

Press article

Mexico | Recap and outlook for monetary policy decisions

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We will learn this month about the last monetary policy decisions of the year in Mexico and the United States. The announcements from the central banks of both countries will be crucial for analysts, market participants, and the general public to gain a clearer understanding of the direction that monetary policy will take next year.

In March 2020, the Federal Reserve (the Fed) cut short-term interest rates nearly to zero and launched a quantitative easing program to boost economic activity amid the then-uncertain effects of the pandemic. Two years later, after a prolonged debate about the transitory nature of inflationary pressures that emerged during the economic recovery that accompanied the rapid development of vaccines, and that were further intensified by the war between Russia and Ukraine, the Fed embarked on the most aggressive rate-hiking cycle in decades, raising its benchmark rate to 4.50% by the end of 2022. Most central banks around the world followed suit.

Mexico was not exempt from facing these global economic challenges. Unlike the Fed and central banks of other advanced economies that began normalizing their monetary stances in 2022, Mexico and other developing countries started raising their benchmark rates from mid-2021. Does that mean that the latter were more accurate in anticipating the pace at which inflation would rise? Not necessarily. While the experience with previous inflationary episodes has led emerging markets to be more reactive, it is also likely that the decision to get ahead of developed countries was in part explained by a preemptive strategy against potential episodes of economic and financial instability triggered by sudden contractions in relative monetary stances.

In any case, the Bank of Mexico (Banxico) adopted a strategy similar to that of the Fed. After cutting its target rate from 7.00 to 4.00% between March 2020 and February 2021, the Governing Board of our country's central bank launched an aggressive cycle of rate hikes from June 2021, raising the reference rate to 10.50% by the end of 2022.

Throughout 2023, the decisions of both the Fed and Banxico were aimed at continuing to consolidate a restrictive monetary stance, albeit at a more moderate and cautious pace. Banxico raised its reference rate two more times, reaching a peak of 11.25% starting in March, while the Fed did so four times, bringing the federal funds rate to 5.50%.

It is very likely that Banxico's Governing Board will decide to keep its interest rate unchanged again this month and may choose to begin a gradual easing cycle as early as the first quarter of next year. Meanwhile, although financial markets anticipate that the benchmark rate in the United States has reached its peak in the current tightening cycle, the Fed has kept the door open to an additional increase. Recent data suggest that the U.S. economy is on track for a sustained slowdown in inflation and a rebalancing of the labor market. Although the Fed has tried to convey the message that it will continue to act cautiously, it is most likely that it will decide to keep the rate unchanged again this month and provide some signals that a monetary normalization cycle could begin by the end of the first half of 2024.

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