it appropriate to adjust the accommodative level of monetary policy to attain the inflation target in a sustainable and stable manner. It indicated that it expects real interest rates to remain significantly negative and that accommodative financial conditions will continue supporting economic activity. The Board indicated that, going forward, if most recent forecasts for economic activity and prices materialize, the bank will continue raising the reference rate and adjusting the level of monetary policy accommodation. During the press conference following the monetary policy decision, said central bank governor noted that future increases will be data-dependent and indicated that there is still some road ahead to reach the neutral rate.

In the main emerging economies, some central banks, mainly those in Latin America and Eastern Europe, continued lowering their reference rates. However, some of these central banks moderated the magnitude of their rate cuts or even left their rates unchanged in their most recent decisions. The central bank of China announced cuts in several of its reference rates in July. These included the 7-day reverse repo rate, the 1-year loan prime rate (LPR)

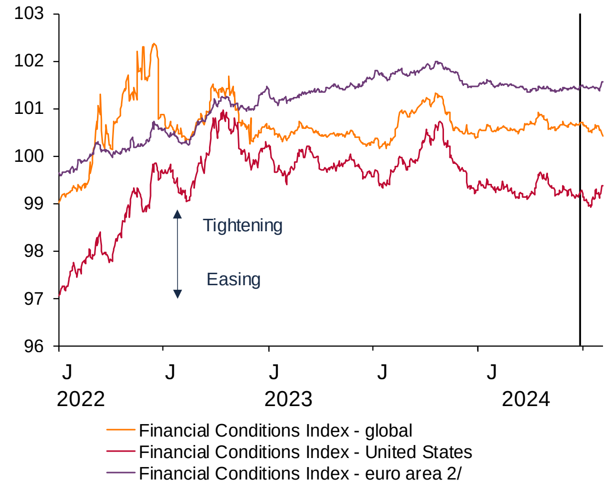
[4] At its March meeting, the Bank of Japan raised its reference rate from -0.1% to a range of 0.0 to 0.1%, after having maintained it at negative levels for over eight years. This was the first rate-hike since 2007. At that meeting, it removed the yield curve control that kept the target level of the Japanese ten-year government bond (JGB) interest rate at around 0%. At its April and June meetings, it left the reference rate unchanged. At its July meeting, it announced a plan to reduce the amount of its monthly Japanese government bond (JGB) purchases to around 3 trillion yen in January-March 2026. In principle, the amount will be reduced by around 400 billion yen each quarter. It also announced changes in the interest rates it applies to various facilities, including the supplementary deposit facility and the provisioning measure to stimulate bank lending.

and the medium-term lending facility rate (MLF), which had not been adjusted since August 2023. In addition, the Central Bank of Russia has recently increased its reference rate by 200 bps, raising it to its highest level since April 2022.

Regarding future actions, the central banks generally indicated that further rate adjustments will remain dependent on incoming economic data and their implications for the inflation outlook. 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.

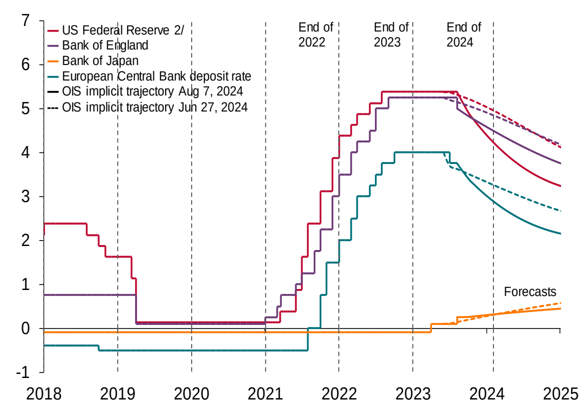
In the first half of July, international financial conditions eased somewhat after the release of lower-than-expected inflation data in the United States and employment data indicating a better balance between supply and demand in the labor market. This led to a downward adjustment in the expected path for the federal funds rate. Starting on the second half of July, the easing of global financial conditions reversed, partly due to the high volatility in stock markets in some advanced economies, largely as a result of corrections in the high technology sector in the United States In addition, at the beginning of August, the publication of labor market data suggesting a lower employment dynamism in the United States generated concerns about the economic outlook in that country and a further deterioration in global financial conditions (Chart 4). The Bank of Japan's unexpected increase in reference rates also contributed to said deterioration. This episode of volatility accentuated the differences in the expected trajectories of reference rates implicit in swap curves (OIS) (Chart 5). Thus, particularly for the United States and the euro area, the implied trajectories foresee reference rate cuts at the end of the third quarter of 2024, with cumulative rate cuts between 70 and 120 bps during 2024.

Chart 4
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.

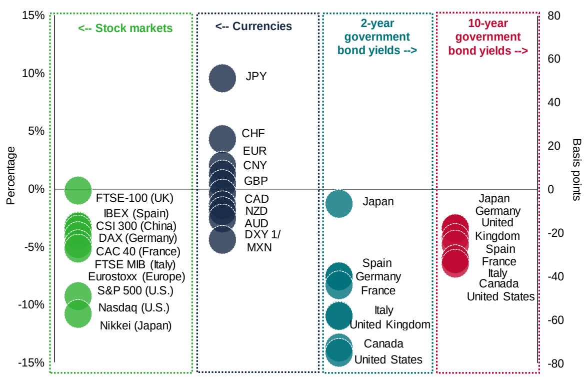
Chart 5
Reference rates and trajectories implied in OIS curves[1/]
Percent



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.

As a result of the aforementioned factors, medium- and long-term rates in most of the major advanced and emerging economies decreased significantly. Stock markets in advanced economies fell, exhibiting significant volatility, especially in Japan and the United States (Chart 6). In foreign exchange markets, the US dollar depreciated against most advanced economies' currencies. Likewise, at the beginning of August, the yen appreciated considerably, which contributed to a greater volatility in foreign exchange markets as elevated short positions against the Japanese yen were liquidated to finance carry trade positions in the currencies of countries with higher interest rates (Chart 7). This derived from the expectation that the Bank of Japan will continue raising the country's reference rates in the future. Lastly, since the last monetary policy decision, there have been net capital inflows to emerging economies both in equity and fixed income assets.

Chart 6
Change in selected financial indicators from June 27 to August 7, 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 June 21, 2024
Percent, basis points

Region	Country	Currencies	Equity markets	2-year interest rates	10-year interest rates	CDS
Latin America	Mexico	-8.10%	-1.03%	-56	-30	13
	Brazil	-6.48%	3.72%	13	-19	5
	Chile	-2.23%	-2.67%	29	-18	9
	Colombia	0.34%	-3.55%	-106	-45	-4
	Peru	1.67%	-4.24%	-9	-28	8
Emerging Europe	Russia	4.61%	-5.24%	319	167	N.A.
	Poland	2.89%	-5.52%	-50	-61	0
	Turkey	-1.68%	-2.77%	-124	-50	17
	Czechia	1.34%	2.44%	-60	-49	2
	Hungary	2.16%	2.61%	-95	-58	-2
Asia	China	1.96%	-3.10%	-21	-14	-1
	Malaysia	6.06%	1.30%	-16	-17	-1
	India	-0.36%	4.89%	-17	-8	-3
	Philippines	1.56%	7.26%	-30	-59	0
	Thailand	3.91%	0.51%	-16	-15	-1
	Indonesia	1.61%	6.22%	-20	-30	1
Africa	South Africa	-3.57%	0.97%	-32	-40	-2

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.

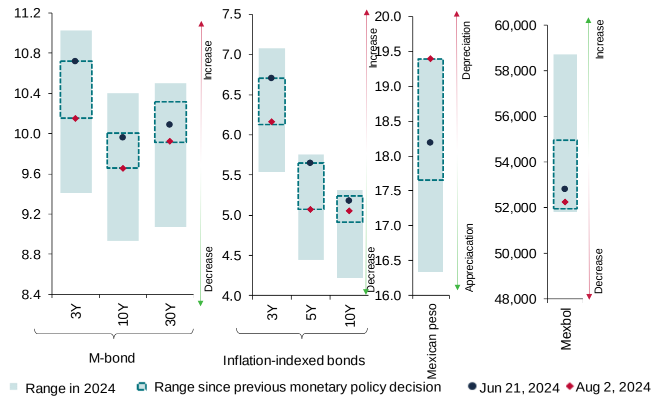
A.2. Current situation of the Mexican economy

A.2.1. Mexican markets

Since Mexico's last monetary policy decision, domestic financial markets were affected by the volatility in international financial markets, with a differentiated performance by asset class. The Mexican peso depreciated significantly against the US dollar, interest rates fell overall, and stock markets were affected by expectations of lower economic growth (Chart 8).

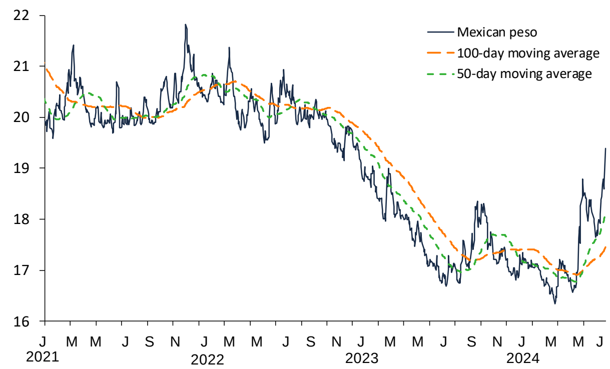
Since Mexico's last monetary policy decision, the Mexican peso traded in a range of 2.64 pesos, between 17.60 and 20.24 pesos per US dollar. During the period, it depreciated 8.10% (Chart 9), due to factors such as the unwinding of carry trade positions against the yen, the evolution of the electoral outlook and economic moderation in the United States, and the persistence of idiosyncratic risk factors. This behavior occurred in an environment characterized by increased volatility and a deterioration in trading conditions.

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



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

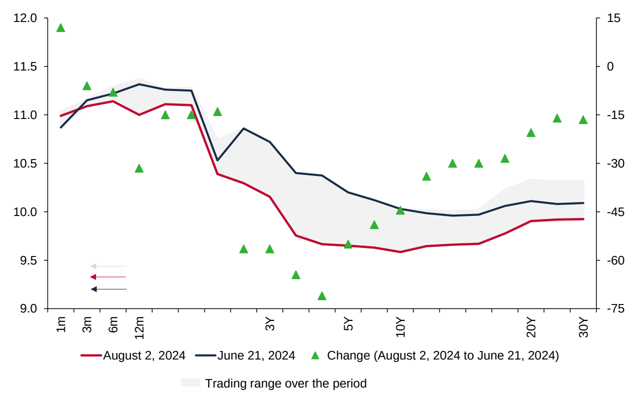
Chart 9
Mexican peso exchange rate
MXN/USD



Source: Banco de México.

Interest rates on government securities decreased along the yield curve, reaching decreases of up to 71 bps in the middle part of the curve (Chart 10). Yields on real-rate instruments also performed positively, with decreases of up to 59 bps in short- and medium-term bonds. 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). Meanwhile, risk premia, including yield spreads between US and Mexican government bond rates, as well as term premia, registered moderate increases. The fixed-income market exhibited an improvement in trading conditions.

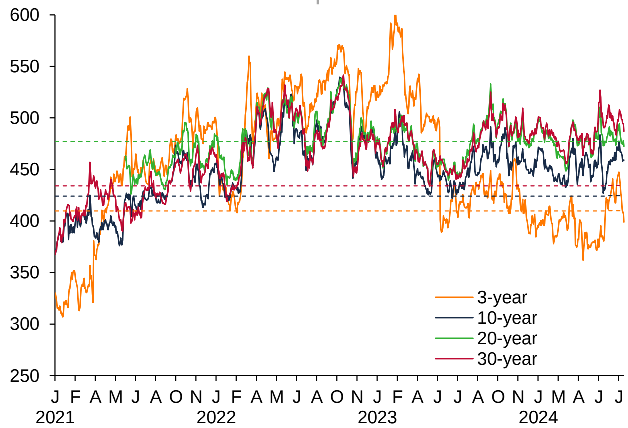
Chart 10
Nominal yield curve of government securities
Percent, basis points



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

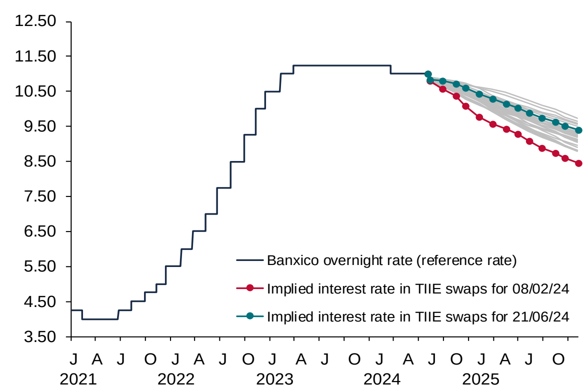
Regarding expectations for the path of the monetary policy reference rate, information implicit in the interest rate swaps curve incorporates with a high probability a decrease in interest rates in the August 2024 decision, with an expectation of 10.10% and 8.59% for the target rate for the end of 2024 and 2025, respectively (Chart 12). In turn, the median of the survey by Citibanamex published on August 6 anticipates a 25-basis-point cut for the September meeting. The median for the end of the year places the reference rate at 10.50%.

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).

Chart 12
Interbank funding rate implied in TIIE swaps
Percent

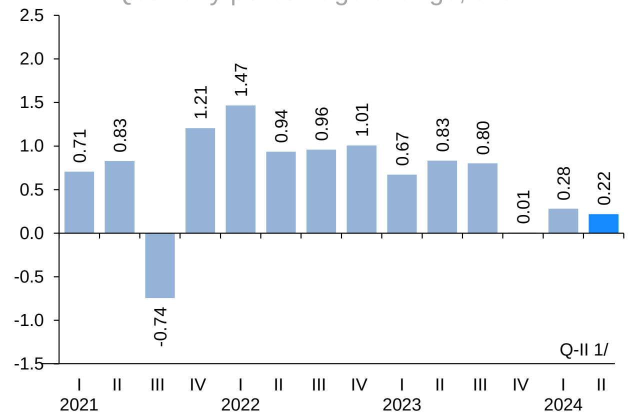


Note: Gray lines represent the range since the last monetary policy decision.
Source: *Proveedor Integral de Precios* (PIP).

A.2.2. Economic activity in Mexico

According to Mexico's GDP flash estimate published by INEGI, in the second quarter of 2024, productive activity registered low growth, thus extending the weakness it has exhibited since the end of 2023 (Chart 13).

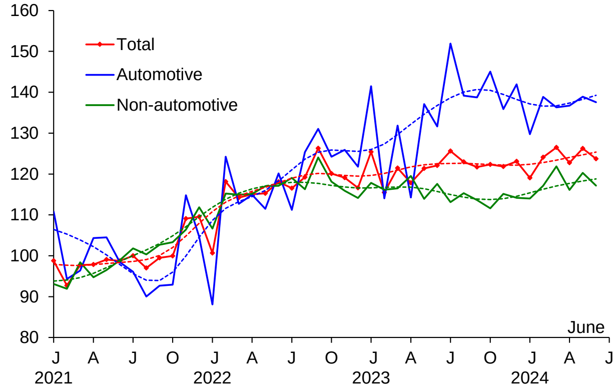
Chart 13
Gross Domestic Product
Quarterly percentage change, s. a.



s. a. / Seasonally adjusted figures. The chart's range was adjusted to facilitate its reading.
1/ The figure for the second quarter of 2024 refers to the timely estimate of quarterly GDP published by INEGI.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Regarding domestic demand, during the period of April-May 2024, consumption contracted with respect to the previous quarter. Within this indicator, both goods and services consumption exhibited weakness. Gross fixed investment continued showing a moderate recovery, although the pace of growth so far in 2024 has been slower than that observed between the last quarter of 2022 and the third quarter of 2023. In this regard, investment in construction continued reactivating, while investment in machinery and equipment continued decelerating. As for external demand, manufacturing exports remained weak during the second quarter of 2024, reflecting some stagnation in both automotive and non-automotive exports (Chart 14).

Chart 14
Manufacturing exports
Indices 2021 = 100, s. a.

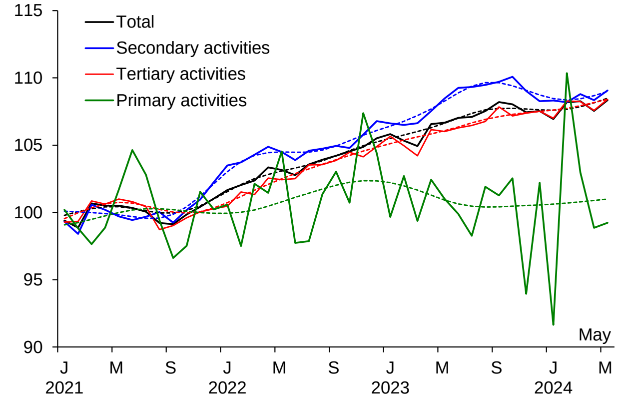


s. a. / Seasonally adjusted series and trend series based on data in nominal US dollars. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Prepared by Banco de México with data from the Tax Administration Service (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.

On the production side, during the period of April-May, services lost dynamism (Chart 15). Despite having increased during the quarter, industrial activity continued performing weakly. This reflected, to a good extent, the sluggishness of the manufacturing sector. In contrast, construction performed better and reached high growth levels. (Chart 16).

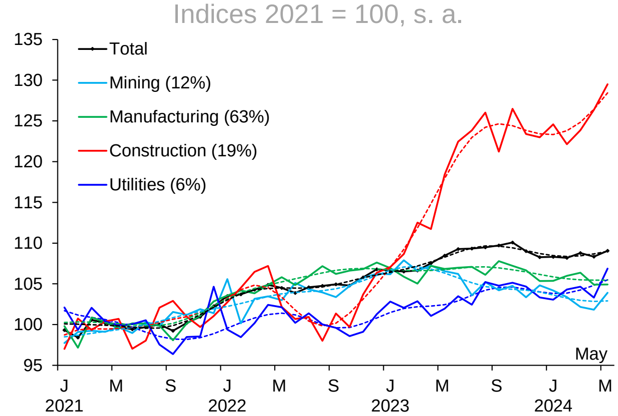
Regarding the cyclical position of the economy, the output gap, which had been becoming progressively less positive, practically closed due to the weakness of economic activity (Chart 17). The labor market continued showing strength in June 2024, albeit with some moderation at the margin. Both national and urban unemployment rates increased in their monthly comparison. However, both remained at low levels (Chart 18). In July, with seasonally adjusted data the number of newly created formal IMSS-insured jobs continued decelerating. Lastly, in May 2024, unit labor costs in the manufacturing sector rebounded to high levels (Chart 19).

Chart 15
Global Indicator of Economic Activity
Indices 2021 = 100, s. a.



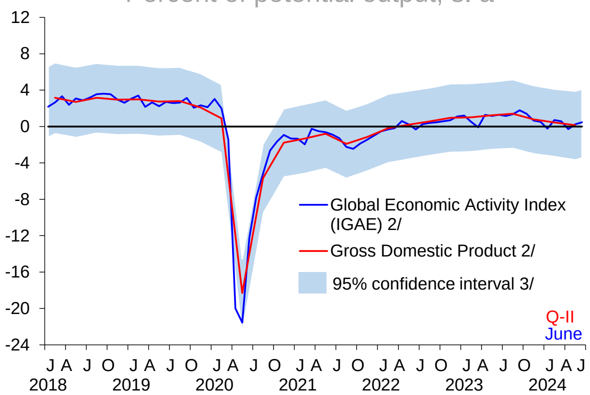
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

Chart 16
Industrial activity 1/
Indices 2021 = 100, s. a.



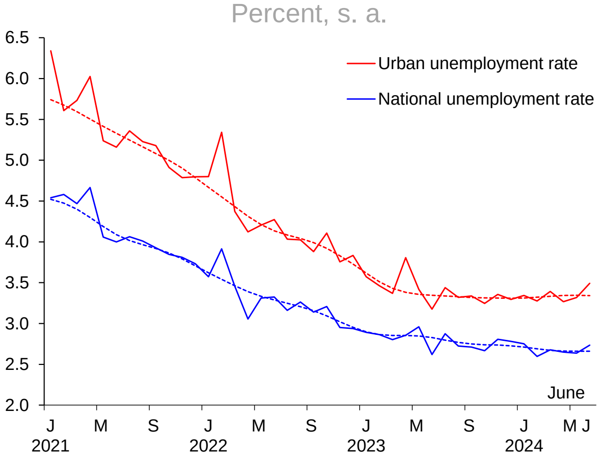
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line
1/ Figures in parenthesis correspond to their share in the total in 2018.
Source: Mexico's System of National Accounts (SCNM, for its Spanish acronym), INEGI.

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



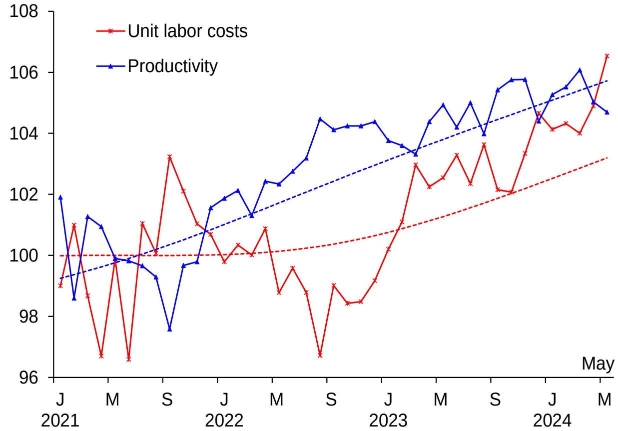
s. a. / Calculations based on seasonally adjusted figures.
1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report, April-June 2009", p.69.
2/ GDP flash estimate up to Q2-2024 and IGAE up to June 2024.
3/ Output gap confidence interval calculated 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: Prepared by Banco de México with data from ENOE, INEGI.

Chart 19
Productivity and unit labor costs in the manufacturing sector [1/]
Indices 2021 = 100, s. a.



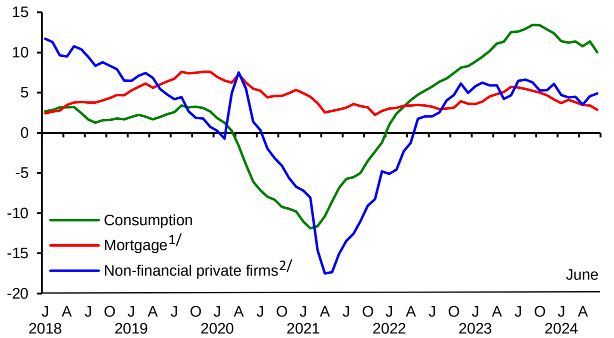
s. a. / Seasonally adjusted series and trend series. The former is represented by a solid line and the latter by a dotted line. The chart's range was adjusted to facilitate its reading
1/ Productivity based on hours worked.
Source: Prepared by Banco de México with seasonally adjusted data of the Monthly 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 June 2024, albeit at a slower pace compared to the dynamism observed throughout 2023. Regarding its components, commercial bank lending to firms registered a lower growth rate than the one observed at the end of the previous year. (Chart 20). Likewise, household loan portfolios continued showing a moderation in their rate of expansion.

As for the cost of financing, interest rates on bank credit to firms remained at high levels in June 2024. Meanwhile, credit intermediation margins did not register significant changes during the period. Bank interest rates on mortgages remained at levels similar to those observed prior to the pandemic. Lastly, regarding commercial bank consumer credit, credit card interest rates did not show significant changes in April 2024, and thus they continued to remain at relatively high levels.

As for portfolio quality, the delinquency rates of bank credit to firms and households remained at low levels in June 2024. In the segment of consumption, this indicator did not register significant changes during the month and thus stopping the upward trend observed since the second half of 2023.

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

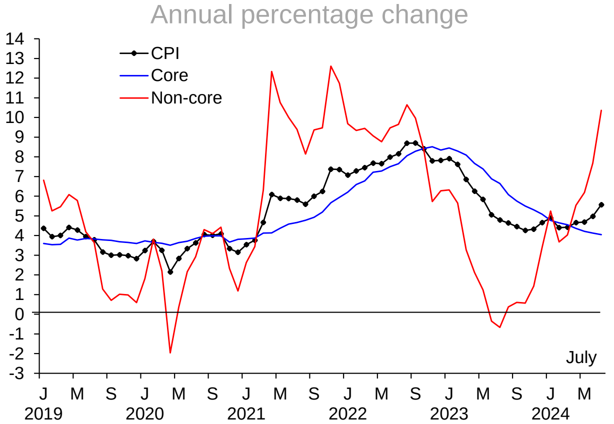


1/ Adjusted to account for the withdrawal from and the incorporation of non-bank financial intermediaries to the credit statistics.
2/ Adjusted for valuation effects due to movements in the exchange rate.
Source: Banco de México.

A.2.3. Development of inflation and inflation outlook

Annual headline inflation increased from 4.98 to 5.57% between June and July 2024 (Chart 21 and Table 1). This upward behavior was due to the increase in non-core inflation. In contrast, core inflation continued declining.

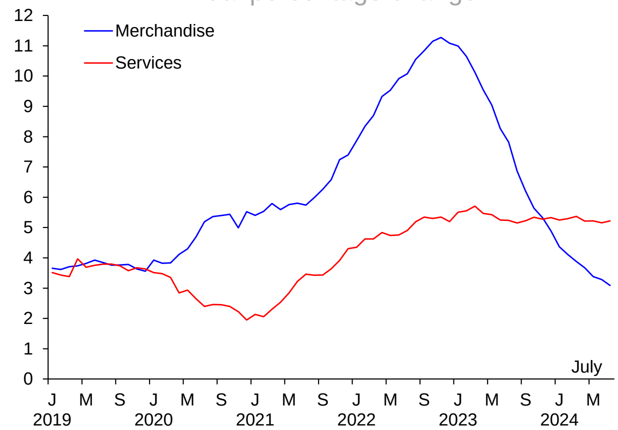
Chart 21
Consumer Price Index
Annual percentage change



Source: INEGI.

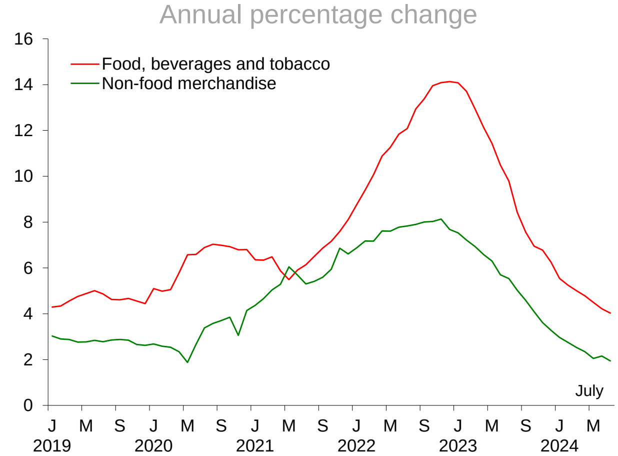
Annual core inflation decreased from 4.13 to 4.05% between June and July 2024. Regarding its components, annual merchandise inflation decreased from 3.28 to 3.09% (Chart 22), influenced by a reduction from 4.22 to 4.03% in food inflation and from 2.16 to 1.95% in non-food inflation (Chart 23). Annual services inflation remained at high levels and without showing a clear downward trend. On those dates, it registered 5.15 and 5.22%, respectively.

Chart 22
Merchandise and services core price subindex
Annual percentage change



Source: INEGI.

Chart 23
Merchandise and services core price subindex
Annual percentage change

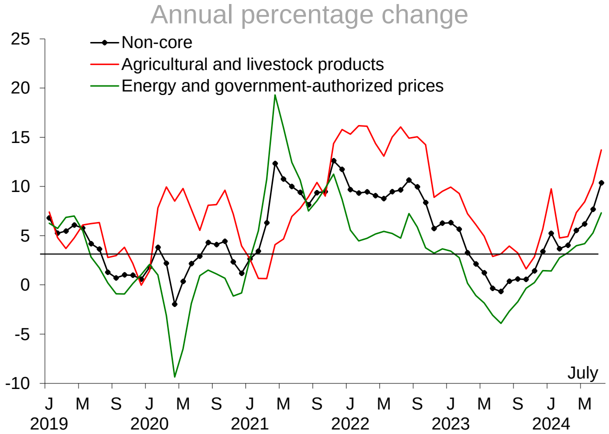


Source: INEGI.

Annual non-core inflation increased from 7.67 to 10.36% between June and July 2024 (Chart 24 and Table 1). This performance reflected pressures on agricultural and livestock prices as well as on energy prices. During said period, annual inflation of agricultural and livestock products rose from 10.36 to 13.72%, mainly driven by an increase from 19.73 to 23.55% in the annual variation of fruits and vegetables prices. This was due to supply shocks that affected the prices of some of its components.

In addition, the annual inflation of livestock products increased from 2.89 to 5.36%. For the same comparison, annual inflation of energy products rose from 6.32 to 9.17%. This result was mainly due to an increase from 12.71 to 25.61% in the annual variation of L.P. gas prices, influenced by the behavior of their international references.

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 May and July 2024, the median of headline inflation for the end of 2024 increased from 4.27 to 4.58%, while that corresponding to the non-core component rose from 4.91 to 6.76%,[5] due to the increase in non-core inflation, which became more evident since the second fortnight of July. In contrast, the median of core inflation decreased from 4.07 a 3.97%. Inflation expectations for the end of 2025 increased. The median of headline inflation rose from 3.71 to 3.83%. The core component remained at a similar level, shifting from 3.70 to 3.71%. At the same time, the median of headline inflation expectations over the next four years remained at 3.70%, while that of core inflation was adjusted from 3.60 to 3.64%. The median of headline and core inflation expectations for the long term (5 to 8 years) remained stable at 3.60 and 3.50%, respectively. Lastly, breakeven inflation tended to increase with respect to the level observed in the last monetary policy decision. Regarding its components, inflation expectations implied in market instruments remained stable, while the inflation risk premium adjusted upwards.

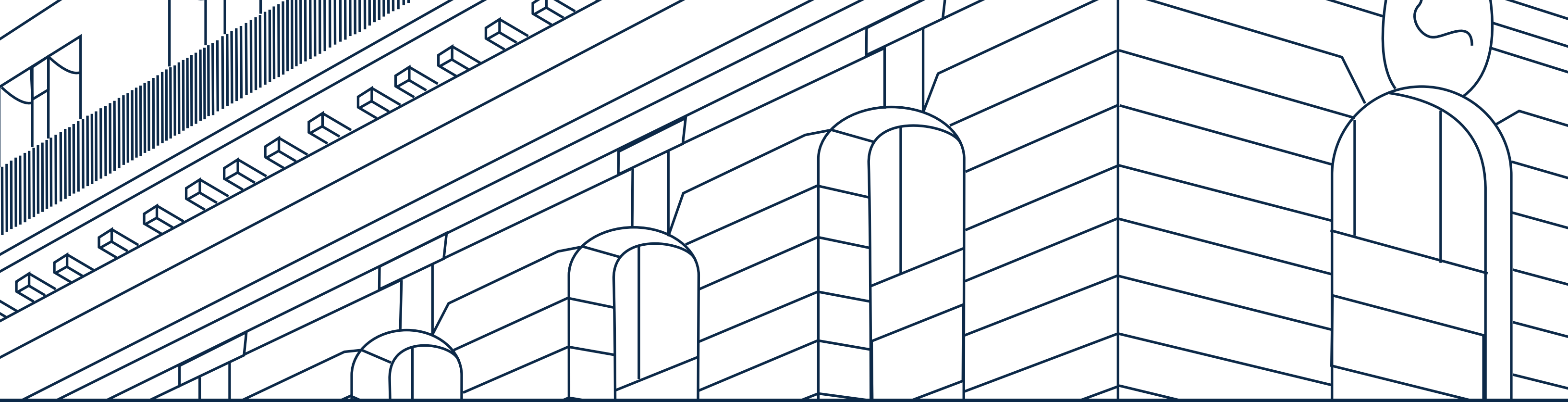
In view of the supply shocks that have affected non-core inflation, the forecasts for headline inflation were revised upwards for the short term. Headline inflation is still expected to converge to the target in the fourth quarter of 2025. These projections are subject to risks. On the upside: i) persistence 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) lower-than-anticipated economic activity; ii) a lower pass-through effect from some cost-related pressures, and iii) a lower-than-anticipated effect of the peso's depreciation on inflation. The balance of risks for the trajectory of inflation within the forecast horizon remains biased to the upside.

[5] Non-core inflation expectations are calculated implicitly for each analyst using headline and core inflation expectations. This calculation is only performed for those analysts who provide a forecast for both headline and core inflation.

Table 1
Consumer Price Index and components
Annual percentage change

Item	May 2024	June 2024	July 2024
CPI	**4.69**	**4.98**	**5.57**
Core	**4.21**	**4.13**	**4.05**
Merchandise	**3.38**	**3.28**	**3.09**
Food, beverages and tobacco	4.49	4.22	4.03
Non-food merchandise	2.05	2.16	1.95
Services	**5.22**	**5.15**	**5.22**
Housing	3.81	3.87	3.96
Education (tuitions)	6.34	6.35	6.36
Other services	6.14	5.96	6.01
Non-core	**6.19**	**7.67**	**10.36**
Agricultural and livestock products	**8.44**	**10.36**	**13.72**
Fruits and vegetables	18.55	19.73	23.55
Livestock products	0.71	2.89	5.36
Energy and government-authorized prices	**4.20**	**5.28**	**7.31**
Energy products	4.81	6.32	9.17
Government-authorized prices	2.88	3.09	3.42

Source:INEGI.



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