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Press Release

Monetary Policy Statement

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Banco de México's Governing Board decided to maintain the target for the overnight interbank interest rate at 4.25%.

Global economic activity has been recovering, although heterogeneously among countries and sectors. Global financial markets have performed favorably, driven by progress in the development of vaccines against COVID-19, expectations of additional fiscal stimulus in the United States, and lesser geopolitical uncertainty. In advanced economies, inflation remains below the targets of their central banks, which have reiterated their intention to maintain accommodative monetary policy stances for an extended period. The world economy and international financial markets are subject to several risks, mainly the evolution of the pandemic, vaccine production and distribution, the sufficiency of fiscal stimuli, and other tensions worldwide.

Since the last monetary policy decision, the Mexican peso appreciated, while short-term interest rates exhibited moderate adjustments and long-term interest rates decreased. After having recovered during the third quarter, economic activity in Mexico continued to improve at the beginning of the fourth, although it remains below the levels prior to the pandemic, in an environment of uncertainty and downward risks. Ample slack conditions are expected throughout the time frame in which monetary policy operates.

Annual headline inflation declined from 4.09 to 3.33% between October and November 2020 due to reductions in both its core and non-core components. Core inflation fell from 3.98 to 3.66%, mainly driven by the lower annual change in non-food merchandise prices (from 3.85% to 3.06%). The latter associated with the longer duration and greater intensity of discount sales during "El Buen Fin" period. Looking forward, the behavior of non-food merchandise prices might be influenced by the weakness of demand, which would lead to a more persistent decline in prices, as well as by supply-related effects and a recomposition of spending towards merchandise, which could result in upward adjustments once the sales period ends. Non-core inflation fell from 4.42% to 2.33%, mainly due to decreases in the annual rates of change of fruits and vegetable and gasoline prices. Headline inflation expectations for the end of 2020 were adjusted downwards and those for the medium and long terms remained stable at levels above the 3% target.

The challenges for monetary policy posed by the pandemic include both the significant impact on economic activity as well as a financial shock and their effects on inflation. The recent behavior of headline and core inflation, and of the factors that affect them, imply trajectories within the forecast horizon similar to those foreseen in the last Quarterly Report, and those for the next 12-24 months are still expected to be around 3%. These forecasts are subject to short- and medium-term risks. To the downside: i) a greater-than-expected effect due to the negative output gap, greater social distancing measures or some persistence in the reduction in prices due to "El Buen Fin" sales period; ii) lower inflationary pressures worldwide; and, iii) additional foreign exchange appreciation. To the upside: i) core inflation pressures generated by the recomposition of spending towards merchandise; ii) episodes of

foreign exchange depreciation; and, iii) various cost-related pressures for firms. The balance of risks for the projected trajectory of inflation described above is uncertain.

The risks for inflation, economic activity and financial markets pose major challenges for monetary policy and for the economy in general. Considering the mentioned forecasts for inflation, the uncertainty that surrounds them, as well as the convenience of consolidating a downward path for headline and core inflation towards the 3% target, with the presence of all its members, Banco de México's Governing Board decided by majority to maintain the target for the overnight interbank interest rate at 4.25%. Two members voted for lowering the rate to 4.00%. This pause provides the necessary room to confirm that the trajectory of inflation converges to the target. Looking ahead, monetary policy implementation will depend on the evolution of the factors that have an incidence on headline and core inflation, on their foreseen trajectories within the forecast horizon, and on their expectations.

The Governing Board will take the necessary actions on the basis of incoming information in order for the policy rate to be consistent with the orderly and sustained convergence of headline inflation to Banco de México's target within the time frame in which monetary policy operates. In addition, it is imperative to safeguard the institutional framework, strengthen the macroeconomic fundamentals and adopt the necessary actions on both monetary and fiscal policy fronts, to enable a better adjustment of domestic financial markets and of the economy as a whole.