

August 13, 2020

## Press Release

**Monetary Policy Statement**

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**Banco de México's Governing Board decided to lower the target for the overnight interbank interest rate by 50 basis points to 4.5%, effective August 14, 2020.**

Available information indicates that after having declined sharply in March and April, the global economy began to show a slight recovery in May and June. Multilateral organizations and analysts anticipate a strong contraction during this year and a moderate recovery for 2021. These forecasts, however, are subject to a high degree of uncertainty. In advanced economies headline and core inflation are below their central bank's targets. In this context, the monetary authorities have kept policy rates at historically low levels and have continued to use their balance sheets to foster an orderly functioning of financial markets. Likewise, several countries have announced additional fiscal stimulus to mitigate the adverse effects on employment and on households and firms' income.

Since the last monetary policy decision, global financial markets continued to exhibit a positive behavior, reflecting the effects of the fiscal, monetary and financial stimuli measures adopted by the advanced economies and the gradual reopening of their productive activities, although the conditions prevailing before the pandemic have not been reached. In Mexico, the peso traded in a narrow range, with some episodes of volatility. Government bond yields decreased throughout the yield curve. Global and domestic financial conditions will continue to be subject mainly to the effects of the pandemic.

Timely information indicates that economic activity in Mexico contracted significantly during the second quarter of the year as the negative effects of the pandemic intensified substantially. Various indicators point to a recovery in June from low levels of activity, in response to the reopening of some sectors, the loosening of restrictions to mobility, and a moderate recovery of external demand, although an environment of uncertainty prevails. For this reason, greater economic slack is expected within the time frame in which monetary policy operates and significant risks to the downside persist.

Annual headline inflation rose from 3.33 to 3.62% between June and July 2020 due to increases in both its non-core and core components. This results from an increase in energy prices as well as a recomposition of core inflation, with a decrease in services inflation and merchandise inflation accelerating with high annual rates of change in food products. These adjustments are partly associated with the pandemic and led to an increase in headline inflation expectations for the end of 2020, while those for the medium and long terms have remained relatively stable, albeit 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. Although the recent increases in headline and core inflation affect their foreseen trajectories in the short term, both are expected to lay around 3% within the 12-24 month forecast horizon. It is worth noting that these forecasts are subject to considerable risks. To the downside: i) a greater than expected impact of the widening of the negative output gap; ii) downward inflationary pressures worldwide; and iii) social distancing measures reducing

the demand for certain services. To the upside: i) additional episodes of foreign exchange depreciation; ii) a greater persistence of core inflation; and iii) logistical and supply-related problems concerning certain goods and services, as well as cost-related pressures associated with the adoption of sanitary measures. In this context, the balance of risks for inflation remains uncertain.

Taking into account the referred risks for inflation, economic activity and financial markets, major challenges arise for monetary policy and for the economy in general. Based on the foreseen scenarios, and considering the room for maneuvering that on balance these provide to monetary policy, with the presence of all its members, on this occasion, Banco de México's Governing Board decided by majority to lower the target for the overnight interbank interest rate by 50 basis points to a level of 4.5%. One member voted for lowering the target to 4.75%. Looking ahead, the available room for maneuver will depend on the evolution of the factors that have an incidence on the outlook for inflation and its expectations, including the effects that the pandemic might have on both factors.

The Governing Board will take the necessary actions on the basis of incoming information and considering the large impact on productive activity as well as the evolution of the financial shock that we are currently facing, so that the policy rate is 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. Perseverance in strengthening the macroeconomic fundamentals and adopting the necessary actions, regarding both monetary and fiscal policies, will contribute to a better adjustment of domestic financial markets and of the economy as a whole.