Mexico: Macroeconomic outlook and opportunities for the coming years.

Remarks by

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Good afternoon. It is an honor for me to accompany you at this event that represents a unique opportunity for Mexican companies and industry leaders to make themselves known in front of the most influential investors in the financial center of the world.

I am sure many good things can result from bringing together entrepreneurs, investors, senior public officials, and financial market participants in one place.

As you know, one of the purposes of BIVA is to actively contribute to the development and growth of the Mexican economy by promoting investment opportunities to increase domestic and foreign investments in Mexico, through capital markets.

Therefore, I would like to take this opportunity to share some thoughts that, from my perspective as a central banker, I consider fundamental to understanding where we are and how we can contribute to making this goal possible in a sustainable way.

Since June 2019, when the first BIVA-DAY took place, the world has changed in ways we did not then imagine, especially for monetary policy.

This new reality brings challenges and opportunities for the global economy and has fundamental implications on investment opportunities for all.

I will begin by briefly describing the main changes in the economic environment we have experienced over the past three years and then focus on the economic outlook and opportunities for the years to come. Later, I will comment on the current situation of the Mexican capital market, the measures taken to boost its development, and some areas of opportunity we must take advantage of. Finally, I will share with you the progress we have made in contributing to the greening of the financial system, which has become a priority of the financial authorities in our country.

Before I begin, I must acknowledge that my participation in this event is in my personal capacity, so my comments and opinions should not be attributed to the Bank of Mexico or its Governing Board.

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By 2019, before COVID, the world economy was growing rapidly, driven by emerging Asian economies, mainly India and China, while inflation rates in advanced economies were below their central banks' targets. However, there was some moderation in global economic activity due to the escalation of trade tensions between the United States and other economies. Central banks began adopting more accommodative monetary positions in this context, given the absence of inflationary pressures.

Three years later, the international scene is entirely different. The COVID-19 pandemic and the fiscal and monetary policies implemented to mitigate it, together with the effects of the war in Ukraine, have been the main factors that have determined the global economic environment and economic policy priorities in the world.

First, the performance of the global economy is less now than it was three years ago. The slowdown of the Asian emerging economies, especially China, given the pandemic closures and the deepening of the housing crisis, explains part of it. The downward revision of growth in

Europe has also been influenced by the war in Ukraine. In addition, above all, we must highlight the tightening of monetary policy associated with the resurgence of inflation as a global phenomenon.

Lower growth and high inflation have significant implications for capital flows to emerging economies.

In Mexico, the economic landscape has also changed substantially over the past three years. In June 2019, a stagnation of economic activity was already perceived, led by the weakening of domestic demand, particularly investment. However, overall inflation showed a downward trend, while core inflation, which eliminates the most volatile prices and better reflects domestic inflationary pressures, remained above our inflation target of 3%.

Since then, an environment of considerable uncertainty for the growth of the Mexican economy had already stood out, and the risk balance was downwards. The main concerns stemmed from uncertainty due to global trade disputes and the extended ratification process of the USMCA. However, the slowdown in domestic investment and consumption was also a cause for concern. Regarding inflation, while there was also a perception of significant uncertainty, the balance of risks remained balanced.

Currently, the growth outlook has deteriorated, but unlike 2019, it is now mainly responding to the weakening of the external environment. On the other hand, domestic demand has recovered gradually, primarily driven by consumption. However, inflation has risen to unrecorded levels in two decades, and there are signs of price formation contamination and the beginning of the de-anchoring of inflation expectations. Therefore, since June 2021, Banxico began to raise its benchmark rate by 450 basis points from 4% to bring it to 8.5%, the highest level in history.

It is clear that reducing inflation towards our target is a job that needs to be done; otherwise, the costs would be much higher. Thus, we expect to face a global environment characterized by economic weakness with high-interest rates for longer than expected. Price stability is the foundation for investment and sustained growth.

But investment also needs a conducive environment in terms of certainty, rule of law and anticorruption. We have also emphasized the need to tackle these constraints; especially considering the unique opportunities that have emerged in our country during the last three years:

First, the Mexican economy has shown remarkable resilience in the face of the onslaught of the pandemic and is positioned in a prominent situation in relation to its peers. The strength of the Mexican economy can be perceived in the evolution of the relative stability of the Mexican peso. Maintaining a sound macroeconomic framework characterized by fiscal discipline and prudent monetary policy has contributed to this positive outcome.

Second, the ratification and effectiveness of the USMCA opens numerous long-term investment opportunities in Mexico that promote development in the north American region.

Finally, the pandemic and its adverse consequences on global supply chains and fragmentation of trade in some regions have highlighted the advantages of "near-shoring" and "ally-shoring" into production chains, which represents unparalleled opportunities to invest in Mexico.

Opportunities are there, but guaranteeing price stability is necessary in order to take advantage of them. At the Mexican central bank, we are committed to conducting our monetary policy to converge to our inflation target. In the current complex and uncertain international environment, emerging economies have to act forcefully and with a prudent approach. The sooner the better, but we need to ensure an orderly adjustment of markets to make it sustainable and attractive to investors.

Now, let me move on to making some reflections on the capital markets in Mexico.

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My main message is that capital markets have great potential, and regulators have been working to harvest it, but there still a lot to be done.

Despite being the 16th largest economy in the world, Mexico occupies the 20th place regarding stock market capitalization and 25th in the number of listed companies. Stock market capitalization as a percentage of GDP is

33%, far below other Latin American economies such as Chile (84%), Brazil (49%), and Peru (42%).

According to the OECD, the volume traded in the Mexican capital market would have to increase six-fold to achieve the size of its economy. Nonetheless, since November 2017, there have been no IPOs in the Mexican stock market. Likewise, more than five companies have delisted or have started delisting processes during such period. At the end of 2018, the debt issued in capital markets represented only 9% of the total financing of listed companies.

Obstacles hindering Mexico's equity market development are extensive, but I will refer to some of the most relevant.

One of the main problems of the low and limited access by the retail sector, which represent more than 90% of the enterprise sector in Mexico, is investors' notion that going public is costly. They consider that the cost will not be compensated for the risk of losing control of the company and the risks that may come with increased transparency and disclosure.

Therefore, investment funds are highly concentrated in fixed income and liquid assets.

On the issuers' side, weak corporate governance still prevails in addition to slow public placement processes. Companies instead prefer to seek alternative sources of financing other than those offered by the stock market, such as private equity funds instead of a public offering which are more attractive in terms of regulation and corporate governance.

But on the other hand, Mexico is the Latin American leader in the financial technology start-up ecosystem, with 238 companies, followed by Brazil (219), Colombia (124), and Chile (75). It holds second place in hosting unicorns, which surpass one billion dollars in value without being listed on the stock market, both in number and valuation, only after Brazil. This data emphasizes the tremendous potential of the Mexican market. There is also a growing notion of listing advantages over reputational enhancement and increased access to capital.

Mexican financial authorities have given increasing importance to the development of the equity market. The concession of a new stock exchange BIVA, and the approval of significant reforms that aim to strengthen companies' ecosystem in the country speak for this. More actions toward strengthening the market have been implemented, among others:

One: Enabling access to the market for retail investors by reducing transaction costs and simplifying access to digital platforms, increasing the opening of savings accounts, and improving financial education.

Two: Creating a bidirectional market to attract new investors by means of hedge fund schemes or similar investment vehicles, development of securities lending, and increasing coverage of market and information assessment.

Three: Diversification of investors' profiles via institutional investment in specialized mutual funds, optimization of capital cost according to the financial instruments, and alignment of brokerage models toward market needs.

Four: Raising private capital and entrepreneurship by authorizing specialized stock exchanges with specific regulation, like regulatory sandboxes.

Five: Removing access barriers for new and existing issuers by simplifying capital listing for SMEs. Encouraging corporate governance to facilitate market access, creating mechanisms for easy debt issuance processes, and temporarily reducing the tax rate for listed companies.

And six: Increasing attractiveness for foreign investors with tax incentives for individual investors and funds and creating a central clearing house, starting with the bond house.

Looking forward, we need to systematically evaluate the impact of these measures and work together with private participants to push for an improvement in financial education and corporate governance practices.

Finally, I will move to a topic that I personally consider “the name of the game” for the coming years: the greening of the financial system. In this respect, I would like to share the work that Banco de Mexico, together with other financial authorities has done in the last years.

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Since 2017, Banxico has been a founding member of the Network for Greening the Financial System (NGFS), which acknowledged that, "climate-related risks are a source of financial risk. Therefore, it is within the mandates of central banks and supervisors to ensure that the financial system is resilient to these risks."

In this context, both the analysis of the effects that climate risk can have on financial stability, as well as strategies aimed at promoting and greening the financial system, are parts of a joint strategy that must be approached from many fronts.

From my point of view, Banxico's task is to integrate the climate component into its financial system risk analysis to achieve a broader objective with specific ends. Greening the financial system by promoting a more significant capital mobilization towards lower-carbon investments is one of such goals.

Banxico can leverage technical work to model the transmission channels of physical and transitional risks and their interaction with traditional financial risks. This way, we can contribute to the debate on the international agenda and take advantage of its means of dissemination to bring visibility to the issue and internalize it in the national agenda.

To achieve this objective, we have worked on internal capacity building, inter-agency coordination among financial authorities, academic researchers, and international organizations to promote the exchange of knowledge and technical assistance.

Through these efforts, the Sustainable Finance Committee (SFC) as part of the Financial System Stability Council (FSSC) was created. The SFC is an advisory board to the Council on topics related to sustainable finance. The SFC has a clear agenda ranging from developing a taxonomy of sustainable financing and incorporating climate into the financial risk framework using dissemination strategies and promoting green investments. The work of the SFC is in close coordination with broad project on Strengthening the Governance of the Financial System for

Sustainable Development, coordinated by the United Nations Environment Program. On the institutional front, just 10 months ago, Banco de Mexico created a directorate of Environmental and Social Risk Policy and Analysis with the goal of mainstreaming the environmental approach and factors into our main operations and functions. The aforementioned demonstrates our commitment to the transition to a green and inclusive economy.

Concerning ESG standards in Mexico, I would like to share that in a joint effort, in December 2021, we set up a Task Force on Climate-related Financial Disclosures (TCFD) in Mexico, emulating the successful case of the TCFD consortium in Japan. The Mexican TCFD is a private sector platform with the participation of financial authorities as observers, focused on disclosing TCFD recommendations divided into four pillars: governance, strategy, risk analysis, and metrics. This will expedite the disclosure of material information and the use of such information by investors.

I am confident we are already on the right track and moving forward decisively. We are going through an intensive stage in acquiring knowledge and promoting education that should lead us to implement an effective deployment strategy.

Last but not least, I would like to mention that since 2016, private and public Mexican institutions have issued a total of more than 33,000 million pesos in green bonds, of which more than 90% is outstanding today. There is an increasing appetite for these instruments, and the issuances have had a positive performance. I trust it will continue this way.

I will stop here, and I will gladly take your questions now.