

Monetary Policy Implementation through an Operational Interest Rate Target¹

In order to meet the constitutional mandate of keeping inflation under control, the central bank has to define an operational target that guides monetary policy implementation. As of January 21, 2008, Banco de México adopted as its operational target the overnight interest rate (“tasa de fondeo”) as a substitute for the target level for the banks’ balances at Banco de México (a target formerly known as the “corto”).

A central bank cannot directly control inflation or the factors that determine inflation. However, central banks do have the tools needed to directly affect a group of nominal variables that in turn have an impact on the determinants of inflation. These variables are known as operational targets, and among others they include short-term interest rates and balances in the current accounts of commercial banks at the central bank. To implement monetary policy, a central bank must choose one of these operational targets.

Starting in 2003, Banco de México made some changes to its monetary policy implementation. First, the target for the current accounts held at the central bank was no longer determined on the basis of accumulated balances but on the basis of final daily balances. Additionally, the bank decided to establish predetermined dates on which to announce its monetary policy stance.

Later, with the development of the domestic financial market and inflation starting to consolidate at low levels, Banco de México modified its monetary policy implementation procedures. After using its long-term inflation target defined as of 2001, Banco de México found that it needed to be more specific about the desired level of the interest rate and took a series of measures to pave the way for the adoption of an operational interest rate target. Thus, starting in January 2008 Banco de México substituted the [operational target for daily balances](#) (“corto”) for a target rate on the overnight bank funding operations.

On a daily basis, Banco de México provides or withdraws liquidity through [Open Market Operations](#) to guaranty that short term rates remain near the target. Deposits on banks’ current accounts are not remunerated whereas overdrafts are charged twice the target overnight rate.

¹ For more information, see Appendix 3 of the [Inflation Report July-September 2007](#).

The operational interest rate target has several advantages:

- It facilitates the understanding of monetary policy actions and their effectiveness.
- It provides short-term interest rates with more stability and gives monetary policy more importance in shaping the yield curve.
- It standardizes the implementation of monetary policy with that of many central banks around the world.