



# Quarterly Report

## April – June 2020

August 26, 2020



BANCO DE MÉXICO

# Economic and Financial Environment

- The **COVID-19 pandemic** has had a **high human toll** and caused **significant economic damage** in Mexico as well as in the rest of the world.
- Banco de México still faces a **complex environment**, where the **shocks** derived from the pandemic have had an impact on **economic activity**, **inflation** and the country's **financial conditions**, with effects at **different horizons**.
  - ✓ *Given a **sudden increase in risk aversion**, domestic financial markets were affected quickly, which required that various **actions** be taken to insure an **orderly adjustment**.*
  - ✓ *The **impact** over economic activity and inflation has been materializing and is **expected to continue having an effect over a longer period of time**.*
- Banco de México has **conducted monetary policy seeking to preserve the national currency's purchasing power** and an orderly adjustment of the economy in light of the pandemic.
- Within the scope of its possibilities and goals, it has **adopted different measures to promote a sound development of the financial system and an orderly functioning of the payment systems**.

# Outline

**1 External conditions**

**2 Current situation of the Mexican economy**

**3 Inflation**

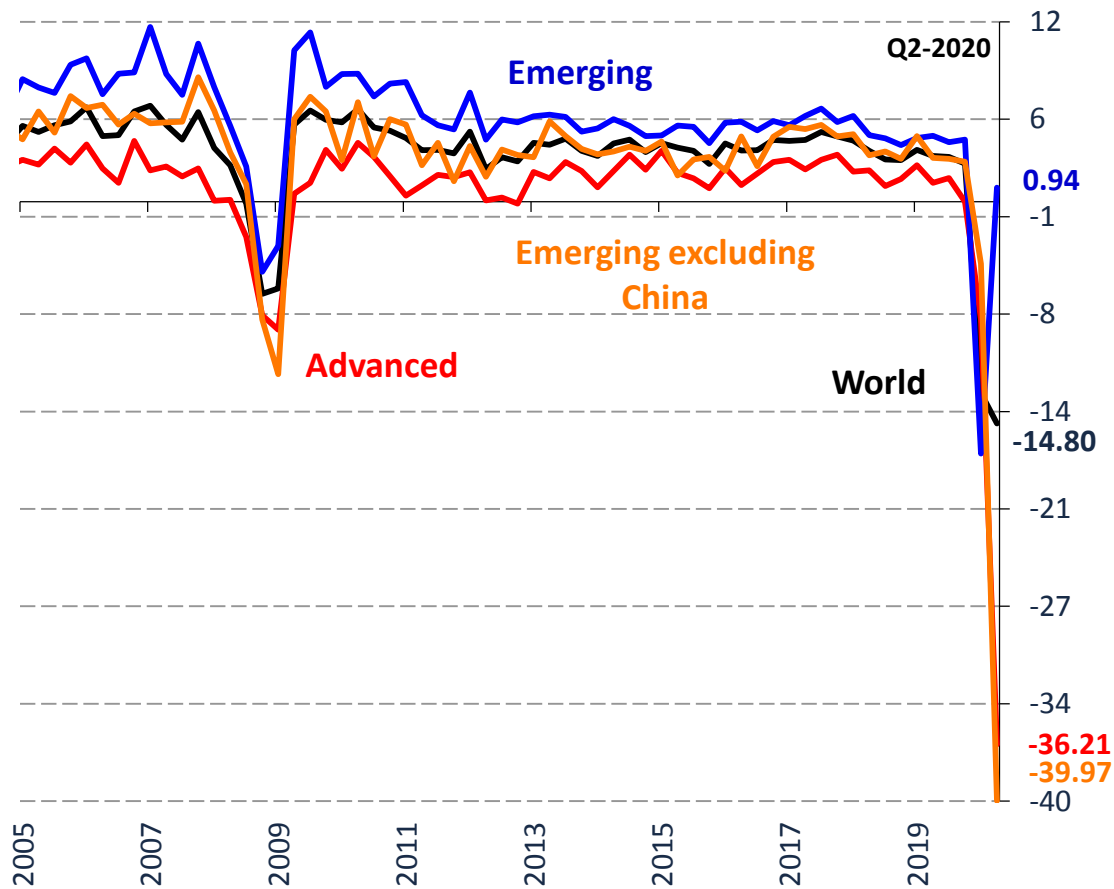
**4 Monetary policy**

**5 Forecasts and final remarks**

After having declined sharply in March and April, the global economy began to show a slight recovery in May and June, reflecting the easing of certain lockdown measures and the effects of the stimulus measures implemented in systemically important economies.

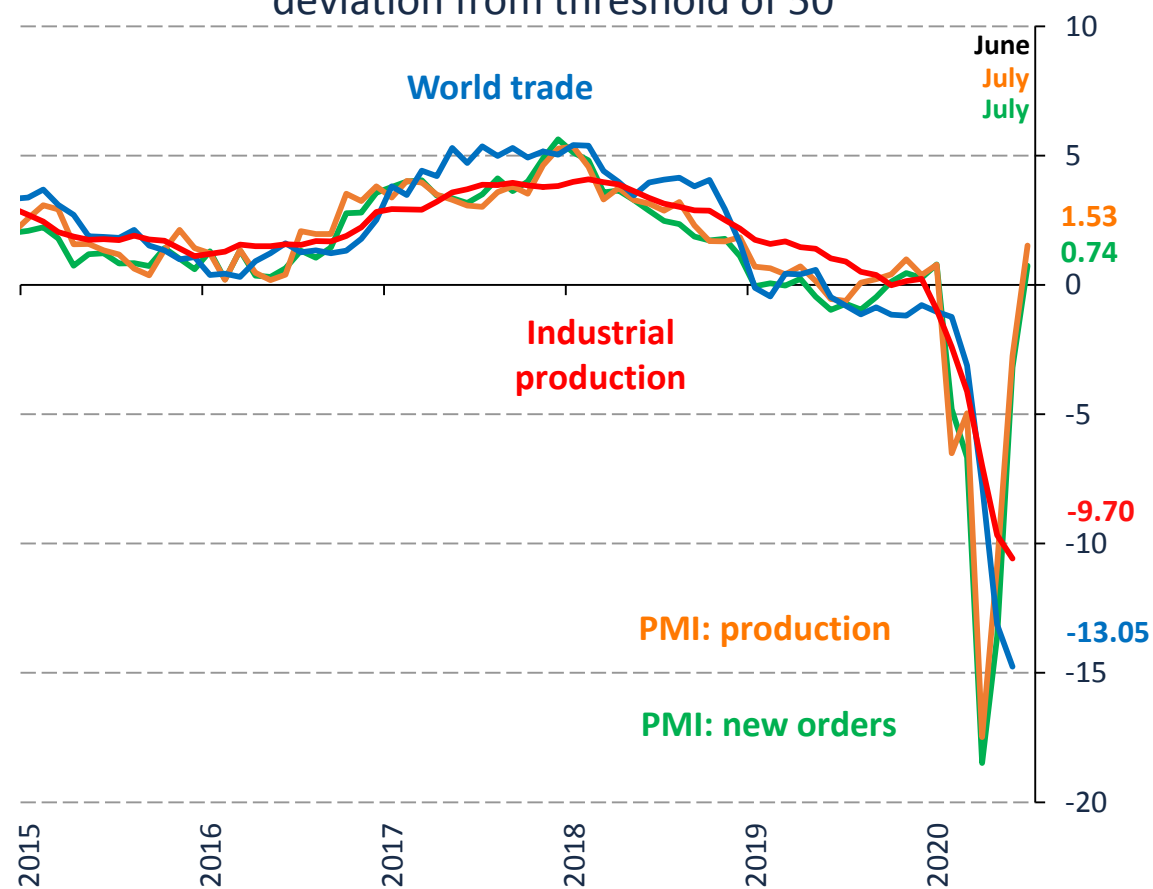
## World Economy

**GDP Growth**  
Quarterly annualized % change, s. a.



s. a. / Seasonally adjusted figures. Note: Estimations were used for Q1-2020 calculations. The sample of countries used for the calculations represents 85.6% of world GDP measured by purchasing power parity. Forecasts for some sample countries are used in the second quarter. Source: Prepared by Banco de México with data from Haver Analytics, J.P. Morgan and International Monetary Fund (IMF).

**Activity Indicators**  
Annual % change of 3-month moving average and deviation from threshold of 50



Source: CPB Netherlands and Markit.

A large contraction is expected for 2020 and a moderate recovery for 2021. These forecasts, however, are subject to a large degree of uncertainty.

## World Economy

### GDP Growth Forecasts for 2020 and 2021

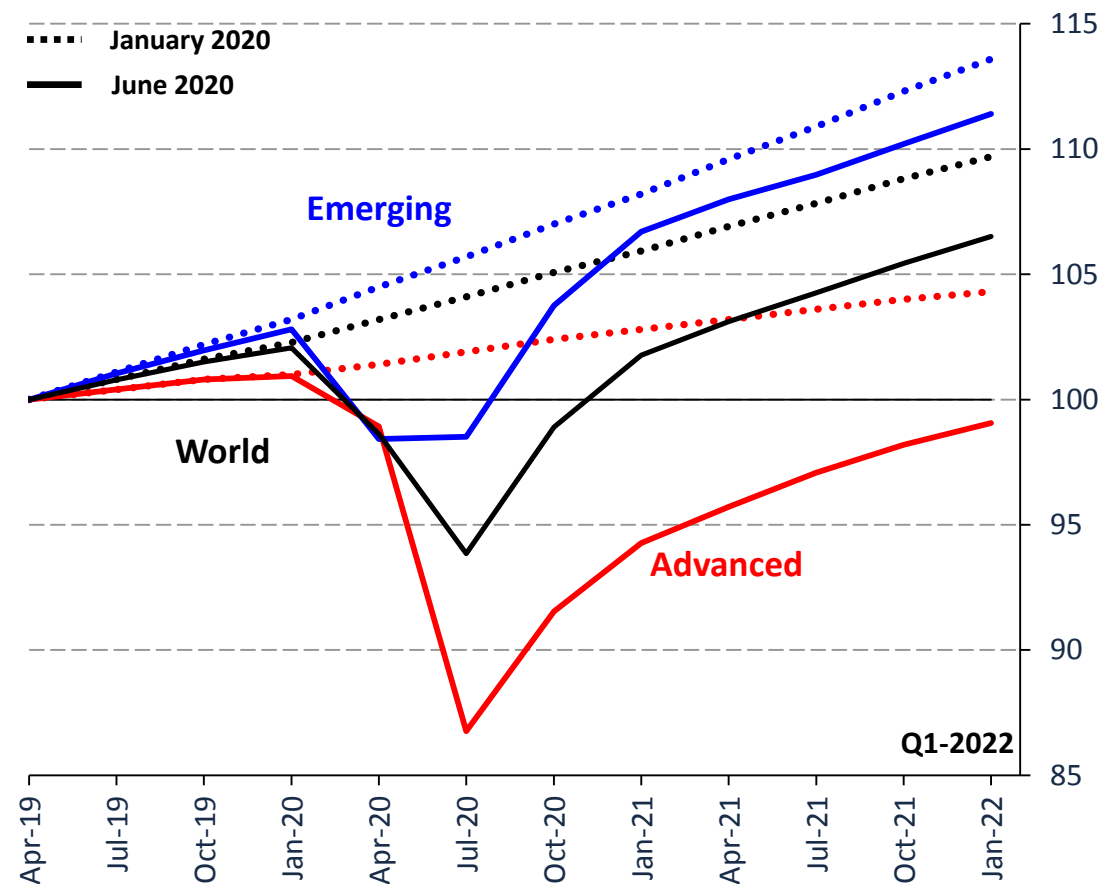
Annual % change

	WEO Forecasts June 2020		WEO Forecasts April 2020		Change compared to April 2020	
	2020	2021	2020	2021	2020	2021
	<b>World</b>	<b>-4.9</b>	<b>5.4</b>	<b>-3.0</b>	<b>5.8</b>	<b>-1.9</b>
<b>Advanced</b>	<b>-8.0</b>	<b>4.8</b>	<b>-6.1</b>	<b>4.5</b>	<b>-1.9</b>	<b>0.3</b>
United States	-8.0	4.5	-5.9	4.7	-2.1	-0.2
Euro area	-10.2	6.0	-7.5	4.7	-2.7	1.3
Japan	-5.8	2.4	-5.2	3.0	-0.6	-0.6
United Kingdom	-10.2	6.3	-6.5	4.0	-3.7	2.3
<b>Emerging</b>	<b>-3.0</b>	<b>5.9</b>	<b>-1.0</b>	<b>6.6</b>	<b>-2.0</b>	<b>-0.7</b>

Source: International Monetary Fund (IMF), World Economic Outlook April and June 2020.

### Gross Domestic Product

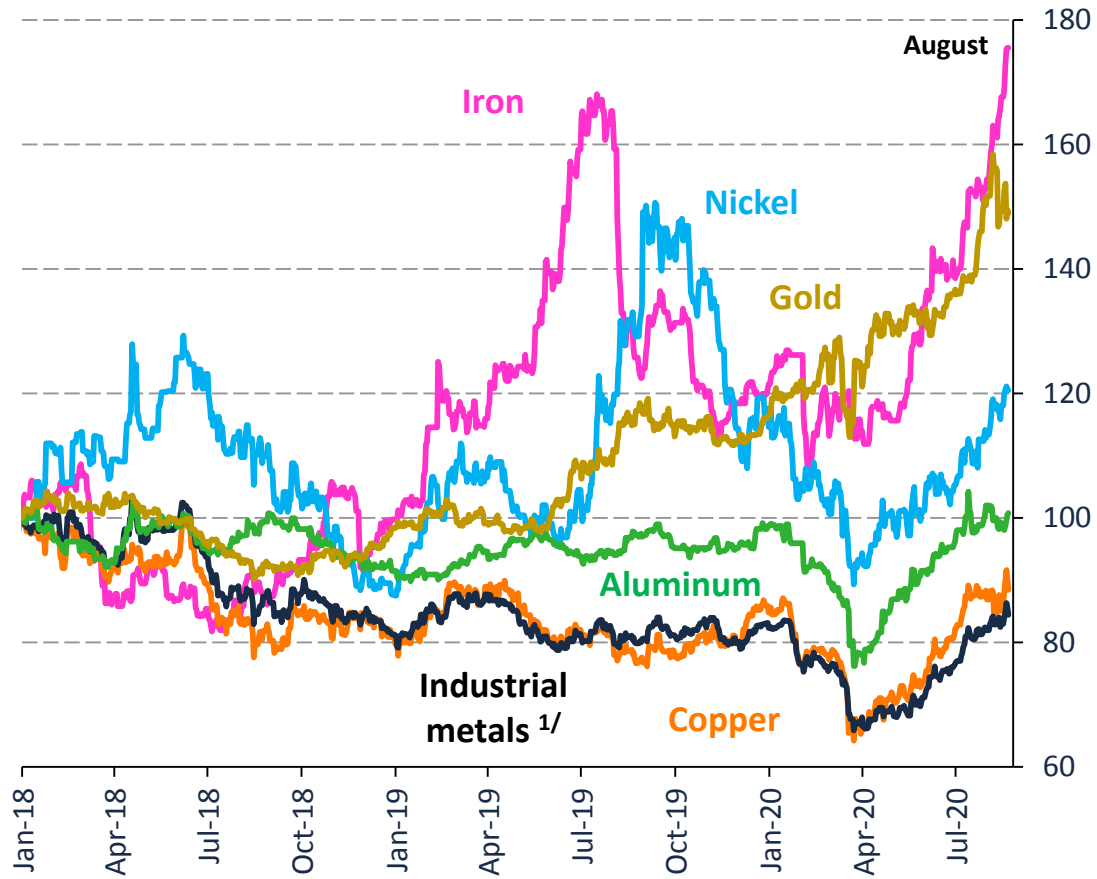
Index Q1-2019=100



Source: International Monetary Fund (IMF), World Economic Outlook January, April and June 2020.

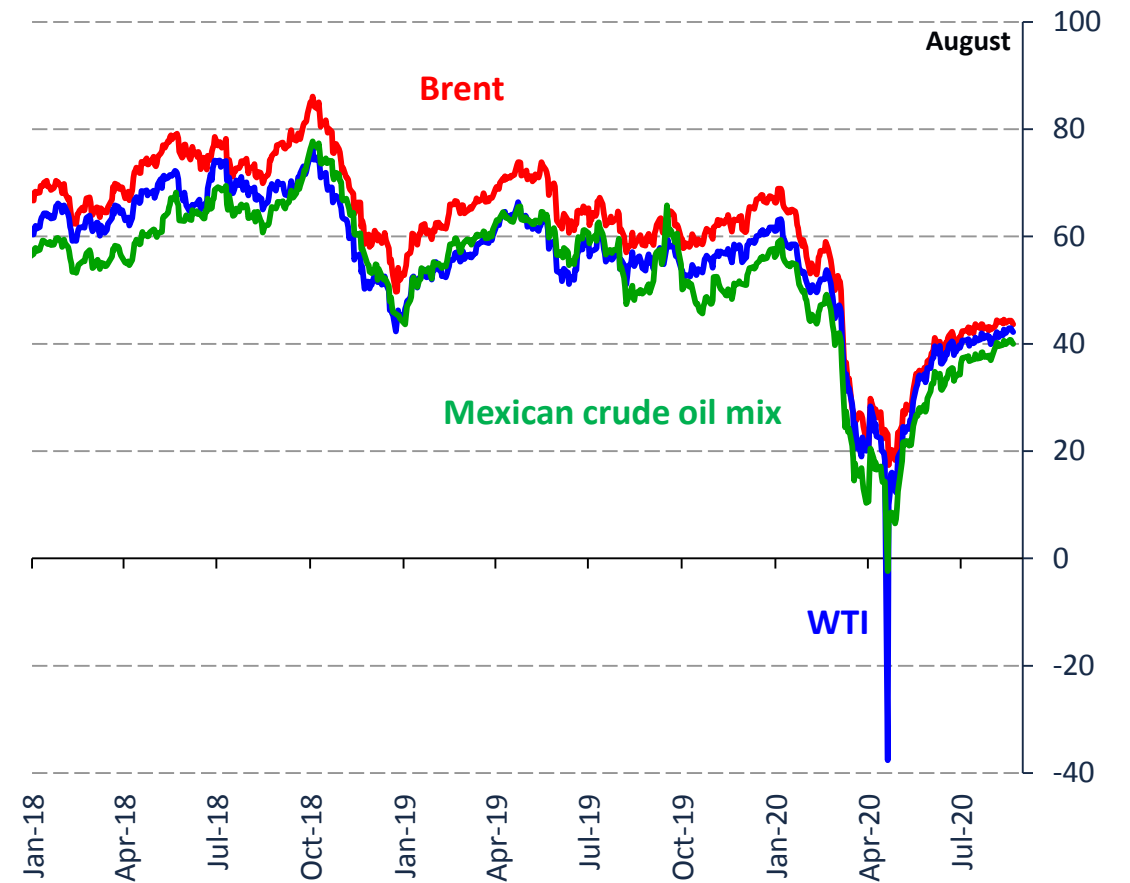
After having declined considerably in March and April given the collapse of global economic activity, international commodity prices have increased moderately.

**Selected Metals Prices**  
Index 01-Jan-2018=100



1/ This index follows the prices of aluminum, copper, nickel, zinc and lead.  
Source: Bloomberg.

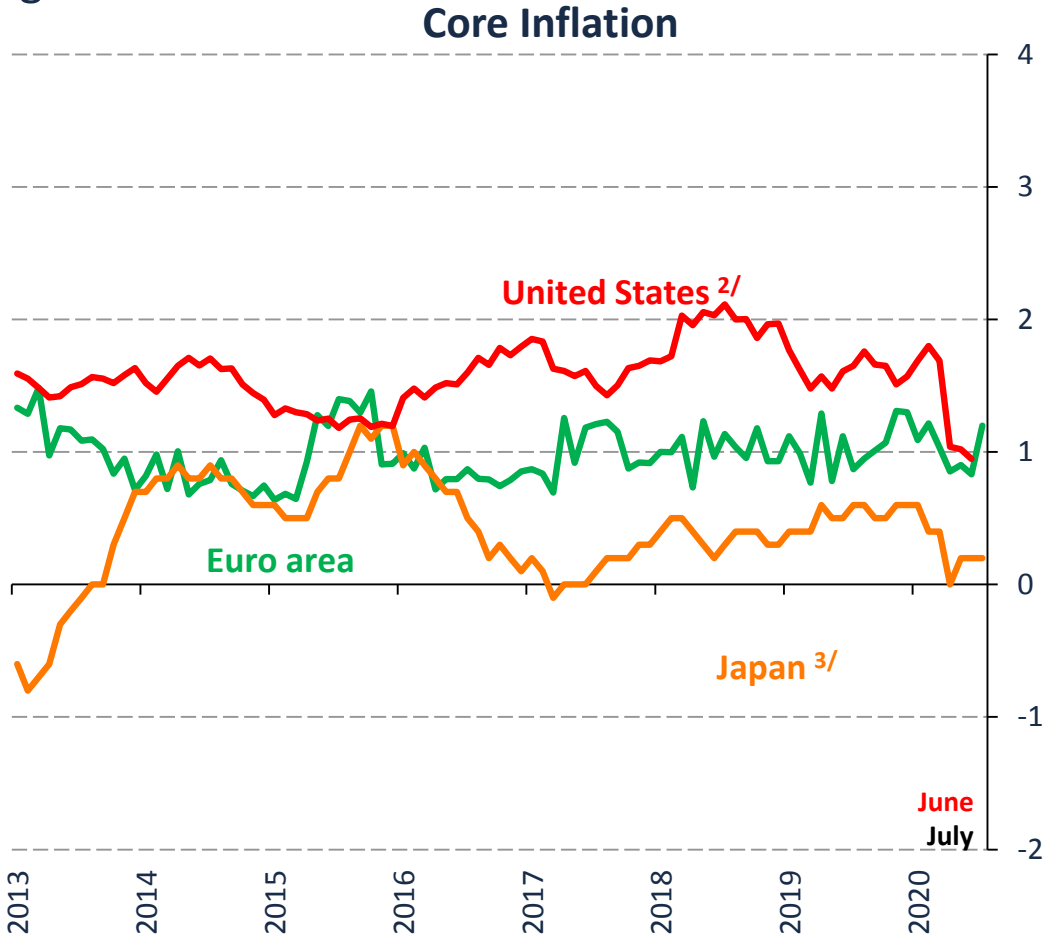
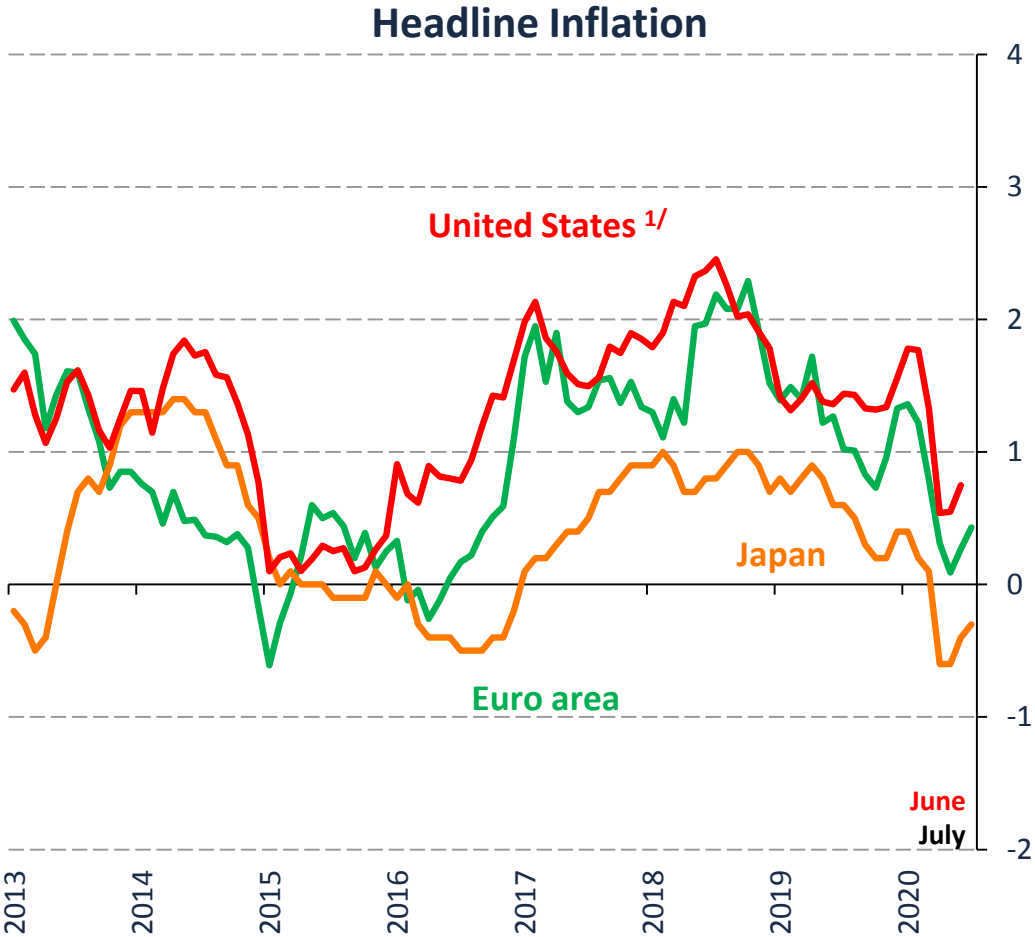
**International Crude Oil Prices**  
US dollars per barrel



Source: Bloomberg.

Headline and core inflation in advanced economies are clearly below the targets of their respective central banks. The recent increase in energy prices has not been able to offset the weakness in core inflation.

Advanced Economies  
Annual % change

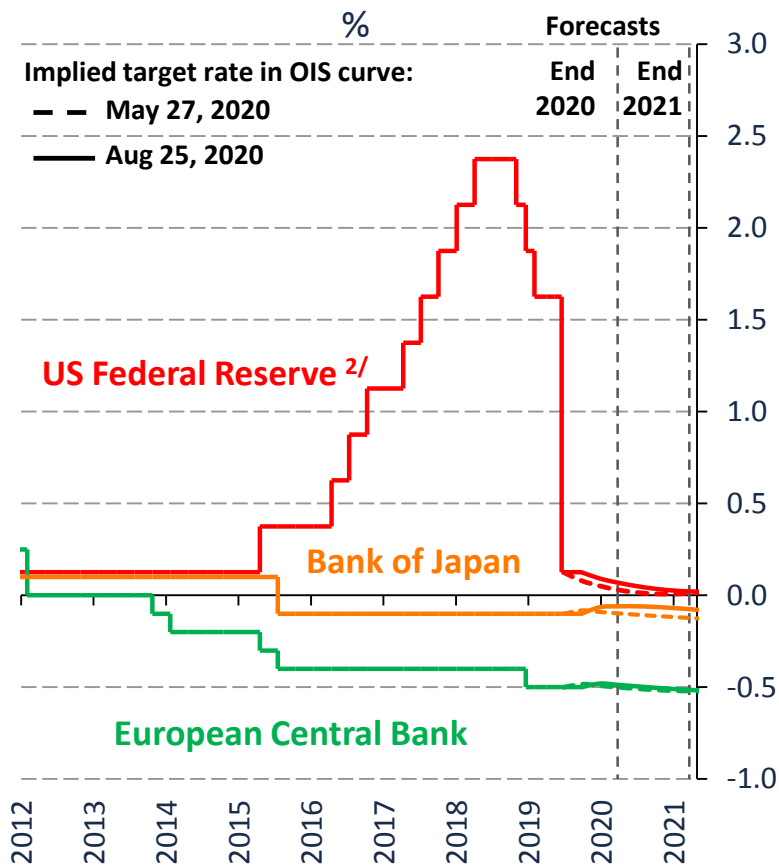


1/ Refers to the Personal Consumption Expenditure Price Index (PCE).  
Source: BEA, Eurostat, Government of Japan Cabinet Office.

2/ Refers to the Personal Consumption Expenditure Price Index (PCE)  
3/ Excludes energy and fresh food and the direct effect of the consumption tax increase.  
Source: BEA, Eurostat, Government of Japan Cabinet Office.

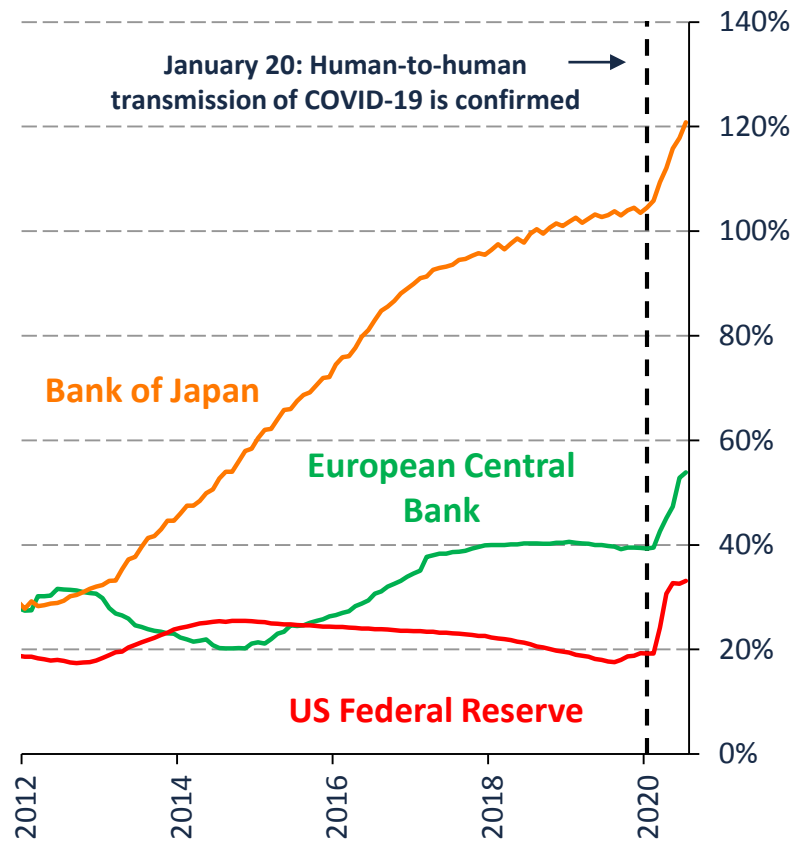
Central banks of advanced economies have kept interest rates at historically low levels, and have expanded their balance sheets to insure an orderly functioning of financial markets. It is foreseen that they will maintain highly accommodative policy stances, which have been implemented alongside fiscal stimulus measures.

Reference Rates and Implied Trajectories in OIS Curves <sup>1/</sup>



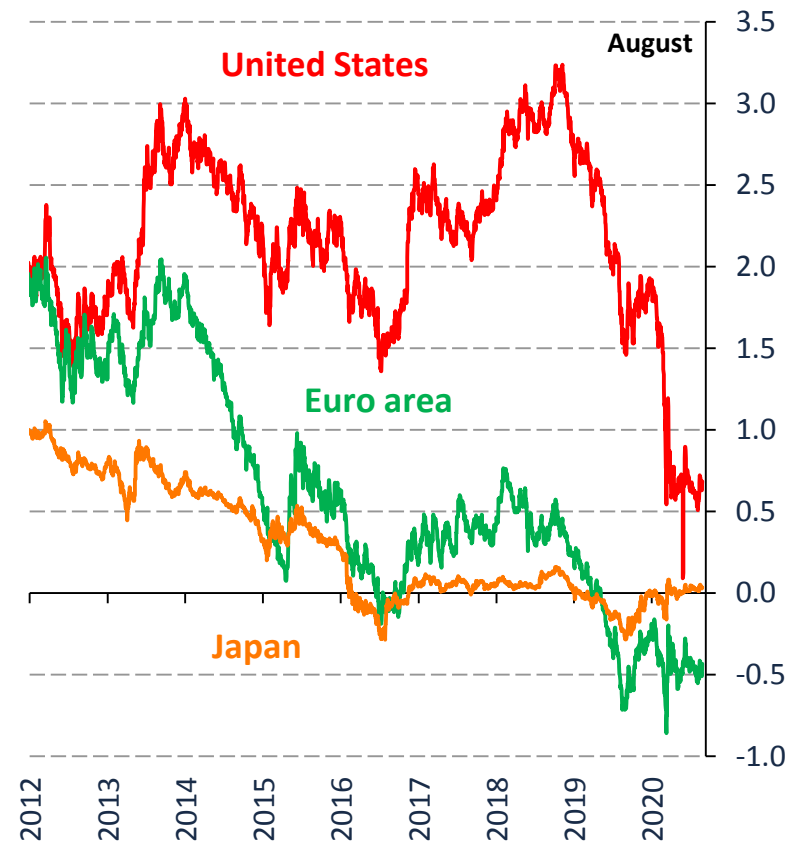
<sup>1/</sup>OIS: Fixed-for-floating swap where the fixed interest rate is the overnight effective reference rate. <sup>2/</sup> Data for the observed federal funds rate corresponds to the average between the lower and upper bounds of the target range (0.0% - 0.25%).  
Source: Prepared by Banco de México with Bloomberg data.

Advanced Economies  
Balance Sheet of the Main Central Banks  
% of GDP



Source: Bloomberg

10-year Government Bonds Interest Rates  
%

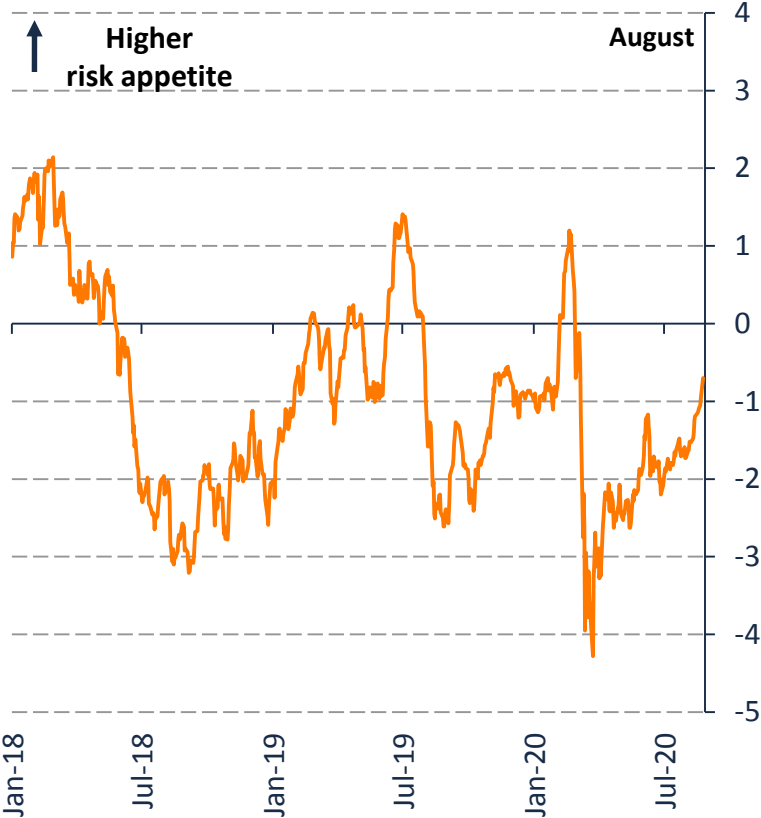


Source: Bloomberg



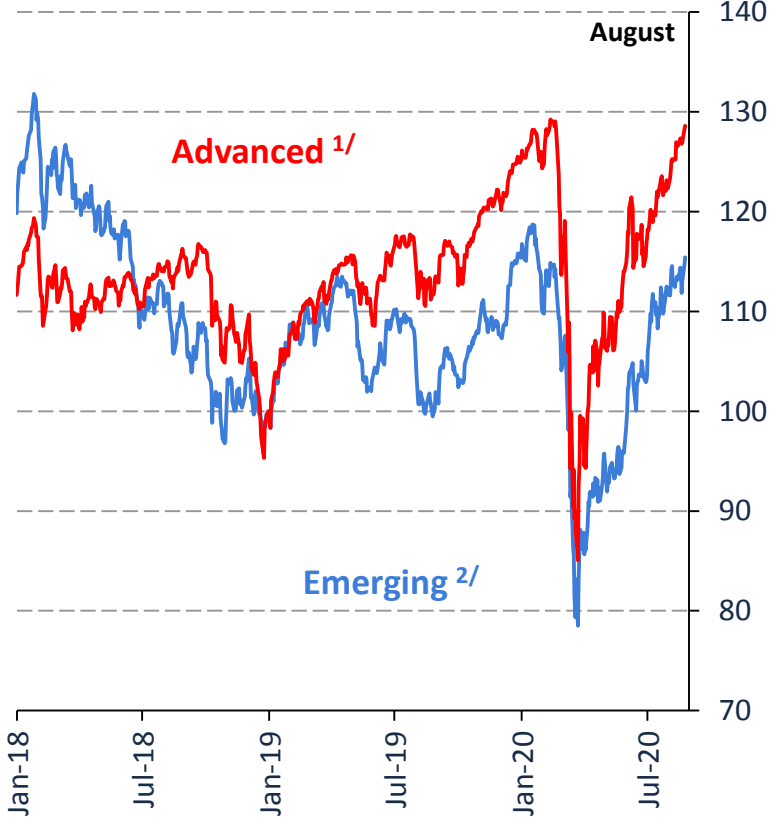
After a sudden tightening in global financial conditions following the fiscal, financial and monetary stimuli implemented in systemically important economies, and the gradual reopening of economic activity in various countries, said conditions have eased.

**Global Risk Appetite Index**  
Index



Note: The risk appetite index compares several financial assets, taking into account that in periods of high appetite for riskier assets these tend to register high returns, while safe assets, such as government bonds of the United States, the euro area and Japan, tend to present negative returns. On the other hand, during periods of low risk appetite, the opposite occurs. In this context, the index value refers to the coefficient of a regression of the daily yield of 64 assets based on their volatility.  
Source: Credit Suisse.

**Stock Markets of Advanced and Emerging Economies**  
Index 01-Jan-2018=100



Note: The MSCI indices of both advanced (MSCI World Index) and emerging (MSCI Emerging Market Index) economies are presented.  
1/ It includes Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Holland, New Zealand, Norway, Portugal, Singapore, Sweden, Switzerland, United Kingdom and the United States.  
2/ It includes Mexico, Brazil, Chile, China, Colombia, Peru, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, South Korea, Malaysia, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and the United Arab Emirates. Source: Bloomberg.

**Global Financial Conditions Index**  
Index



Note: The index is defined as a weighted average of risk-free interest rates, exchange rates, stock valuations, and credit spreads. With the weights corresponding to the direct impact of each variable on GDP. It is prepared with information from 19 advanced economies and 18 emerging economies.  
Source: Goldman Sachs.

After having undergone significant negative effects of the pandemic, financial markets in emerging economies have improved over the last months.

### Asset Performance of Emerging Countries

% and basis points

Since Dec 31, 2019

Since May 1, 2020

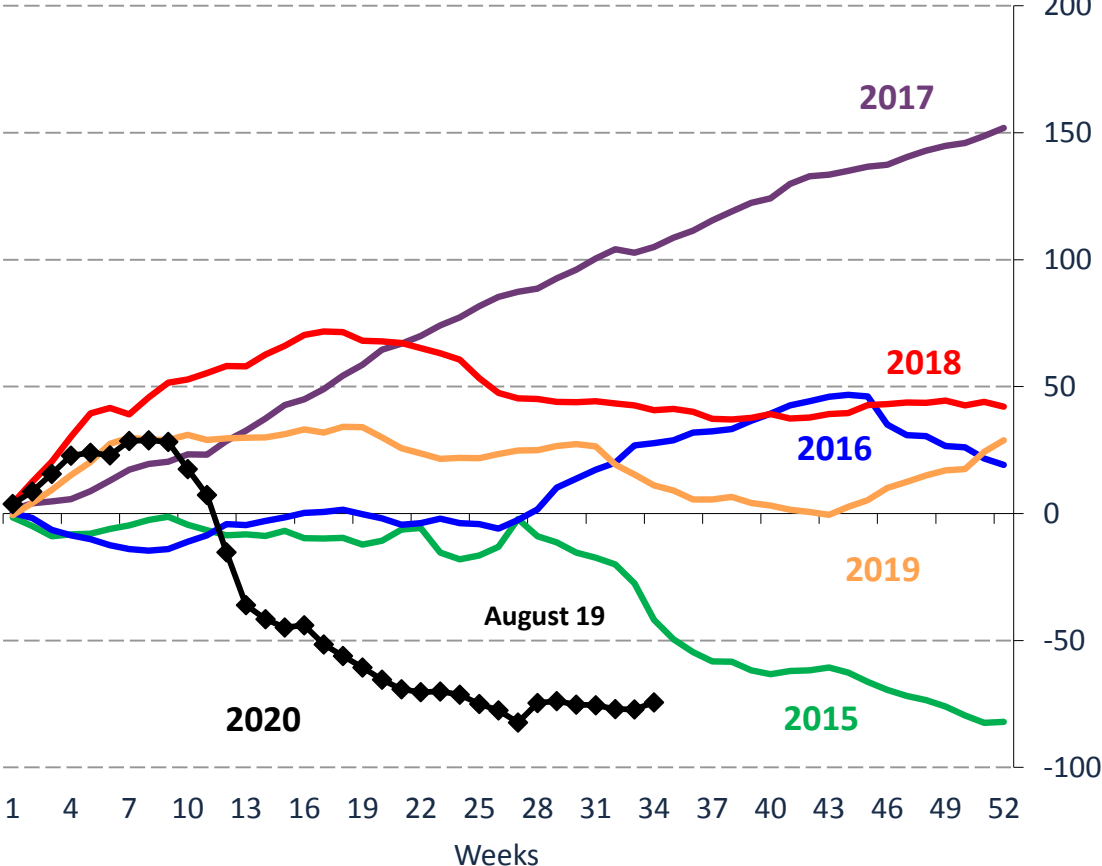
Region	Country	Currencies	Stocks	2Y Interest rates	10Y Interest rates	CDS	Currencies	Stocks	2Y Interest rates	10Y Interest rates	CDS
Latin America	Mexico	-16.11%	-12.51%	-203	-91	49	10.57%	6.80%	-73	-87	-121
	Brazil	-39.45%	-12.21%	-169	60	126	1.16%	25.90%	-45	-86	-88
	Chile	-5.59%	-14.46%	-121	-75	22	4.49%	0.99%	-19	-43	-40
	Colombia	-17.11%	-28.64%	-210	-112	55	3.82%	0.98%	-36	-28	-114
Emerging Europe	Russia	-20.66%	-1.65%	-141	-85	51	2.05%	15.52%	-61	-33	-87
	Poland	1.36%	-10.22%	-145	-84	1	10.72%	14.13%	-8	11	-8
	Turkey	-22.94%	-3.00%	250	144	266	-5.11%	7.19%	449	275	101
	Czech Republic	2.64%	-19.62%	-178	-81	0	11.20%	4.57%	1	12	-11
	Hungary	-0.78%	-21.79%	37	7	-3	9.10%	4.01%	-30	6	-13
Asia	China	0.63%	10.84%	-11	-72	7	1.60%	17.48%	119	22	-8
	Malaysia	-2.13%	-0.73%	-139	-15	16	2.55%	11.14%	-43	43	-58
	India	-4.86%	-6.83%	-164	-112	18	0.26%	12.34%	-25	26	-105
	Philippines	3.88%	-23.16%	-100	-98	15	3.30%	6.60%	2	5	-32
	Thailand	-5.29%	-17.76%	-65	-34	14	3.76%	1.95%	-15	11	-14
	Indonesia	-6.54%	-16.30%	-105	-48	36	0.58%	11.26%	-160	-128	-102
Africa	South Africa	-22.54%	-1.99%	-292	-76	134	7.56%	13.39%	-68	-95	-132

Note: Interest rates correspond to swap rates for a term of two and ten years, with the exception of Indonesia, Turkey and Mexico, where the government values of said terms are used as a reference.  
Source: Bloomberg.

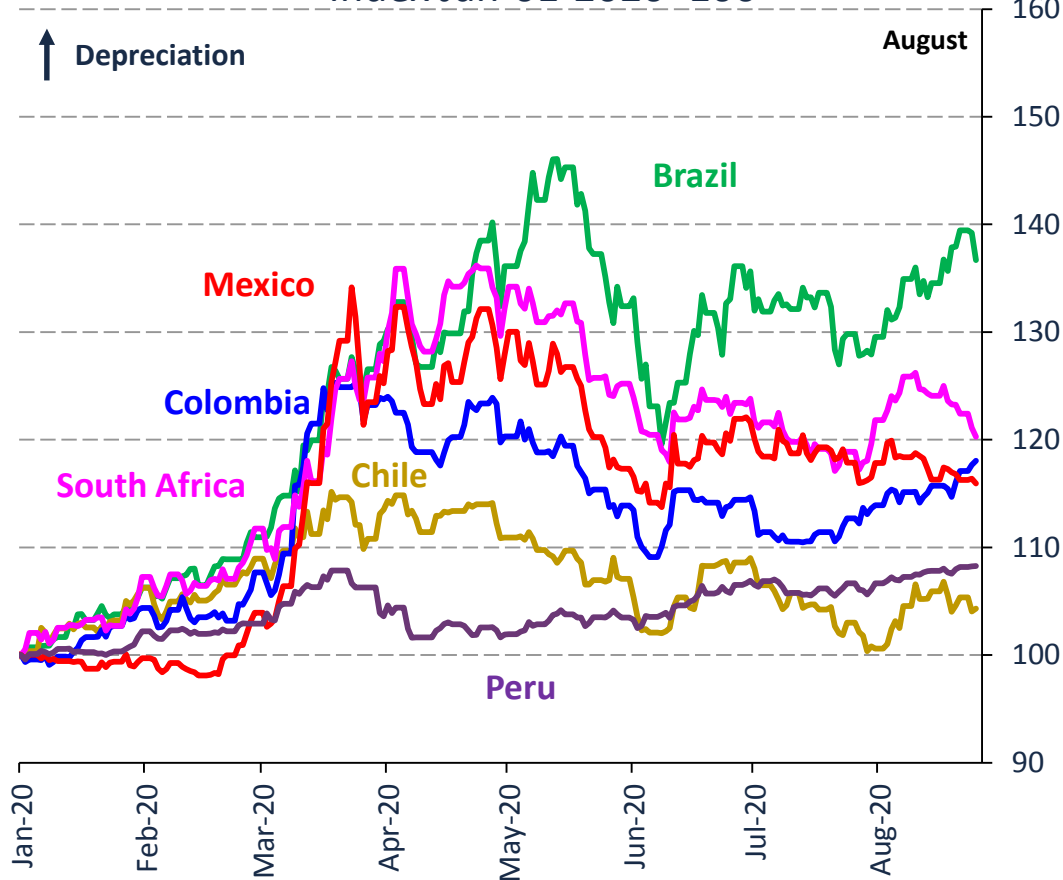
After considerable capital outflows and foreign exchange adjustments were observed in emerging economies in March and April, these have been stabilizing.

### Emerging Economies

Accumulated Capital Flows <sup>1/</sup>  
Billion dollars



Nominal Exchange Rate against USD  
Index Jan-01-2020=100



1/ The sample covers funds used for the buying-selling of stocks and bonds from emerging countries, recorded in advanced countries. Flows exclude portfolio performance and exchange rate fluctuations. Source: Emerging Portfolio Fund Research.

Source: Bloomberg.

# Outline

**1** External conditions

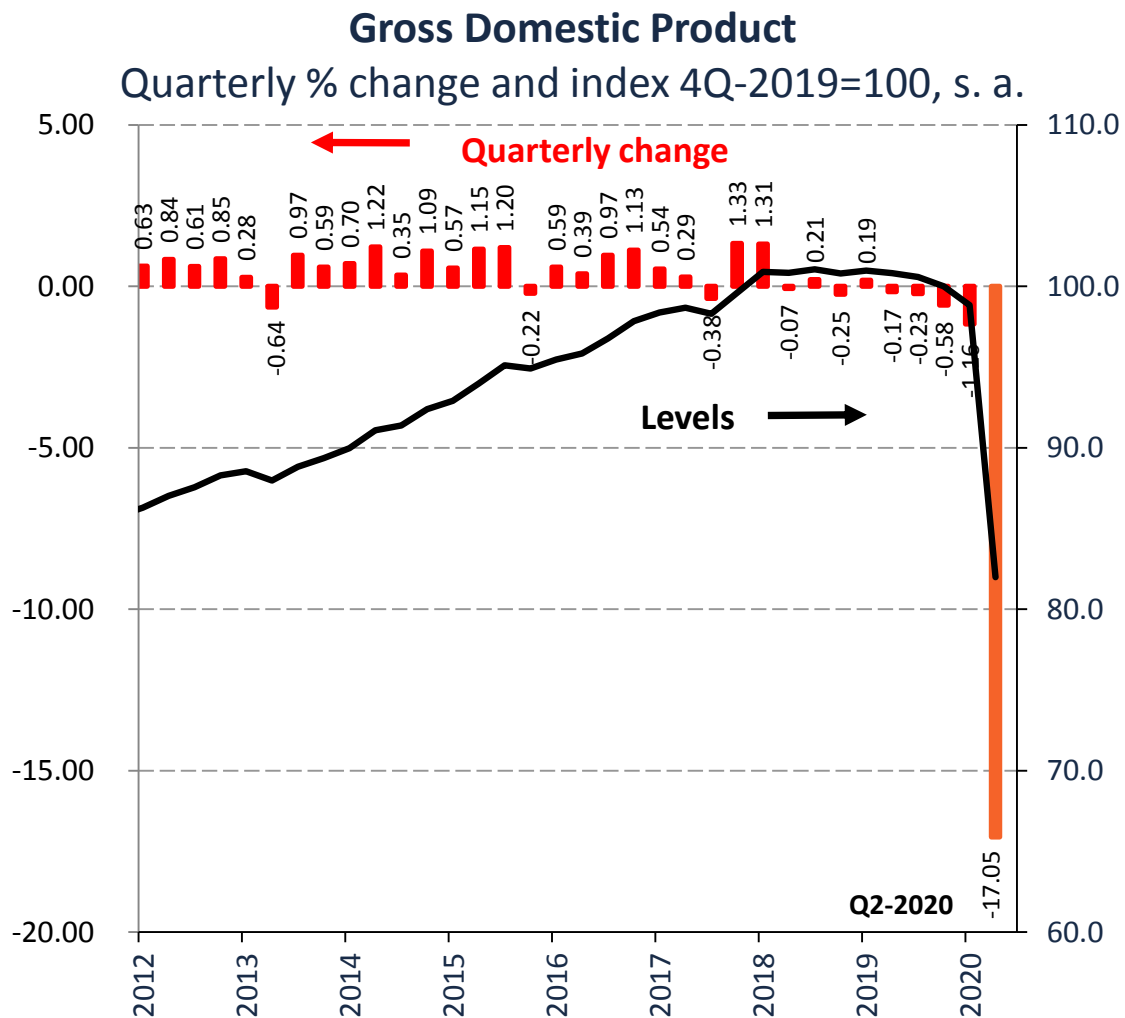
**2** Current situation of the Mexican economy

**3** Inflation

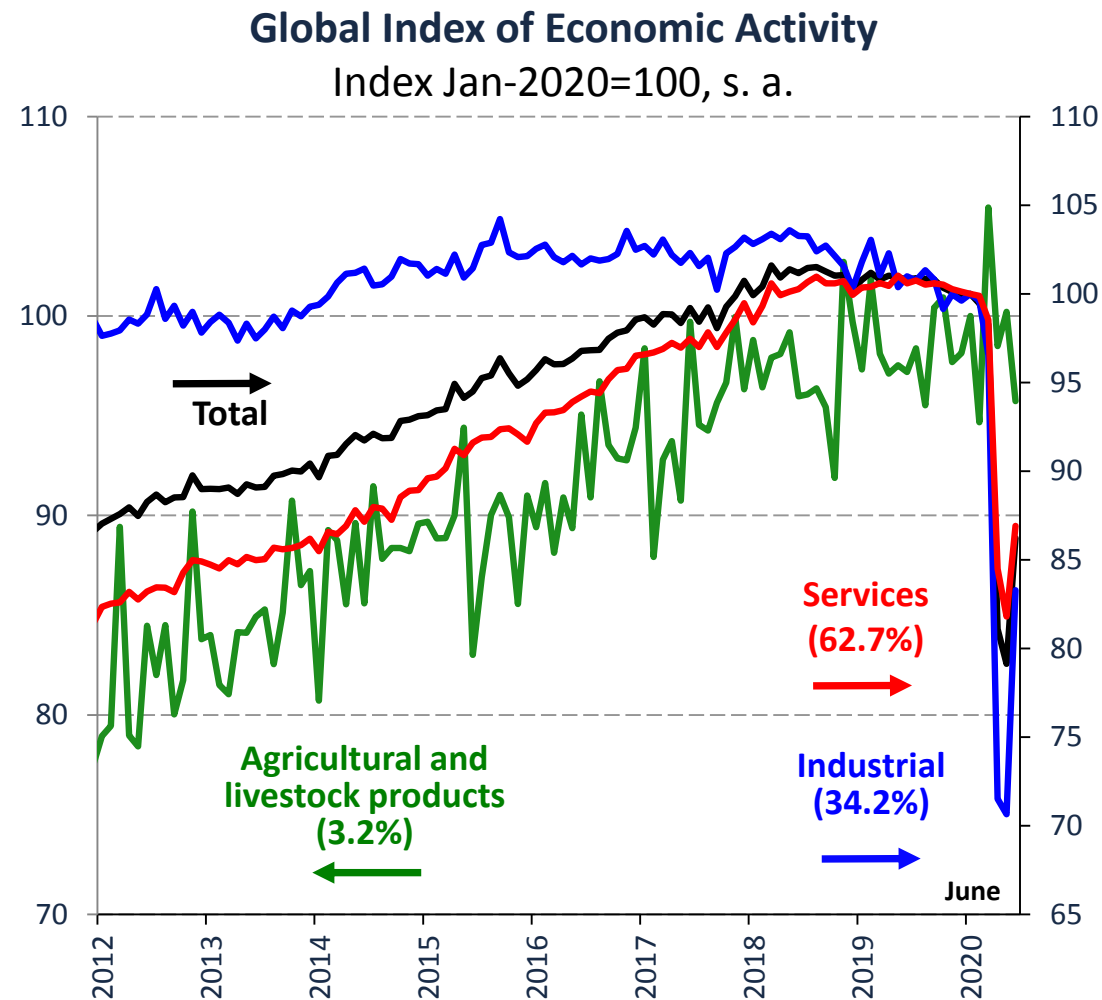
**4** Monetary policy

**5** Forecasts and final remarks

In Q2-2020 economic activity was deeply impacted by the effects of the COVID-19 pandemic and the measures taken to control its spread, especially in April and, to a lesser extent, in May. Some recovery was registered in June, although still at low levels.



s. a./ Seasonally adjusted figures.  
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

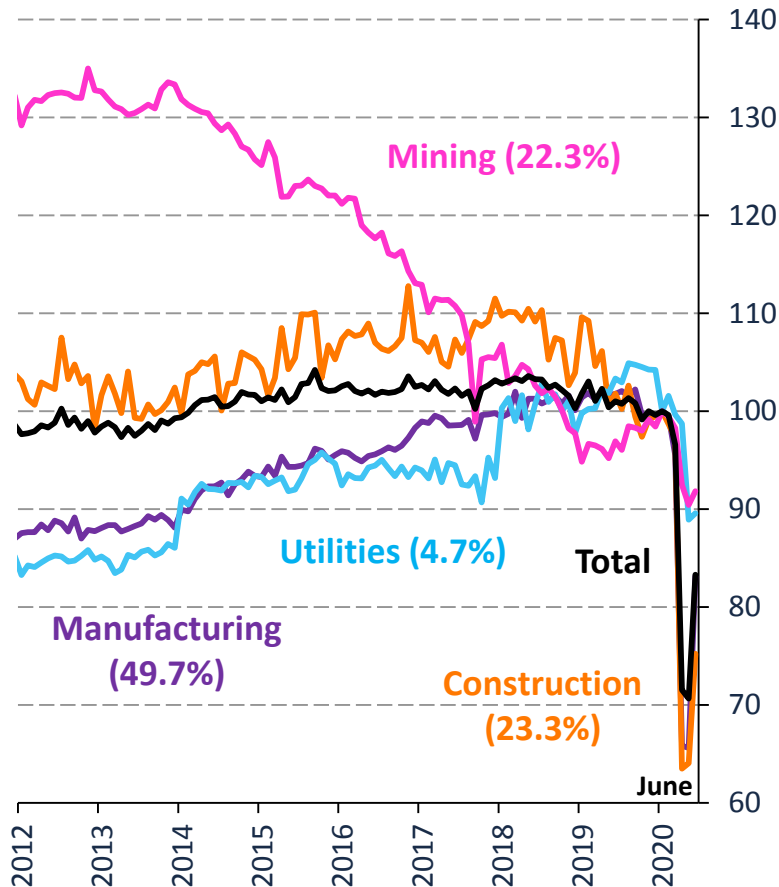


s. a./ Seasonally adjusted figures.  
Note: The sum of the components may not add up due to rounding. Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

In June industrial activity recovered as a result of the partial opening of a considerable number of activities and the easing of other restrictions, especially in the manufacturing and construction sectors, although it remains at low levels.

### Industrial Activity

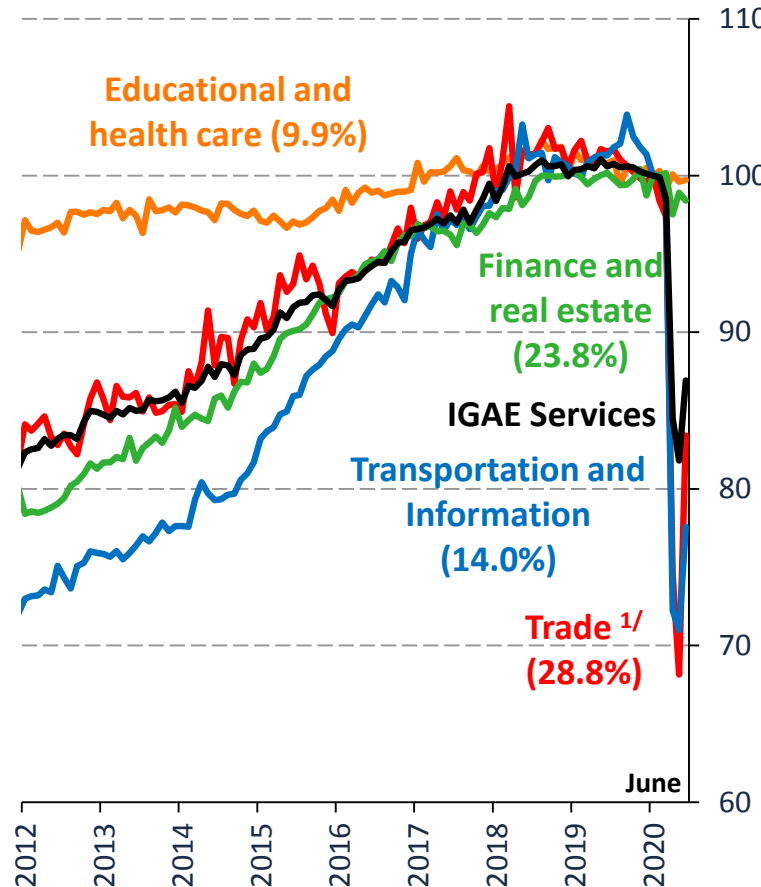
Index Jan-2020=100, s. a.



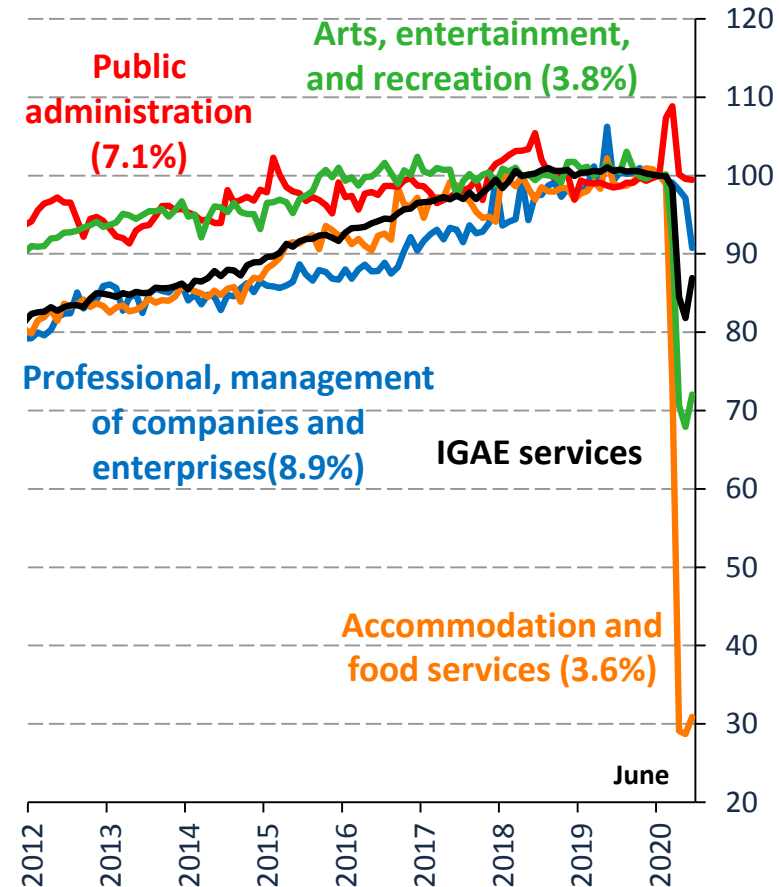
s. a. / Seasonally adjusted figures.  
 Note: Figures in parentheses represent their share in 2013.  
 Source: Monthly Indicator of Industrial Activity, Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

### IGAE Services

Index Jan-2020=100, s. a.

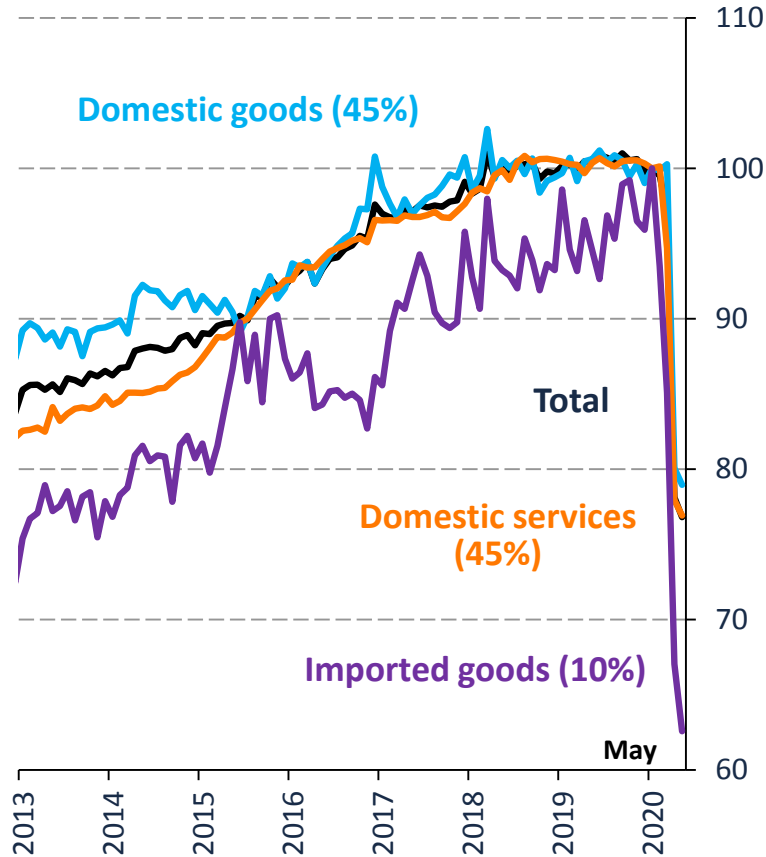


s. a. / Seasonally adjusted figures.  
 Note: Figures in parentheses represent their share in 2013.  
 1/ Includes both wholesale and retail trade.  
 Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.



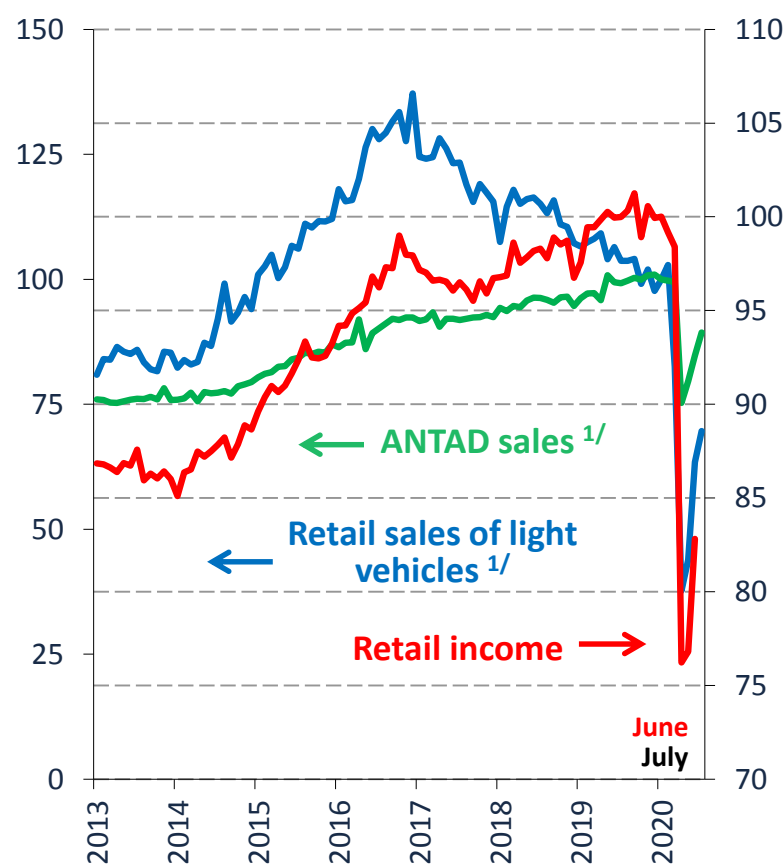
# Indicators related to private consumption suggest a severe damage to this aggregate, both in April and in May, followed by a slight recovery in June.

**Private Consumption**  
Index Jan-2020=100, s. a.



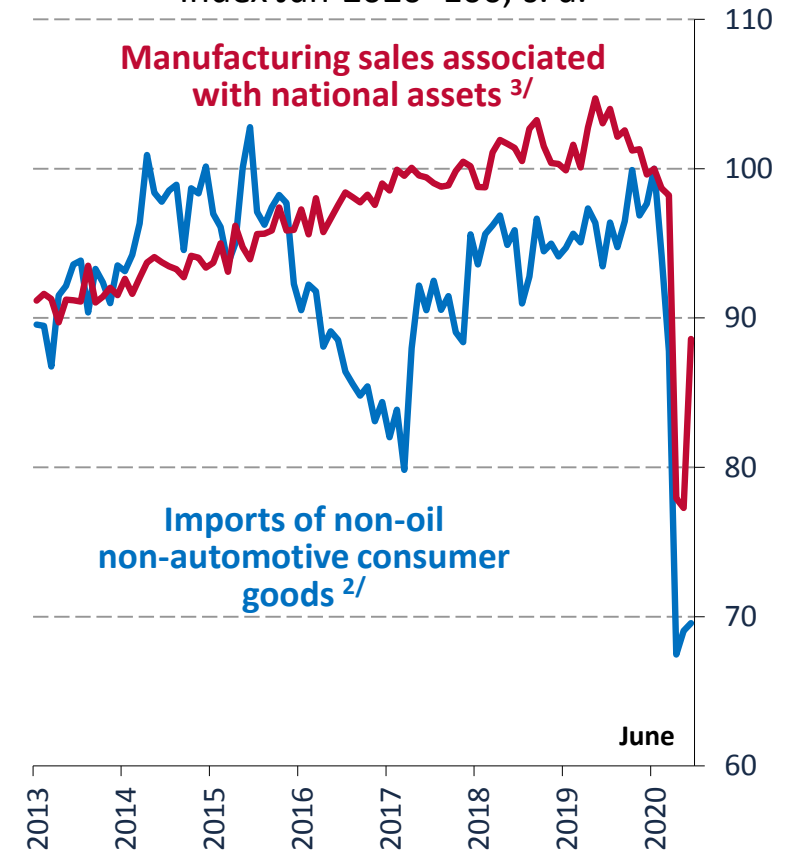
s. a. / Seasonally adjusted figures.  
Note: Figures in parentheses represent their share in 2013.  
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

**Domestic Consumption Indicators**  
Index Jan-2020=100, s. a.



s. a. / Seasonally adjusted figures.  
1/ Seasonal adjustment of ANTAD's actual sales and domestic retail sales of light vehicles by Banco de México. Source: Prepared by Banco de México with data from the National Association of Self-Service and Department Stores (ANTAD for its acronym in Spanish), the Monthly Survey on Commercial Companies (EMEC, for its acronym in Spanish), INEGI, and the Administrative Registry of the Automotive Industry of Light Vehicles, INEGI.

**Consumer Goods Imports and Manufacturing Sales**  
Index Jan-2020=100, s. a.

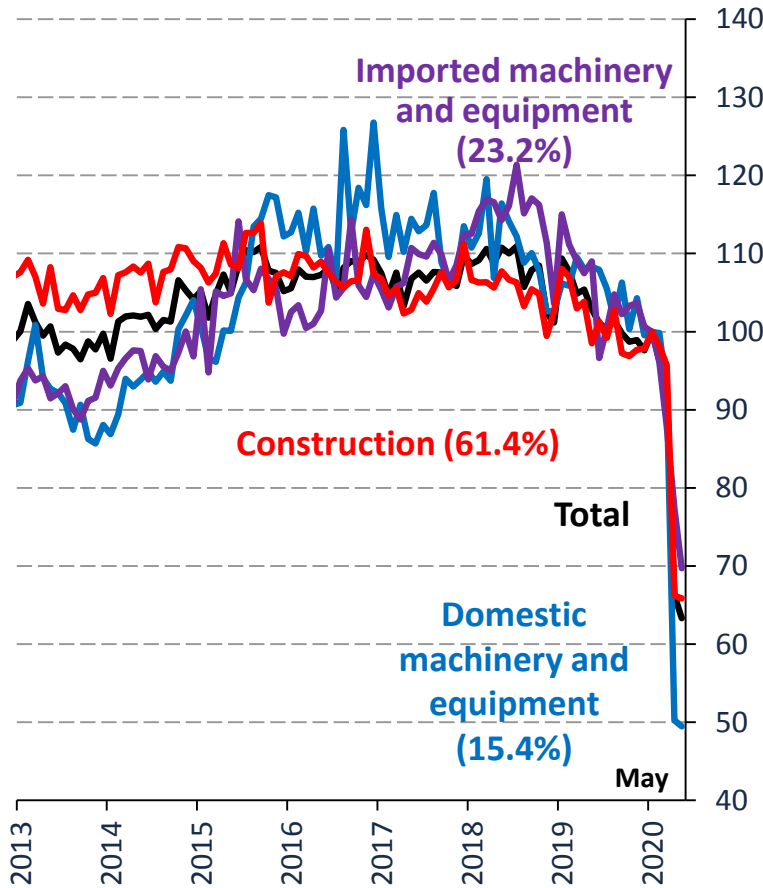


s. a. / Seasonally adjusted figures. 2/ Current dollar figures  
3/ Refers to sales from the Monthly Survey on the Manufacturing Industry (EMIM for its acronym in Spanish) related to the private consumption of goods. Source: Prepared by Banco de México with data from PMI Comercio Internacional, S.A. de C.V., SAT, SE, Banco de México and INEGI. Commercial Balance of Goods of Mexico. SNIEG. Information of National Interest and Banco de México with information from the Monthly Survey of the Manufacturing Industry (EMIM).



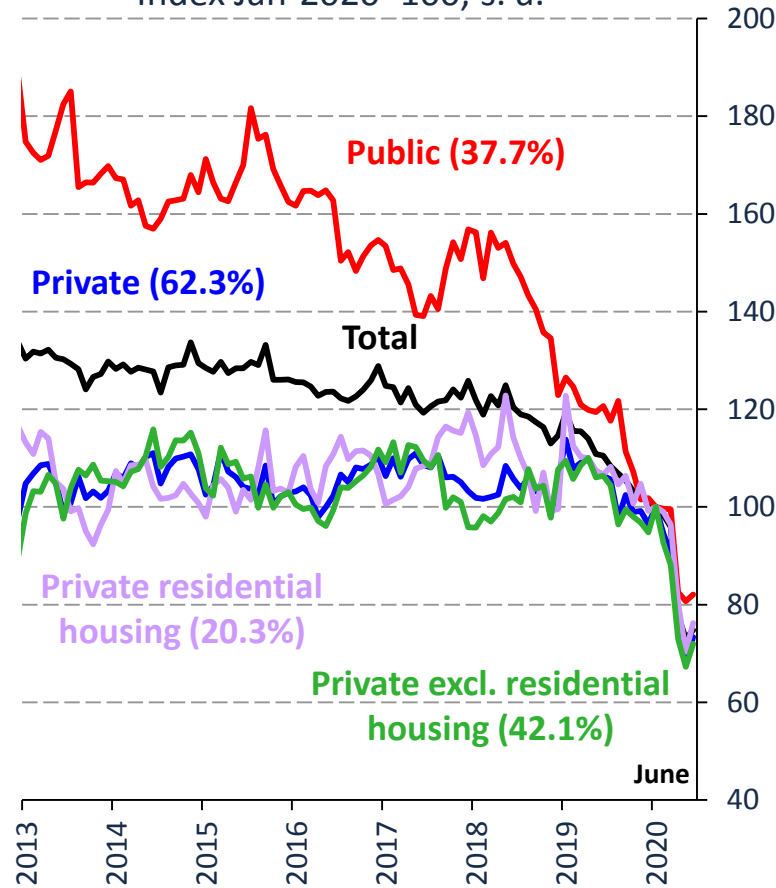
There was a deepening of the negative trend that gross fixed investment has been showing since 2018, and during the April-May period it registered its lowest level in twenty years, with significantly monthly declines in all of its components.

**Investment**  
Index Jan-2020=100, s. a.



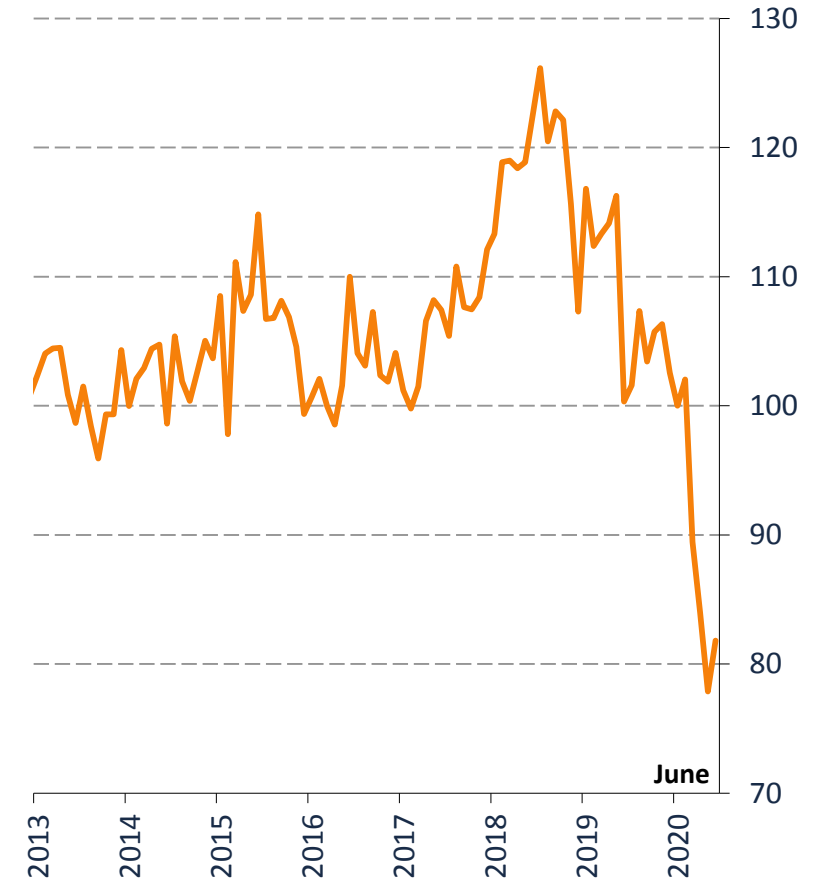
s. a. / Seasonally adjusted figures.  
Note: Figures in parentheses represent their share in total in 2013.  
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

**Real Value of Construction Output by Sector**  
Index Jan-2020=100, s. a.



s. a. / Seasonally adjusted figures.  
Note: Figures in parentheses represent their share in 2019.  
1/ Seasonally adjusted by Banco de México, except for the total series.  
Source: Prepared by Banco de México with data from ENEC, INEGI.

**Imports of Capital Goods**<sup>2/</sup>  
Index Jan-2020=100, s. a.

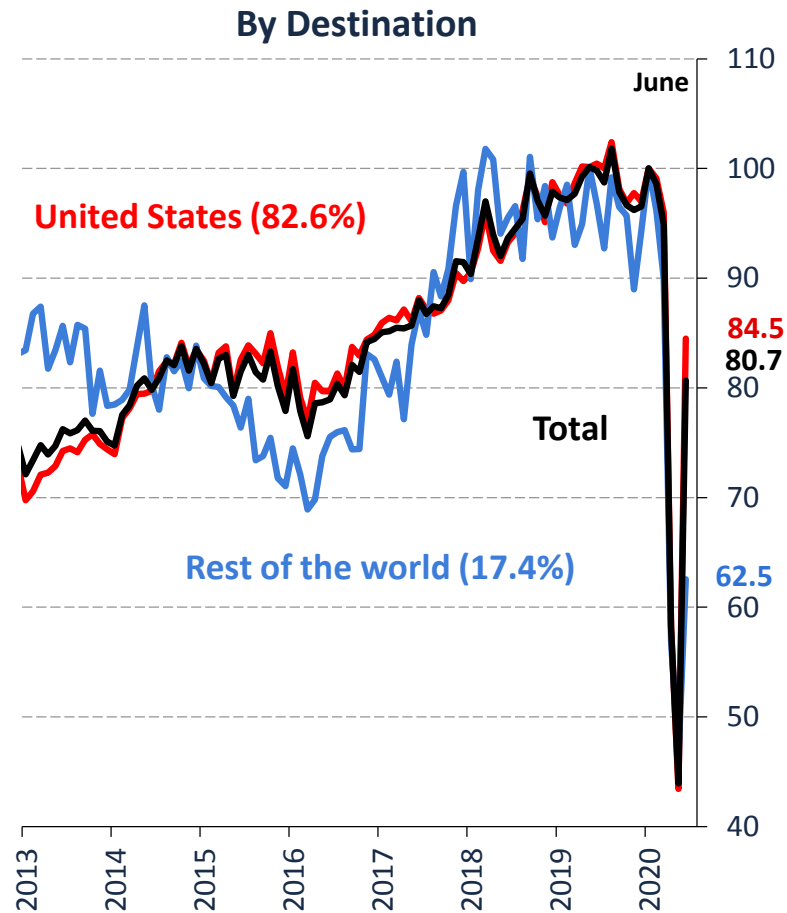
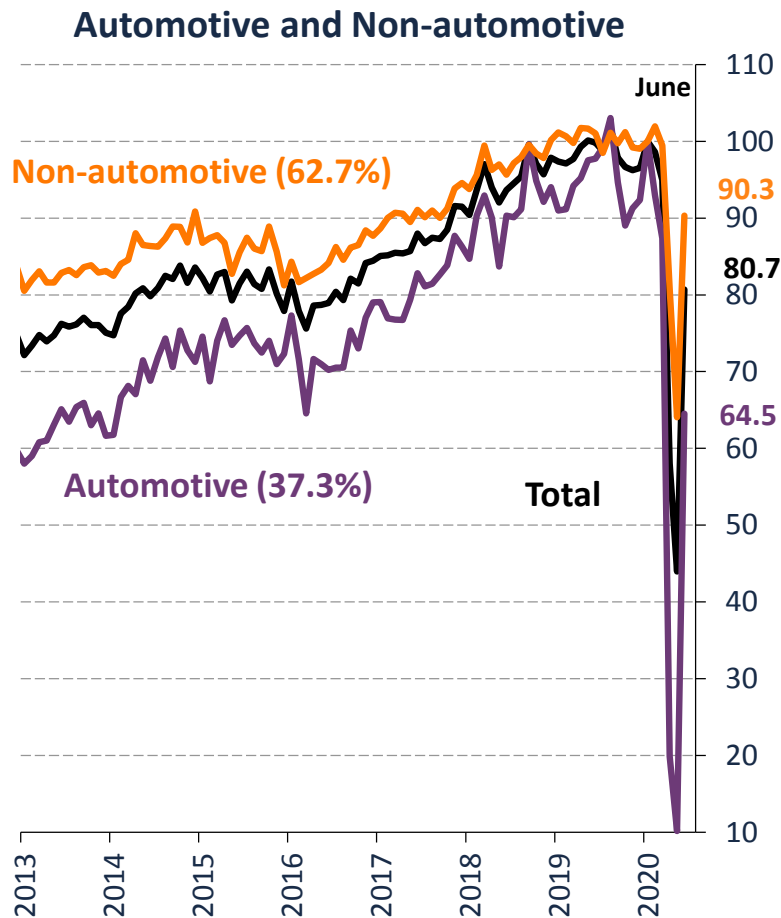


s. a. / Seasonally adjusted figures.  
2/ current dollar figures.  
Source: Prepared by Banco de México with data from PMI Comercio Internacional, S.A. de C.V., SAT, SE, Banco de México and INEGI. Commercial Balance of Goods of Mexico. SNIEG Information of National interest.

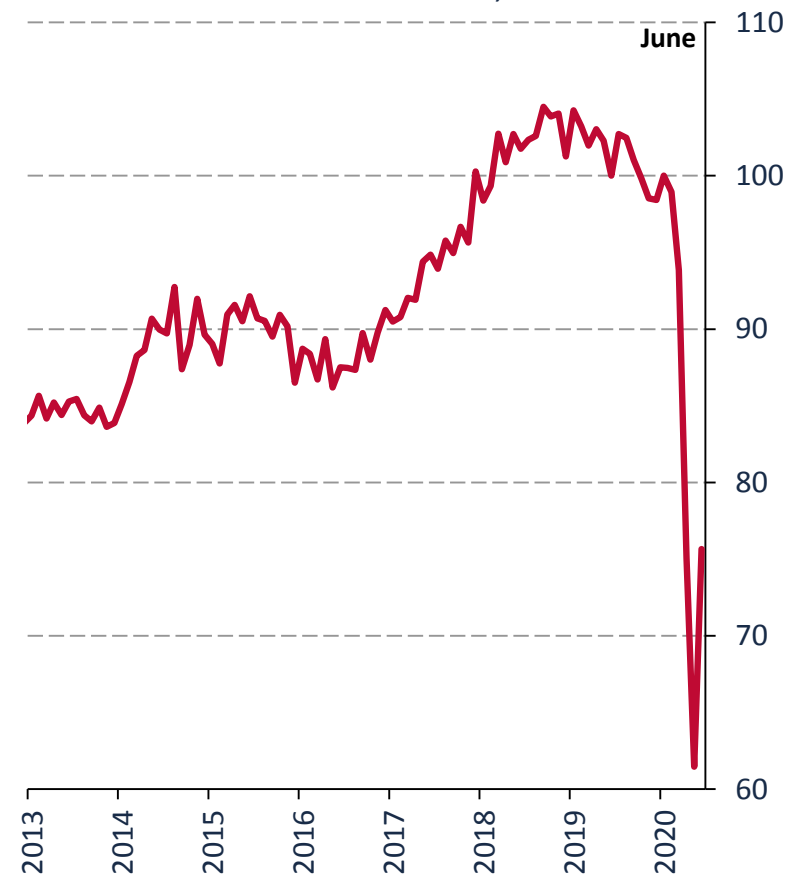


In June, manufacturing exports as well as total imports partially reversed the decline observed in the previous two months, although in both cases they remain at low levels.

**Manufacturing Exports**  
Index Jan-2020=100, s. a.



**Non-Oil Imports <sup>1/</sup>**  
Index Jan-2020=100, s. a.



s. a. / Seasonally adjusted figures.

Note: Figures in parentheses represent their share in total in Jan-2020.

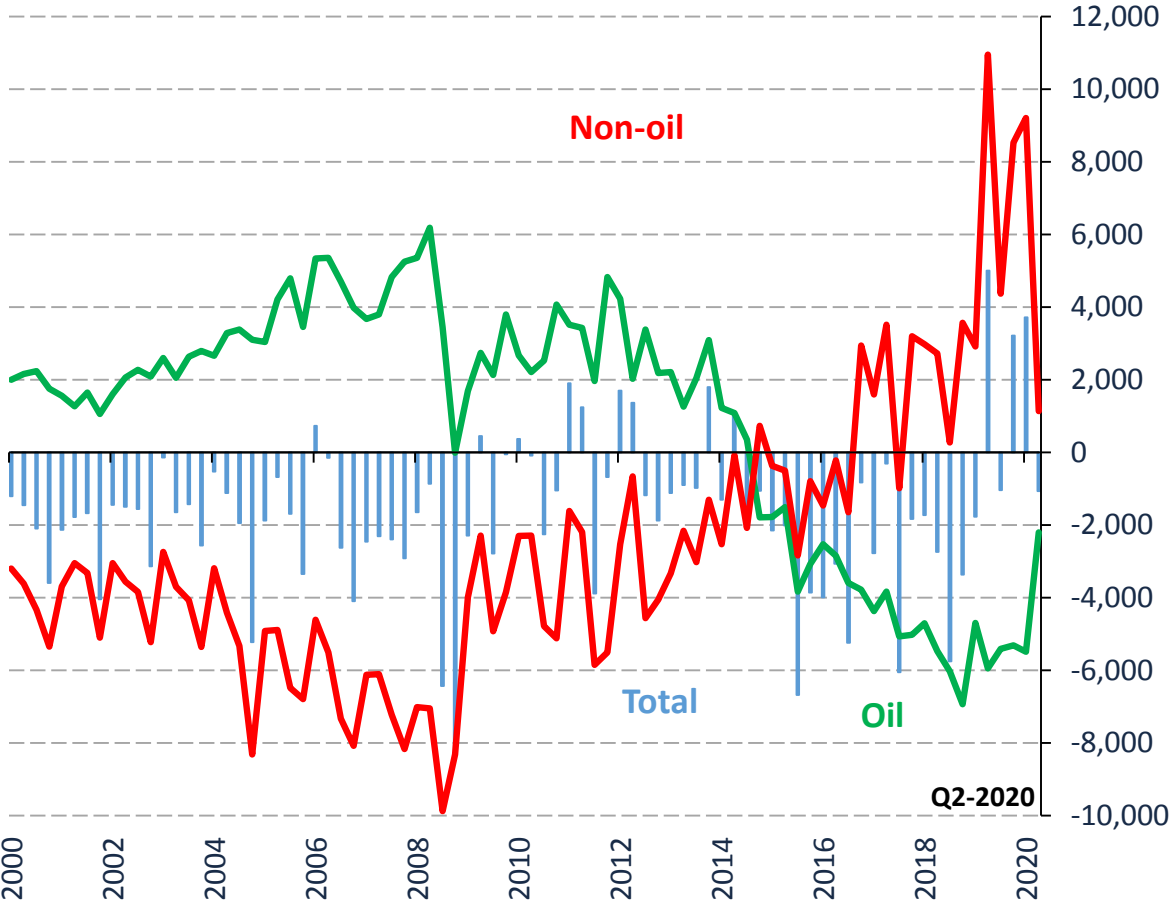
Source: Prepared by Banco de México with data from PMI Comercio Internacional, S.A. de C.V., SAT, SE, Banco de México, INEGI. Commercial Balance of Goods of Mexico. SNIEG. Information of National Interest.

s. a. / Seasonally adjusted figures. 1/ Figures in current US dollars.

Source: Prepared by Banco de México with data from PMI Comercio Internacional, S.A. de C.V., SAT, SE, Banco de México, INEGI. Commercial Balance of Goods of Mexico. SNIEG. Information of National Interest.

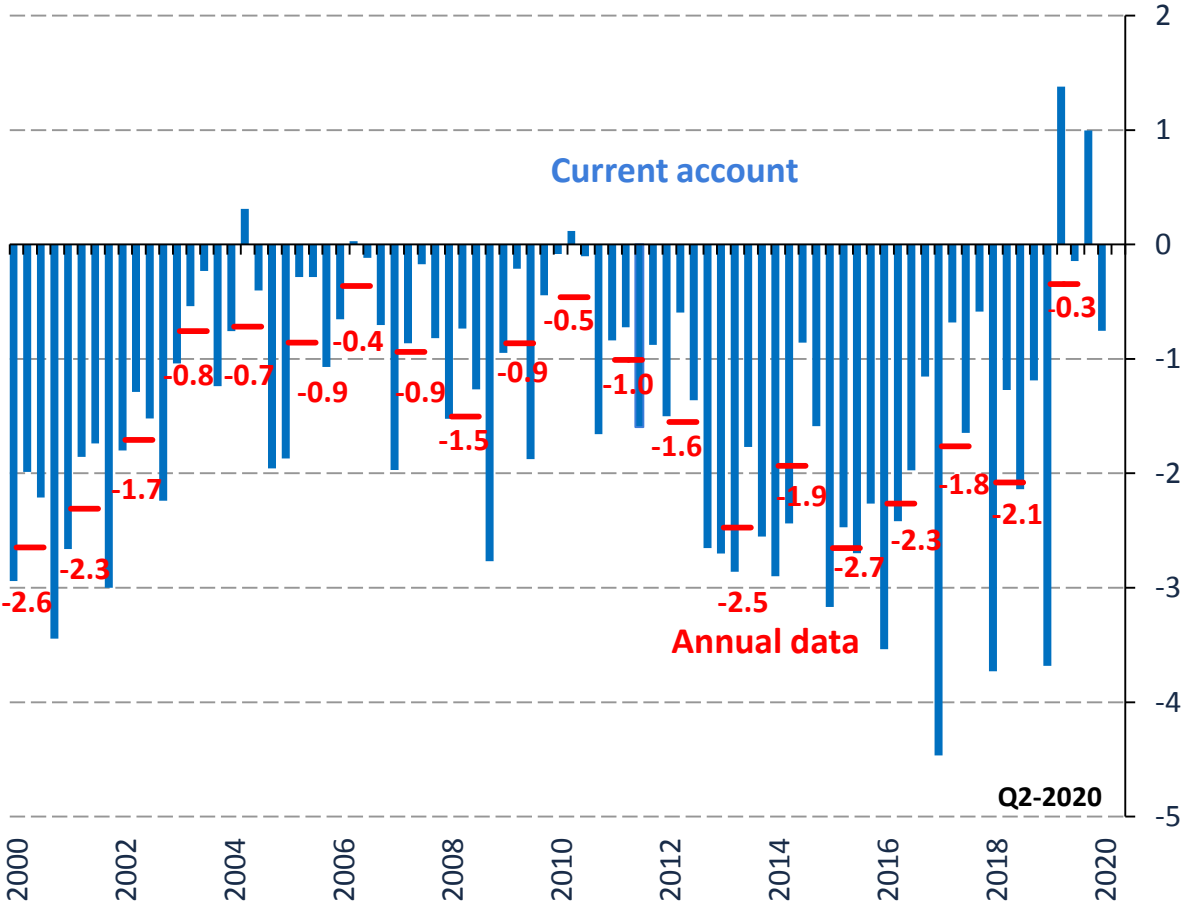
It is estimated that in Q2-2020, the current account balance declined considerably compared to the one reported in Q2-2019.

**Trade Balance**  
USD million



Source: Banco de México and INEGI

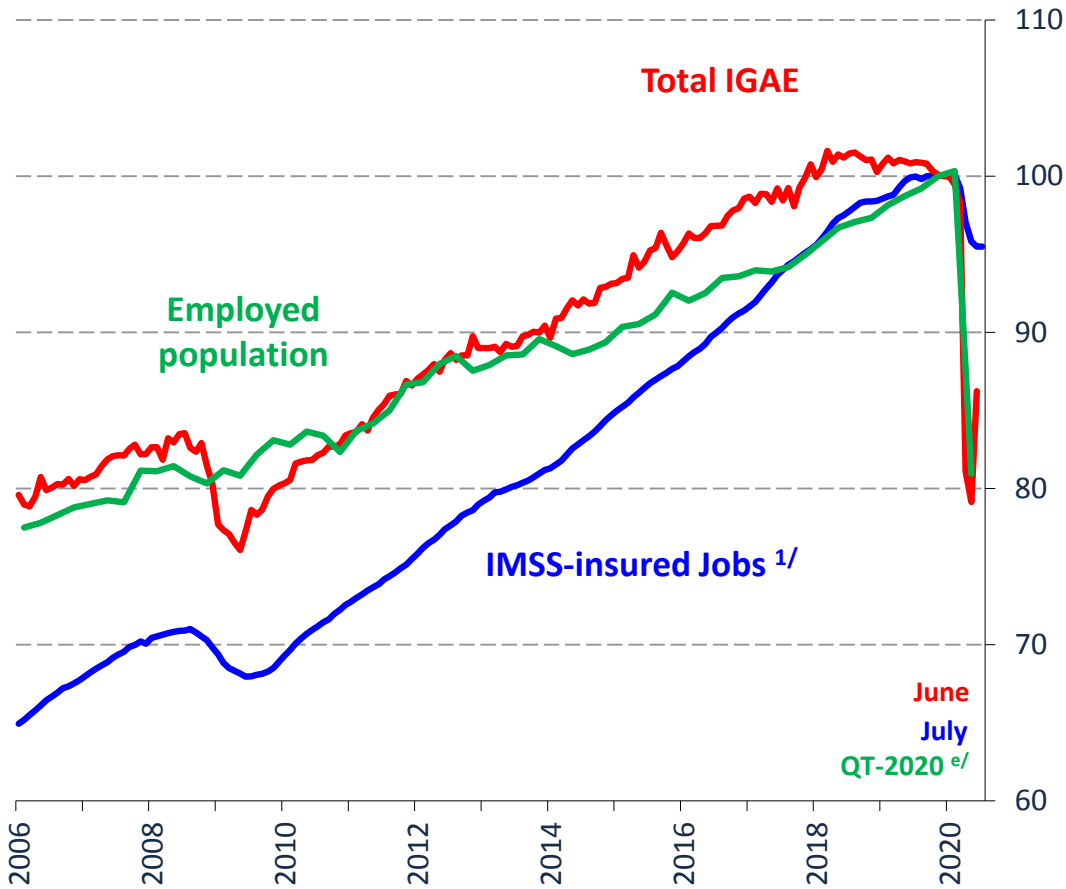
**Current Account**  
% of GDP



Source: SAT, SE, Banco de México, INEGI. Mexico's Merchandise Trade Balance. SNIEG. Information of national interest.

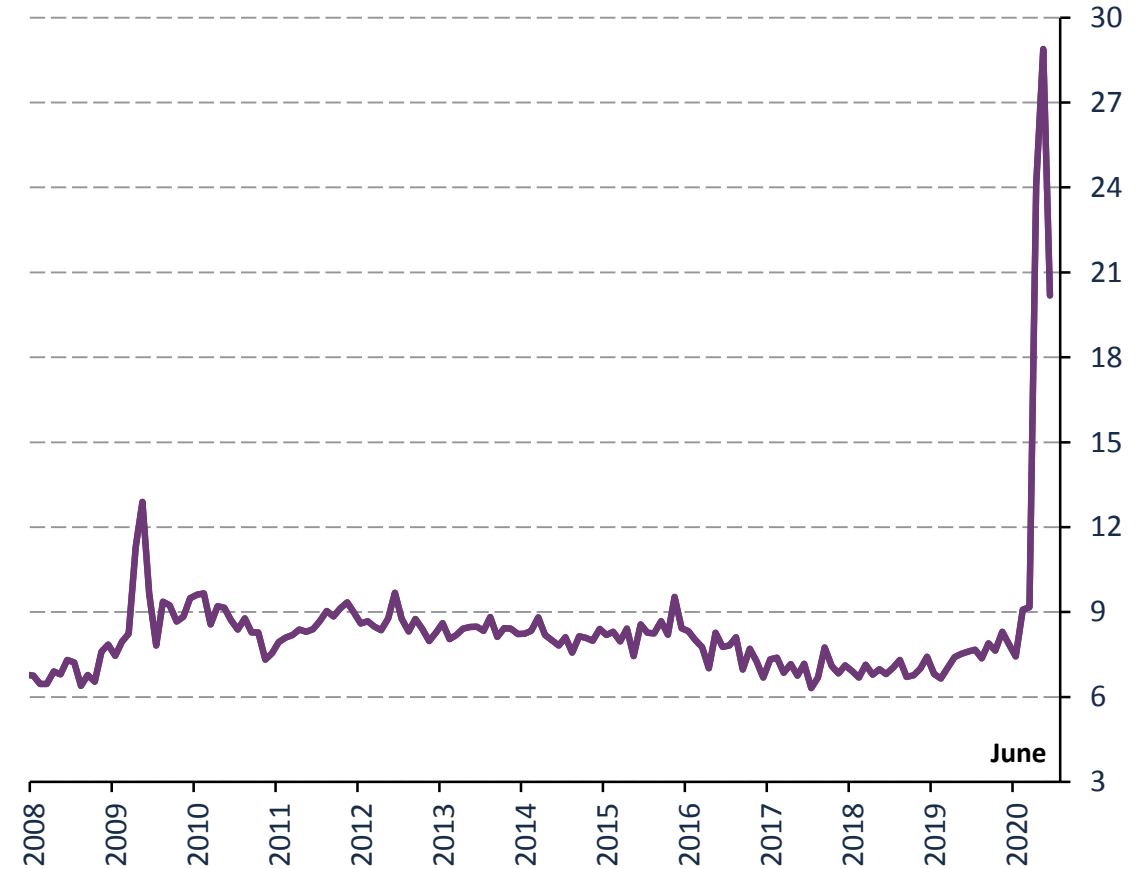
Labor conditions in the formal and, especially, in the informal sector, deteriorated considerably as a result of the COVID-19 pandemic and the measures to contain it.

**IMSS-insured Jobs, Total IGAE and Employed Population**  
Index 2020=100, s. a.



s. a. / Seasonally adjusted figures.  
1/ Refers to permanent and temporary urban workers. Seasonal adjustment by Banco de México.  
e/ Estimation from the April-June 2020 ETOE 2020.  
Source: Prepared by Banco de México with data from IMSS and INEGI. (SCNM, ENOE and ETOE).

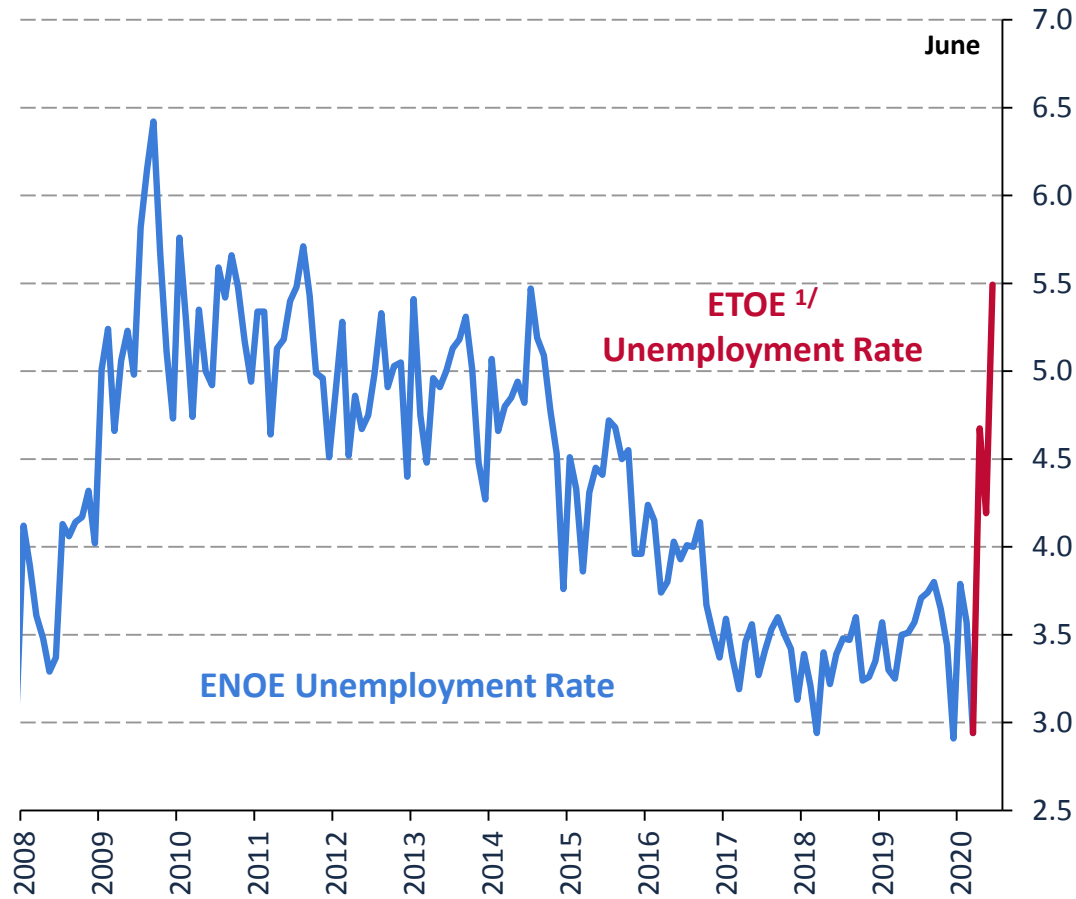
**Underemployment Rate**  
%, s. a.



s. a. / Seasonally adjusted figures. The seasonal adjustment was made based on the seasonal adjustment models used by INEGI.  
Source: Prepared by Banco de México with data from ENOE and ETOE, INEGI.

Employment declined significantly in April, associated with the considerable number of individuals who exited the labor force and a relatively modest increase in the unemployment rate. Insofar as certain restrictions on firms' operations and on population's mobility have eased, an improvement was observed in June.

**National Unemployment Rate**  
%, O. S.



o. s./ Original series

1/ The April, May and June 2020 figures are those released in the Telephone Survey of Occupation and Unemployment (ETOE, for its acronym in Spanish), and are not fully comparable with the figures of the ENOE. They are presented only as a reference.

Source: Prepared by Banco de México with data from ENOE and ETOE, INEGI.

**National Labor Participation Rate <sup>2/</sup>**  
%, s. a.



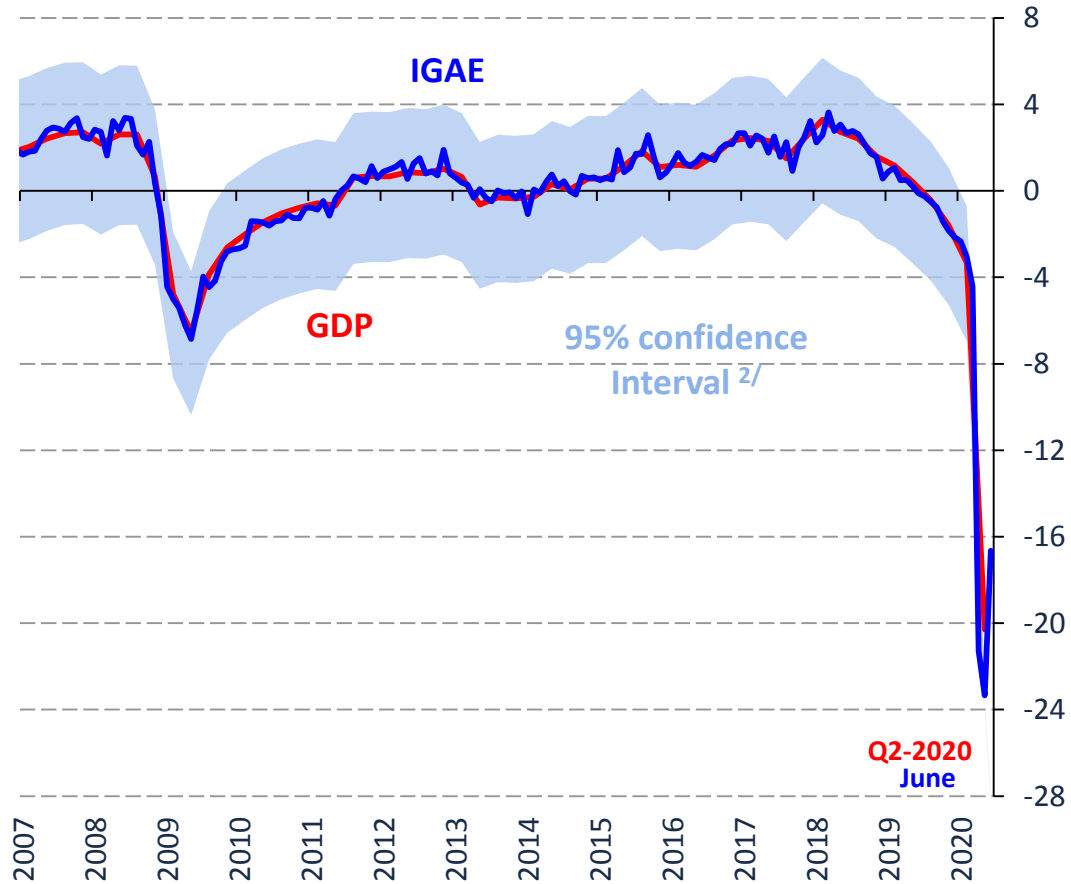
s. a. / Seasonally adjusted and trend data.

2/ Percentage of Economically Active Population (EAP) with respect to the population of 15 years and older.

Source: Prepared by Banco de México with data from ENOE and ETOE, INEGI.

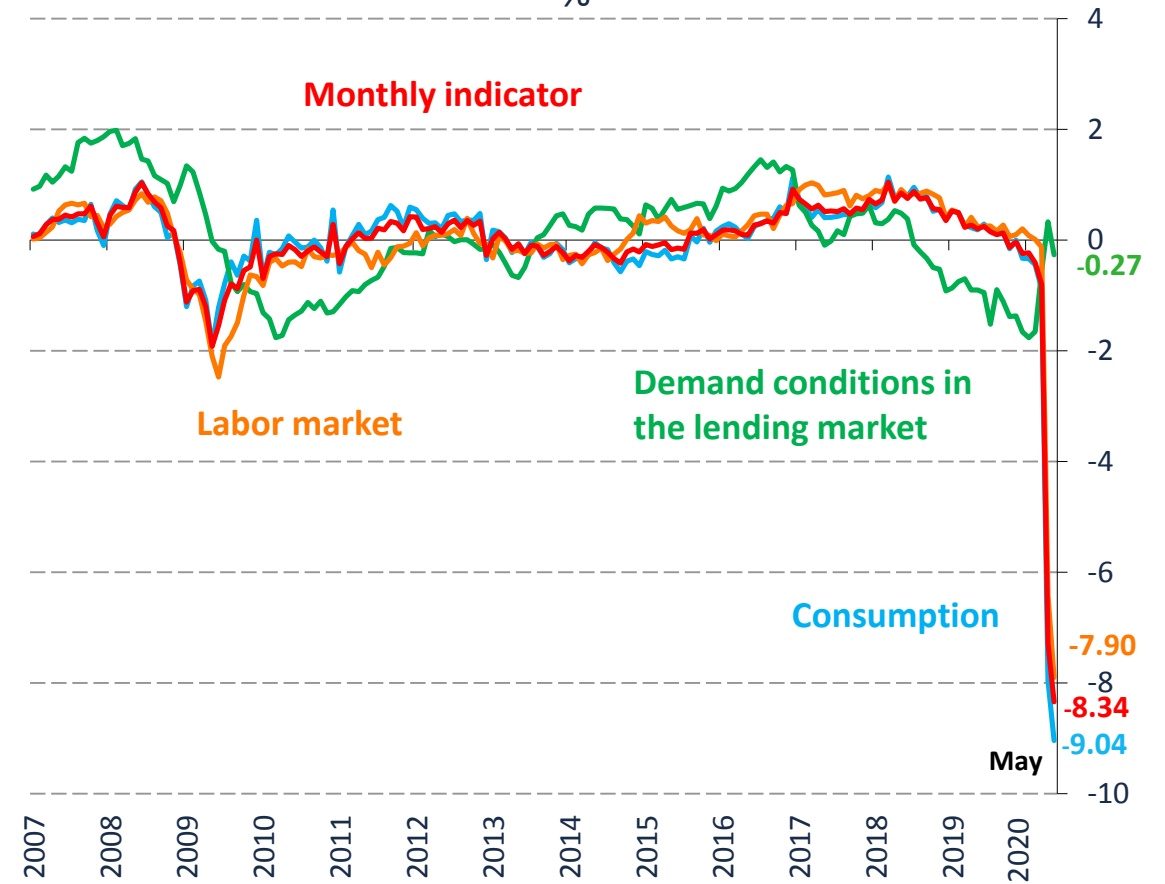
In Q2-2020 slack conditions widened significantly. Output gap estimates for Q2-2020 are significantly below those registered in 2009.

**Output Gap Estimate <sup>1/</sup>**  
% of potential output, s. a.



s. a. / Seasonally adjusted data.  
 1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see “Inflation Report April – June 2009”, Banco de México, p. 74.  
 2/ Output gap confidence interval calculated with a method of unobserved components.  
 Source: Prepared by Banco de México with data from INEGI and Banco de México.

**Monthly Slack Indicators: Main Component by Indicators Frequency <sup>3/</sup>**  
%



3/ Main Indicators constructed using CCM methodology; see Banco de México (2018), “Quarterly Report, October-December 2017”, p.47. Monthly slack indicators are constructed with the main component of sets of series which includes 11 indicators. Slack indicators of consumption, economic activity, aggregate demand, labor market and demand conditions in the lending market are based on the first main component of sets of series which includes 6, 4, 3 and 6 indicators, respectively.  
 Source: Prepared by Banco de México with data from INEGI and Banco de México.

# Outline

**1 External conditions**

**2 Current situation of the Mexican economy**

**3 Inflation**

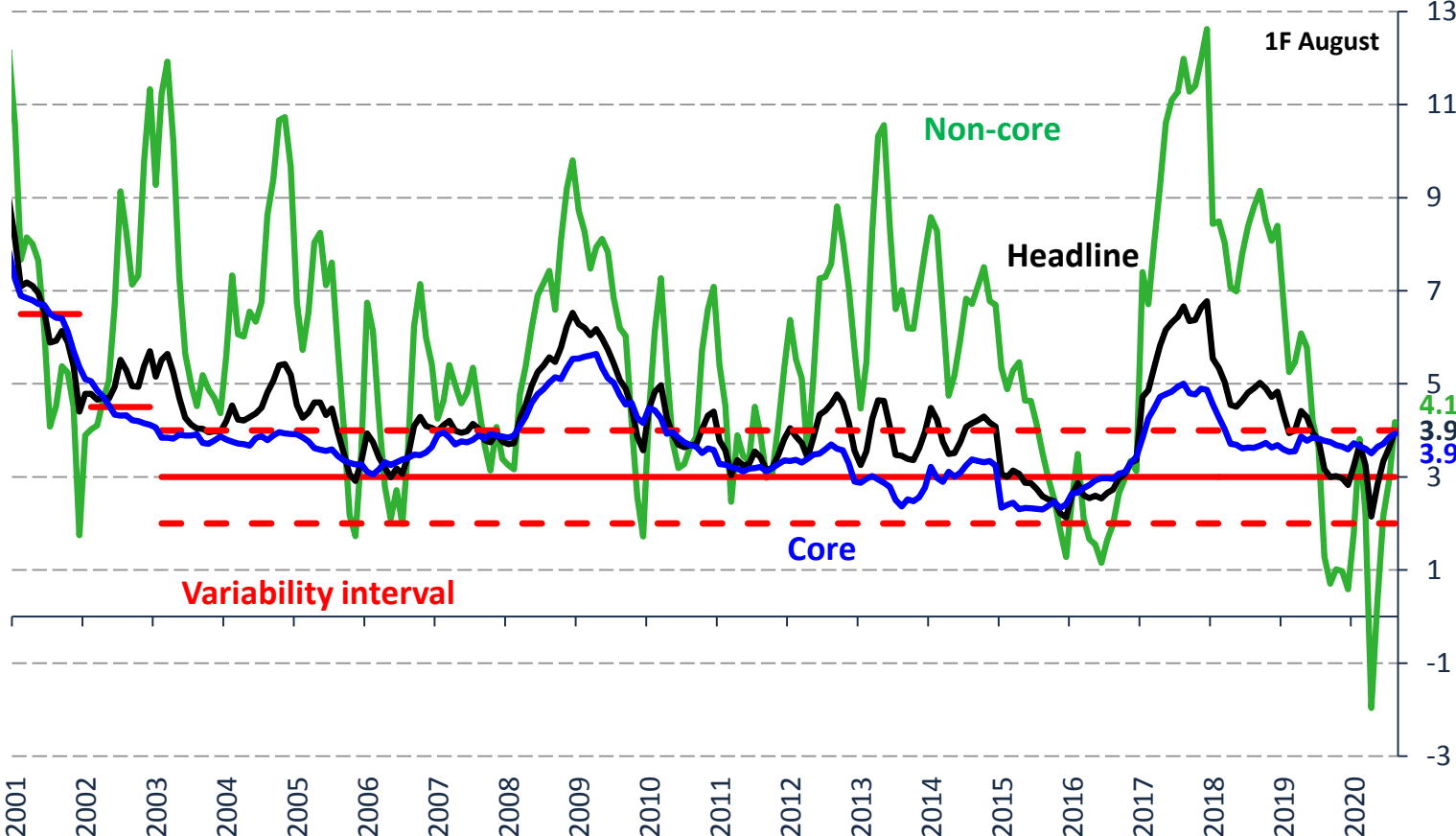
**4 Monetary policy**

**5 Forecasts and final remarks**

The behavior of inflation reflects both downward and upward pressures, resulting from the shocks derived from the COVID-19 pandemic. Annual headline inflation in April was 2.15%, the second lowest on record. Since then it has been increasing, reaching 3.99% in the first fortnight of August.

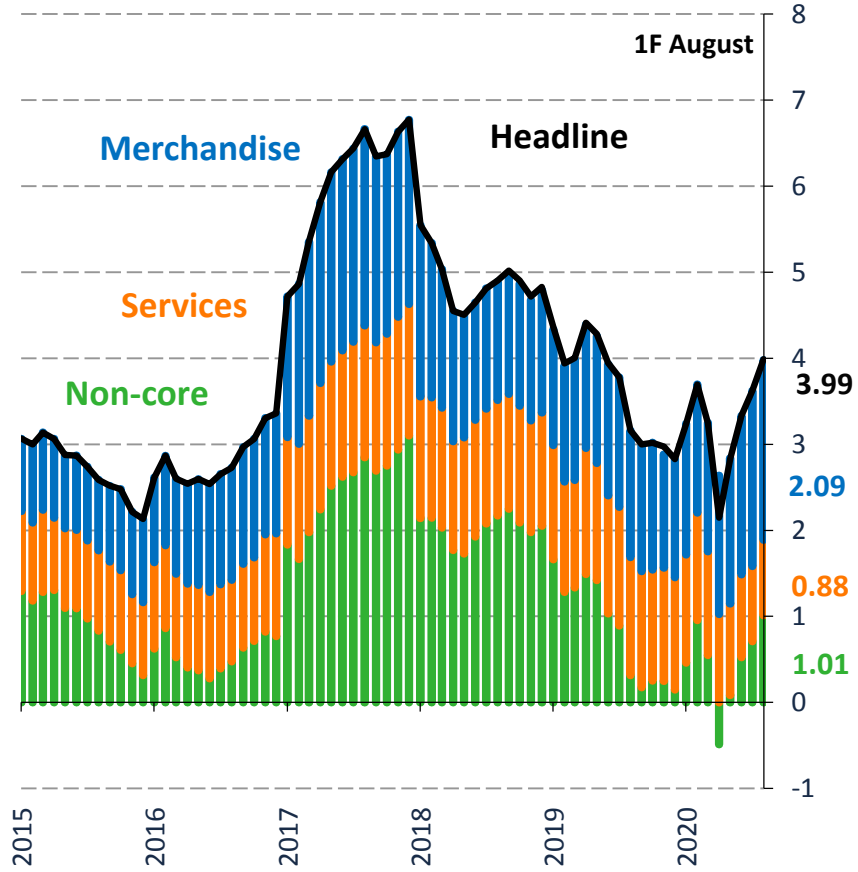
### Consumer Price Index

Annual % change <sup>1/</sup>



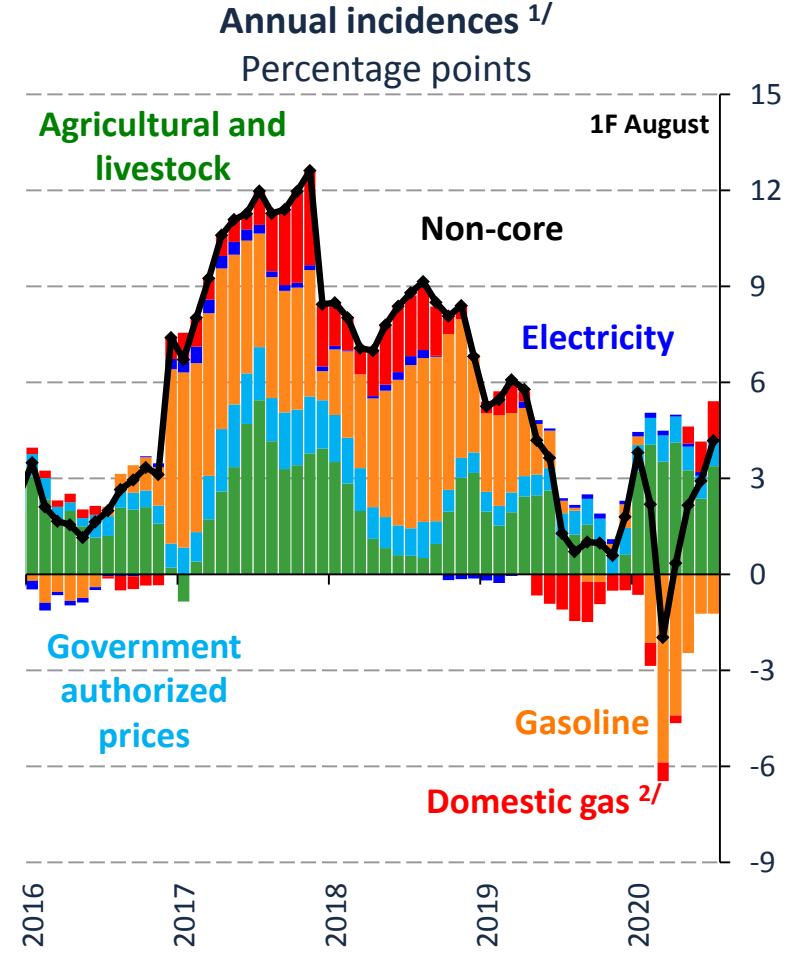
1/ Since 2003, a permanent inflation target of 3%, with a variability interval of +/-1%, was established for headline inflation. Source: Banco de México and INEGI.

Annual Incidences in percentage points <sup>2/</sup>

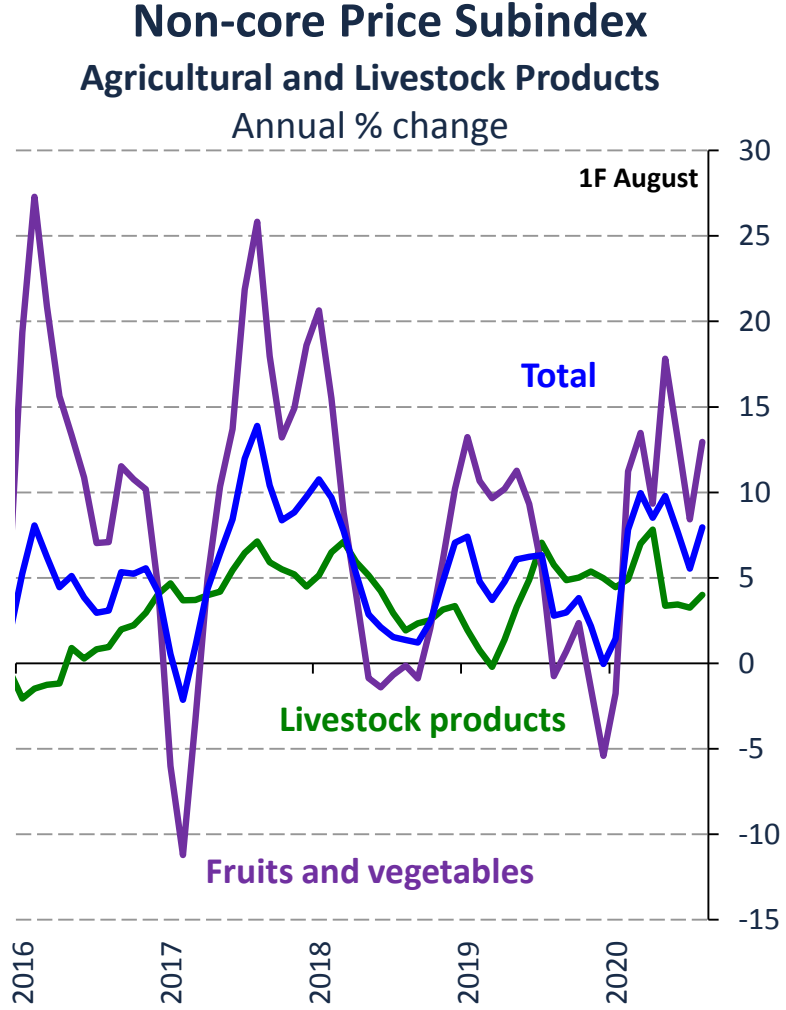


2/ The sum of inflation's components may not add up due to rounding. Source: Prepared by Banco de México with data from INEGI.

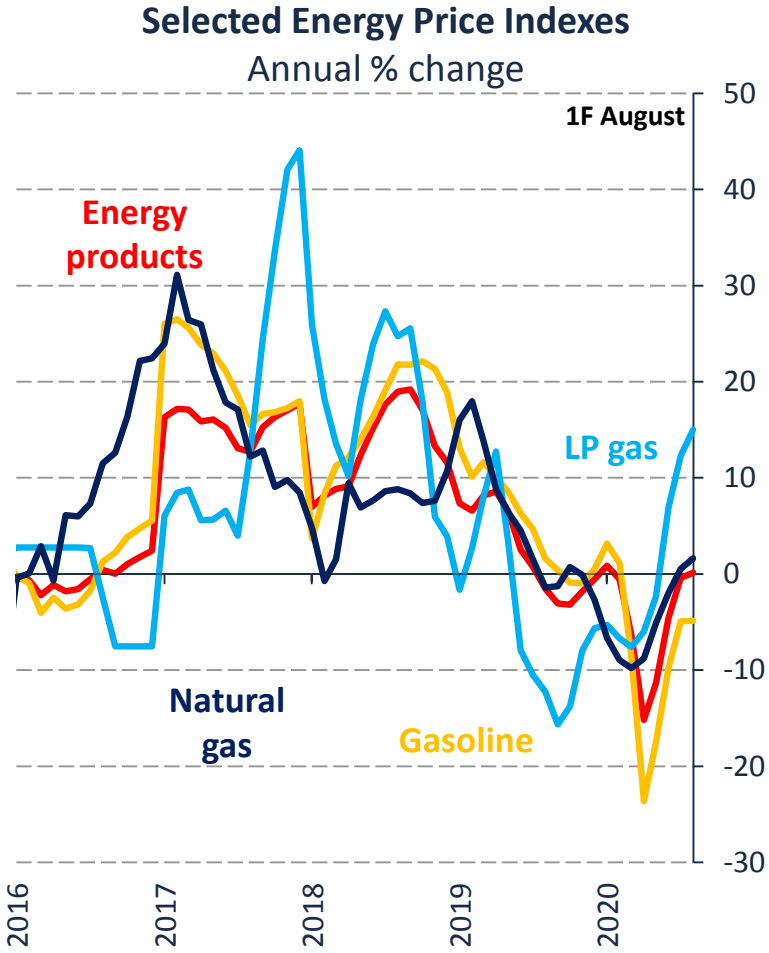
Between Q1 and Q2-2020 non-core inflation declined. In April it lay at an historically low level of -1.96% given the sharp decline in energy prices, albeit these have been increasing in the following months, thus exerting pressure on non-core inflation (4.18% in the first fortnight of August).



1/ In certain cases, the sum of inflation's components may not add up due to rounding. 2/ Includes LP gas and natural gas.  
Source: Calculated by Banco de México with data from INEGI.



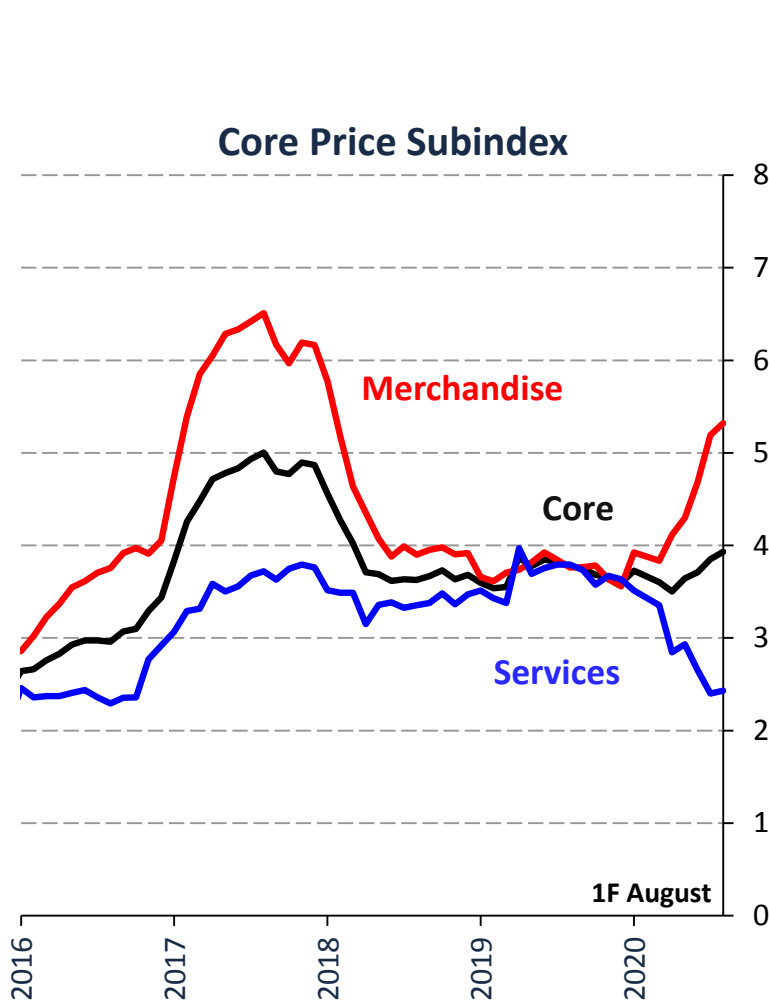
Source: Banco de México and INEGI.



Source: Banco de México and INEGI.

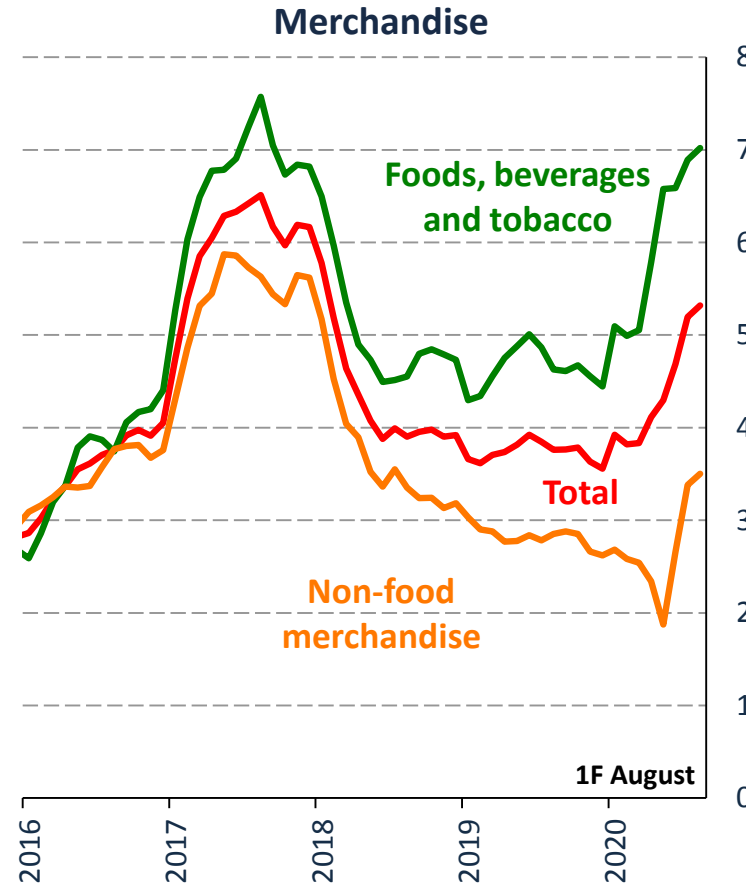


Core inflation has been affected by the pandemic, registering upward pressures in merchandise prices and downward pressures in those of services, with higher annual rates of change.

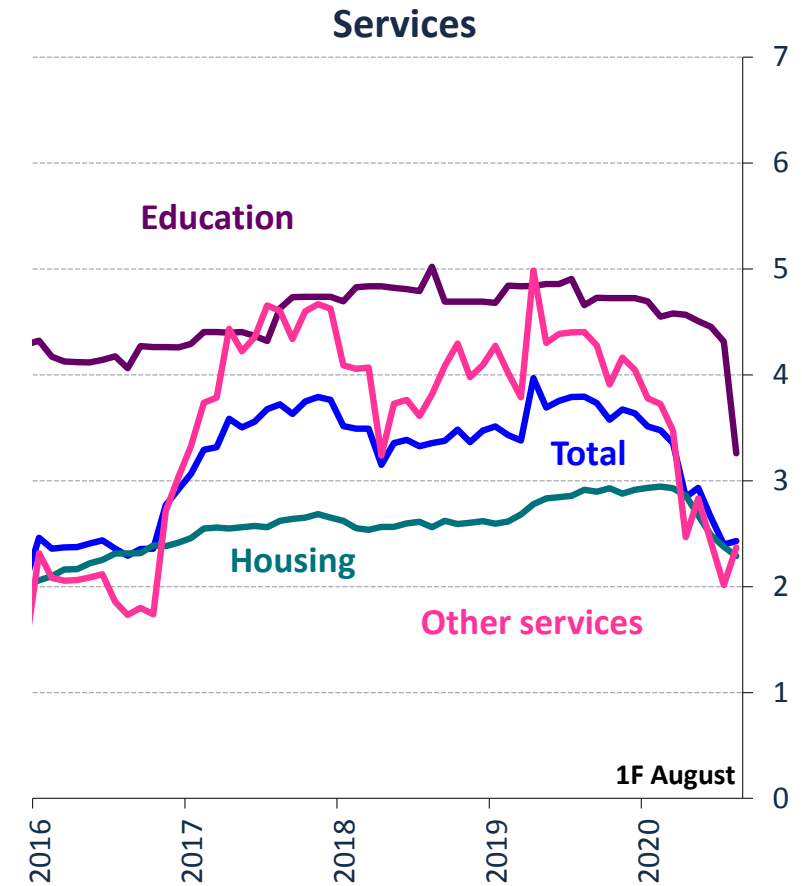


Source: Banco de México and INEGI.

### Core Price Subindex Annual % change



Source: Banco de México and INEGI.



Source: Banco de México and INEGI.

The pandemic has generated significant shocks to inflation. To the upside: in food merchandise prices, and later, in most non-food merchandise prices; to the downside: in services prices.

### Core Inflation and Components

Monthly % change s. a.

April 2020

May 2020

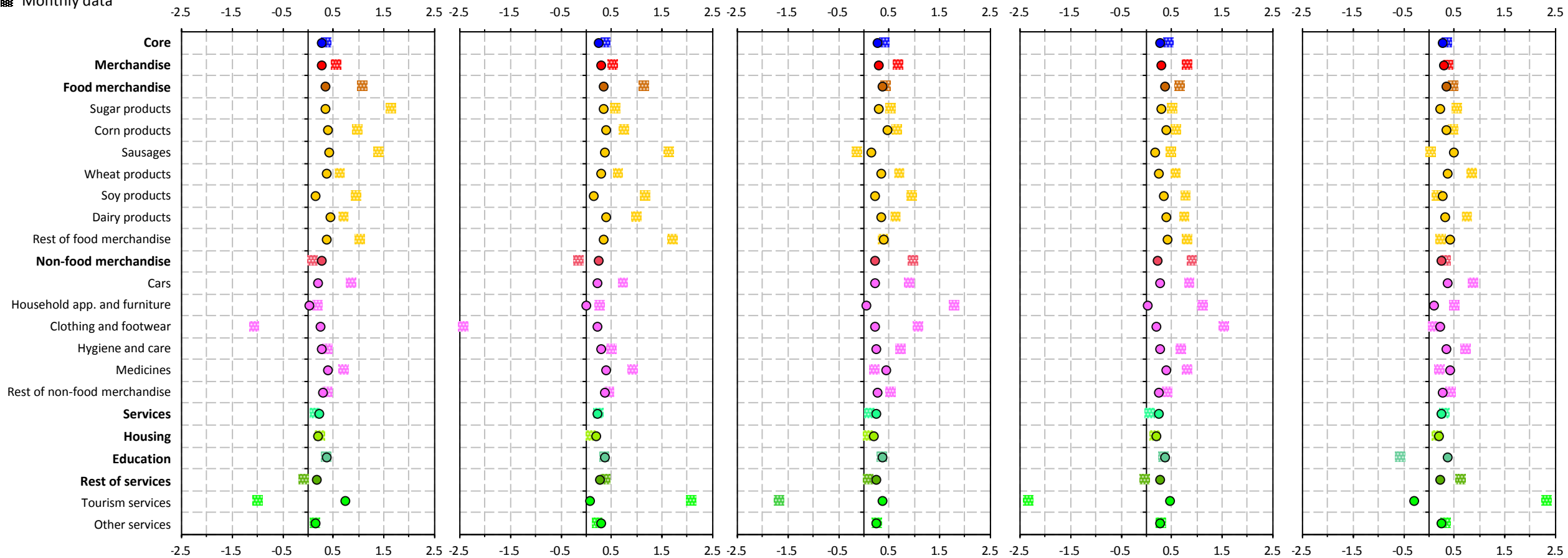
June 2020

July 2020

1F August 2020

● Average 2010-2019

■ Monthly data



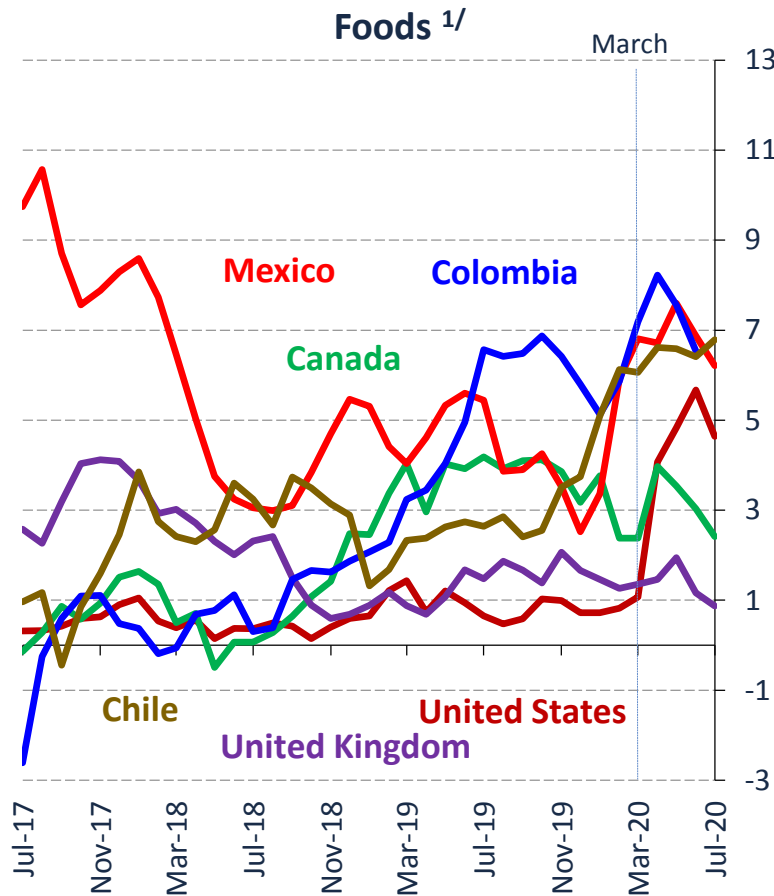
s. a. / Seasonally adjusted figures.

Source: Prepared by Banco de México with INEGI data.

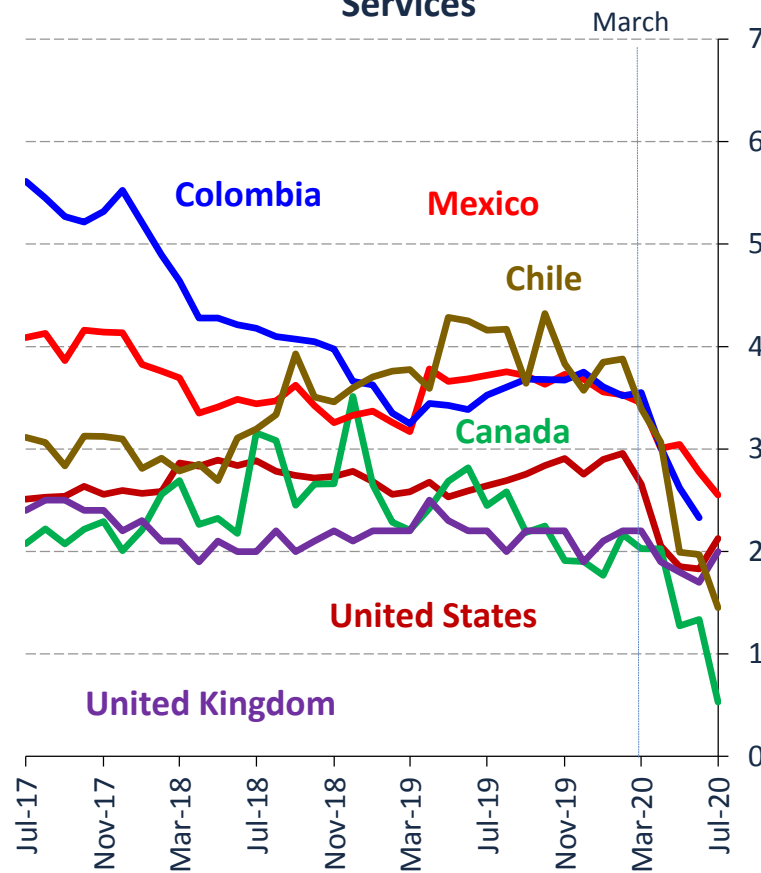
The pandemic has had a significant impact on inflation in different countries, both advanced and emerging. Upward pressures have been observed on food prices and downward pressures on services prices.

### Consumer Price Indices in Different Countries

Annual % change



Services



### Consumer Price Index Weight

%

Country	Foods <sup>2/</sup>	Services
United States	7	64
Canada	11	51
United Kingdom	8	59
Mexico	26	42
Colombia	15	48
Chile	19	44

<sup>2/</sup> Includes processed and unprocessed foods.  
Source: Prepared by Banco de México with data from OECD and Haver Analytics

<sup>1/</sup> Includes processed and unprocessed foods.

Source: Prepared by Banco de México with data from INEGI, OECD and Haver Analytics.

# Outline

**1 External conditions**

**2 Current situation of the Mexican economy**

**3 Inflation**

**4 Monetary policy**

**5 Forecasts and final remarks**

## Banco de México continued to conduct monetary policy in an environment of high uncertainty.

**April**  
(unscheduled decision)  
50bp reduction  
to 6.0%

- ✓ The Governing Board considered the risks for inflation, economic activity and financial markets **derived from the COVID-19 pandemic**, which pose **significant challenges** for monetary policy and the economy in general.
- ✓ The Board announced **additional measures** to promote the well-functioning of financial markets, strengthen credit provision, and provide liquidity for the sound development of the financial system.

**May**  
50bp reduction  
to 5.5%

- ✓ It considered that **the challenges for monetary policy posed by the pandemic** include both the **significant impact on economic activity** and a **financial shock**.
- ✓ It considered **the risks for inflation, economic activity and financial markets**. In this context, the referred decisions were made based on the foreseen scenarios and **considering the room for maneuver that on balance these provide to monetary policy**.

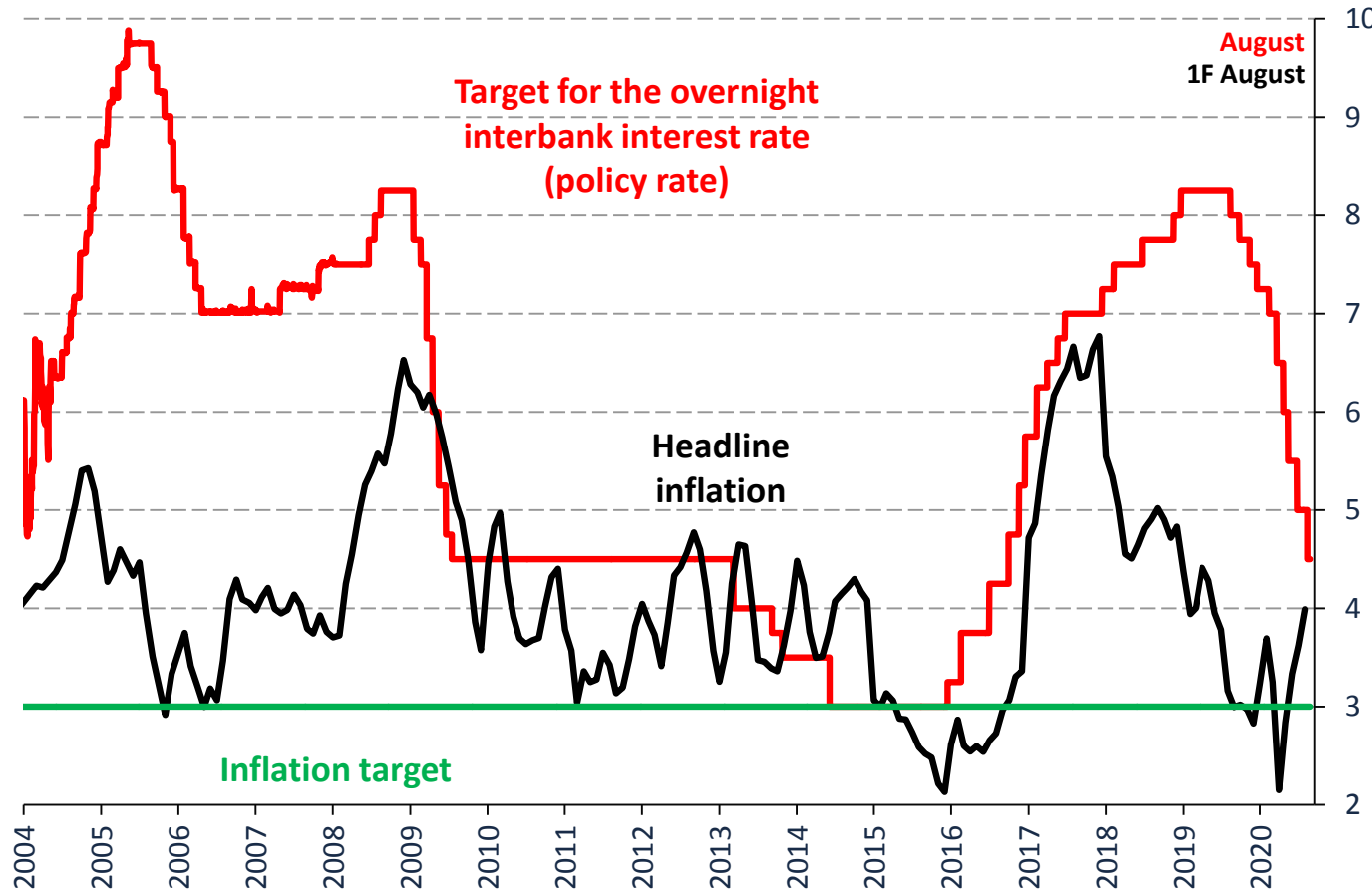
**June**  
50bp reduction  
to 5.0%

- ✓ In the August decision, it stated that looking ahead, **the available room for maneuver** will depend on **the evolution of the factors** that have an incidence on **the inflation outlook and its expectations**, including the effects that the pandemic might have on both.

**August**  
50bp reduction  
to 4.5%

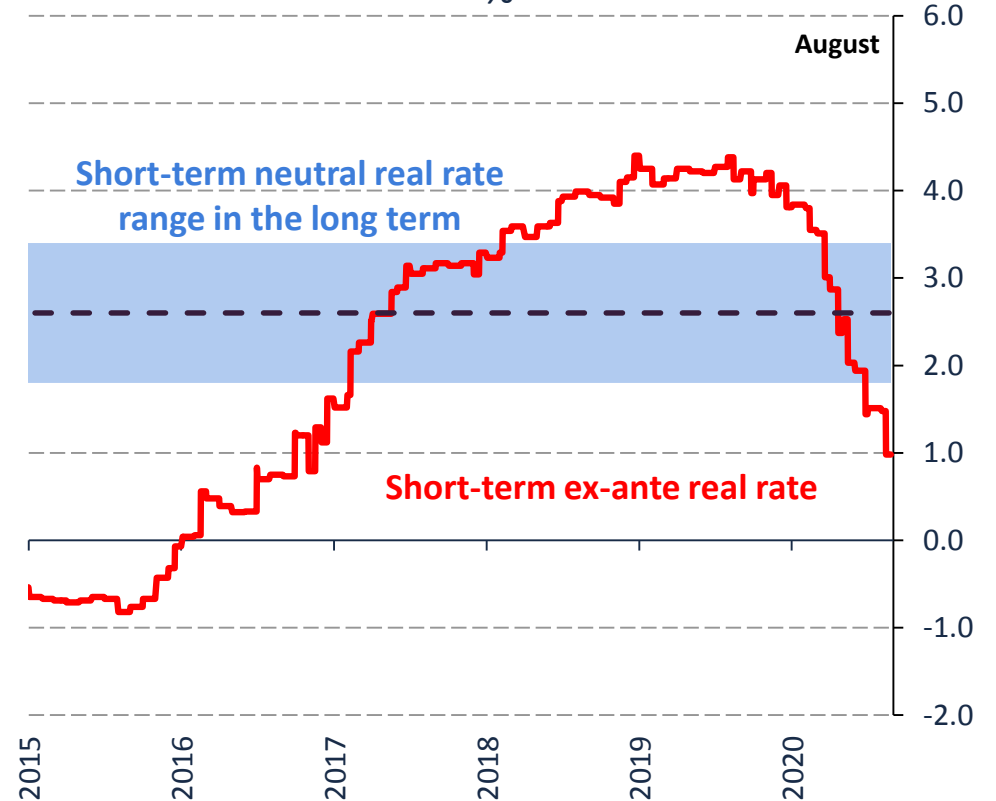
From April 2020 to date the Governing Board lowered the reference rate by 200 basis points, taking the target for the overnight interbank interest rate to its current level of 4.5%.

Target for the Overnight Interbank Interest Rate and Headline Inflation <sup>1/</sup>  
%, annual % change



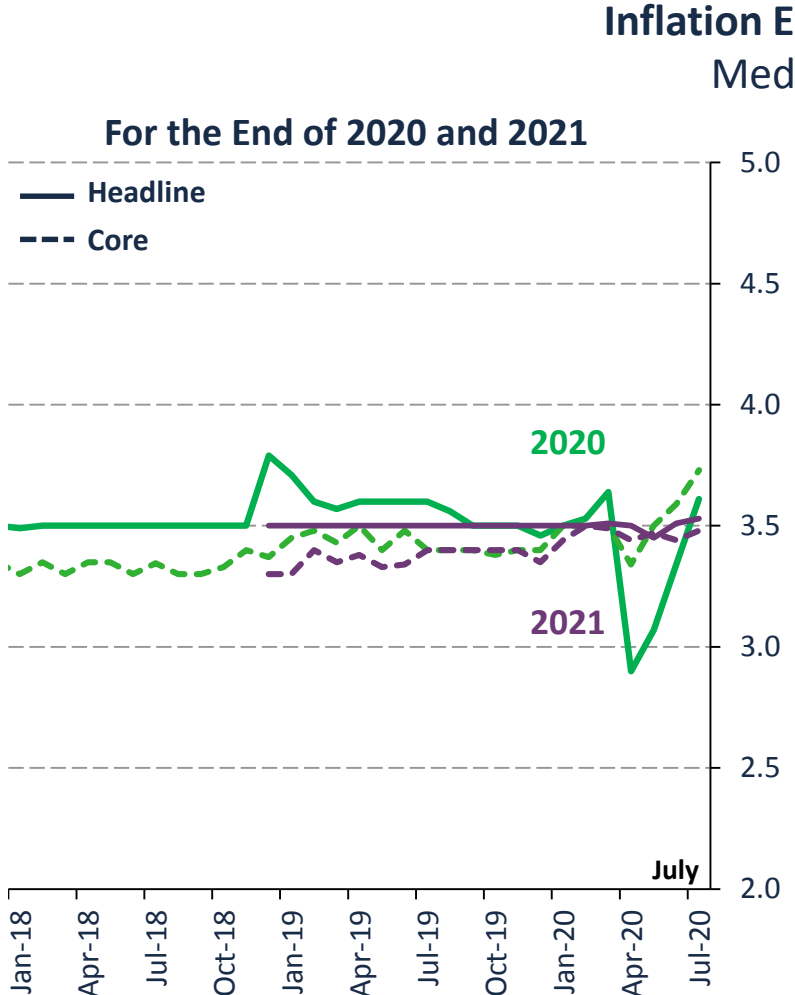
<sup>1/</sup>The data shown up to January 20, 2008 corresponds to the overnight interbank interest rate (policy rate).  
Source: Prepared by Banco de México with INEGI data.

Short-term Ex-ante Real Rate and Estimated Range for the Short-term Neutral Real Rate in the Long Term <sup>2/</sup>  
%

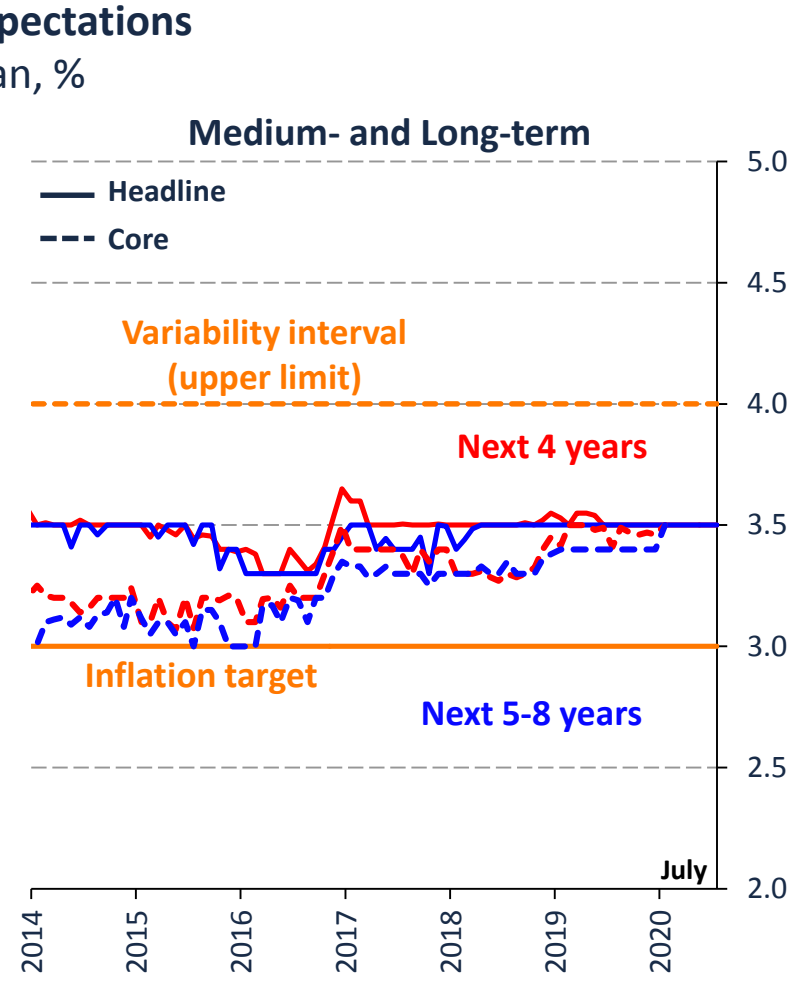


<sup>2/</sup> The short-term ex-ante real rate is constructed using the Target for the Overnight Interbank Interest Rate and 12-month inflation expectations from Banco de México's Survey. The dotted line corresponds to the midpoint of the range for the short-term neutral real rate in the long term, which is now between 1.8 and 3.4%. Source: Banco de México.

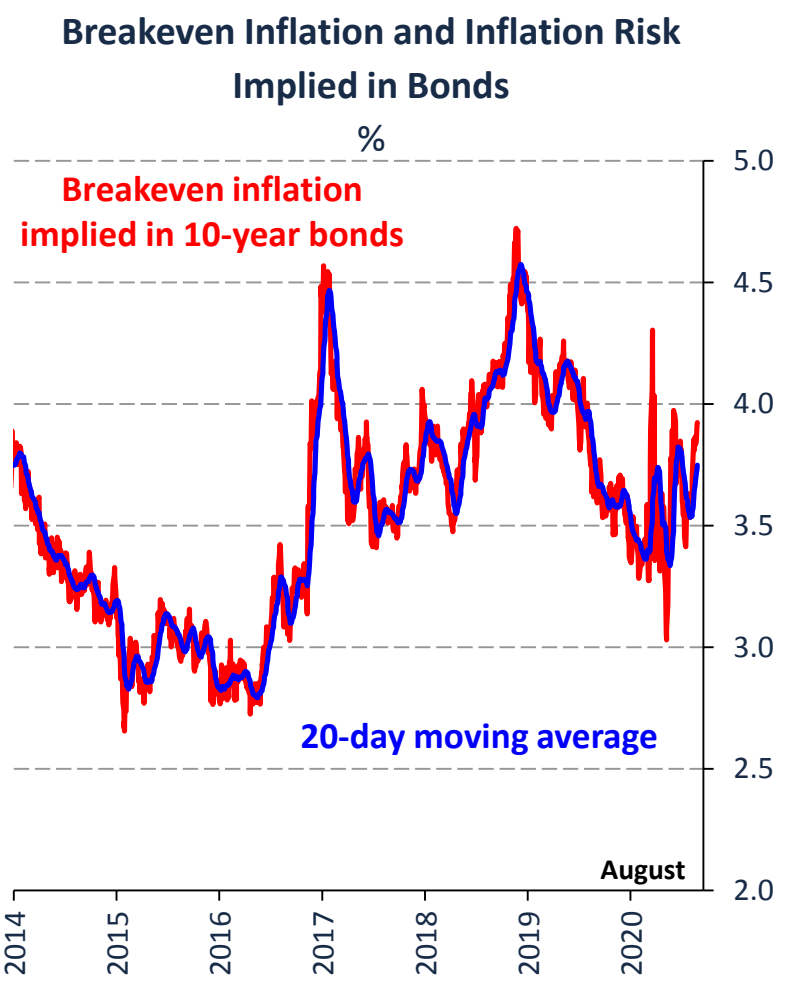
Headline inflation expectations for the end of 2020 have increased given the adjustments exhibited by inflation over the last months. Medium- and long-term expectations remained relatively stable, although breakeven inflation and inflationary risk exhibited volatility.



Source: Banco de México's Survey of Private Sector Forecasters.



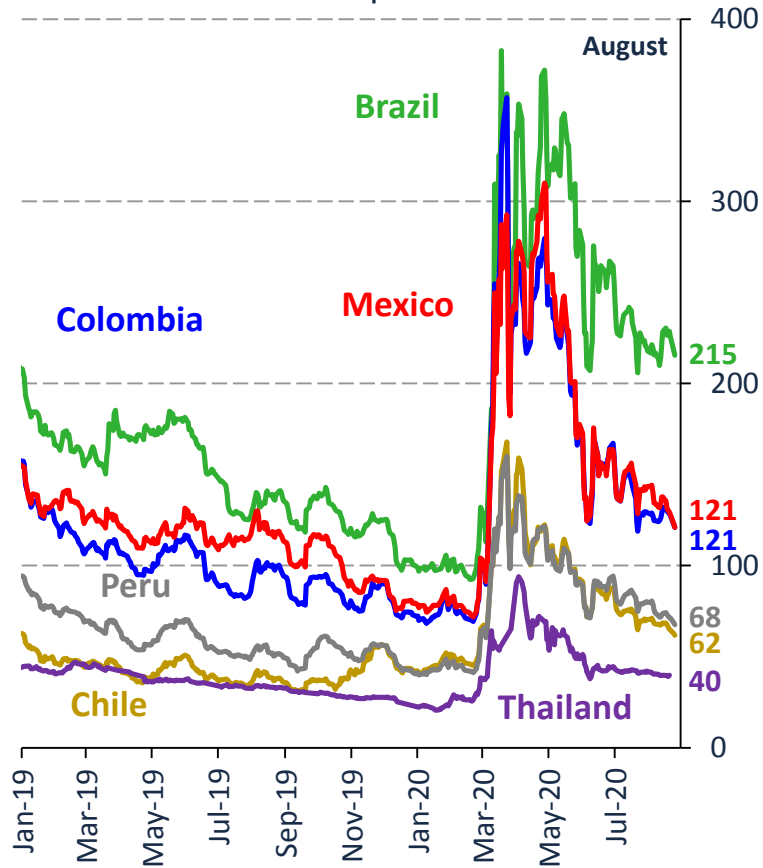
Source: Banco de México's Survey of Private Sector Forecasters.



Note: Breakeven Inflation and Inflation risk is calculated as the difference between nominal and real long-term interest rates.  
Source: Estimated by Banco de México with Valmer and PIP data.

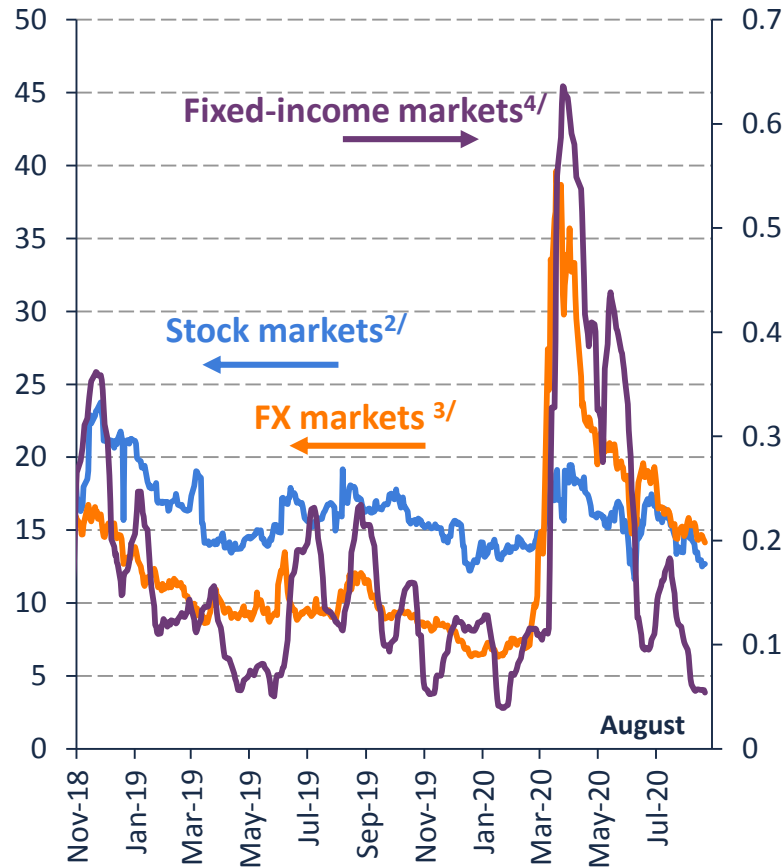
After being affected by the financial shock in March, domestic financial markets began to recover, although they have not returned to pre-pandemic conditions and have continued to register bouts of volatility.

**Market Indicators that Measure Domestic Sovereign Credit Risk<sup>1/</sup>**  
Basis points



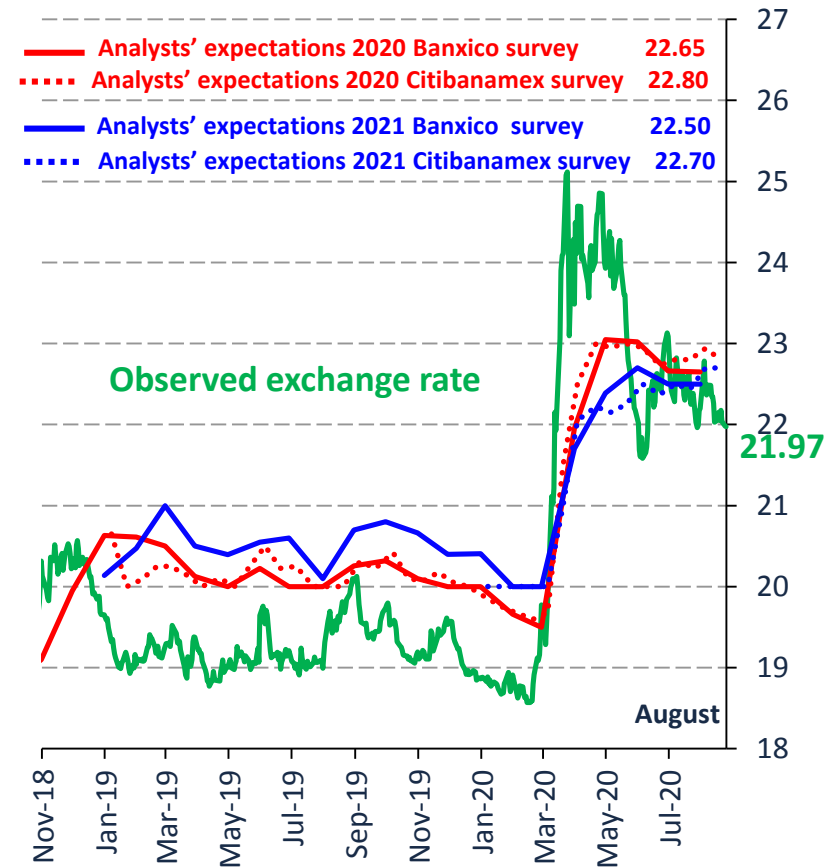
1/ Refers to 5-year Credit Default Swaps (CDS).  
Source: Bloomberg.

**Volatility in Mexican Financial Markets**  
%



2/ Refers to the volatility index of S&P of the Mexican Stock Exchange.  
3/ Refers to volatility implied in 1-month Mexican peso options.  
4/ Refers to a standard deviation of a 30-day moving window of 10-year interest rates in Mexico.  
Source: Bloomberg and Proveedor Integral de Precios (PiP).

**Nominal Exchange Rate<sup>5/</sup>**  
Pesos per US dollar



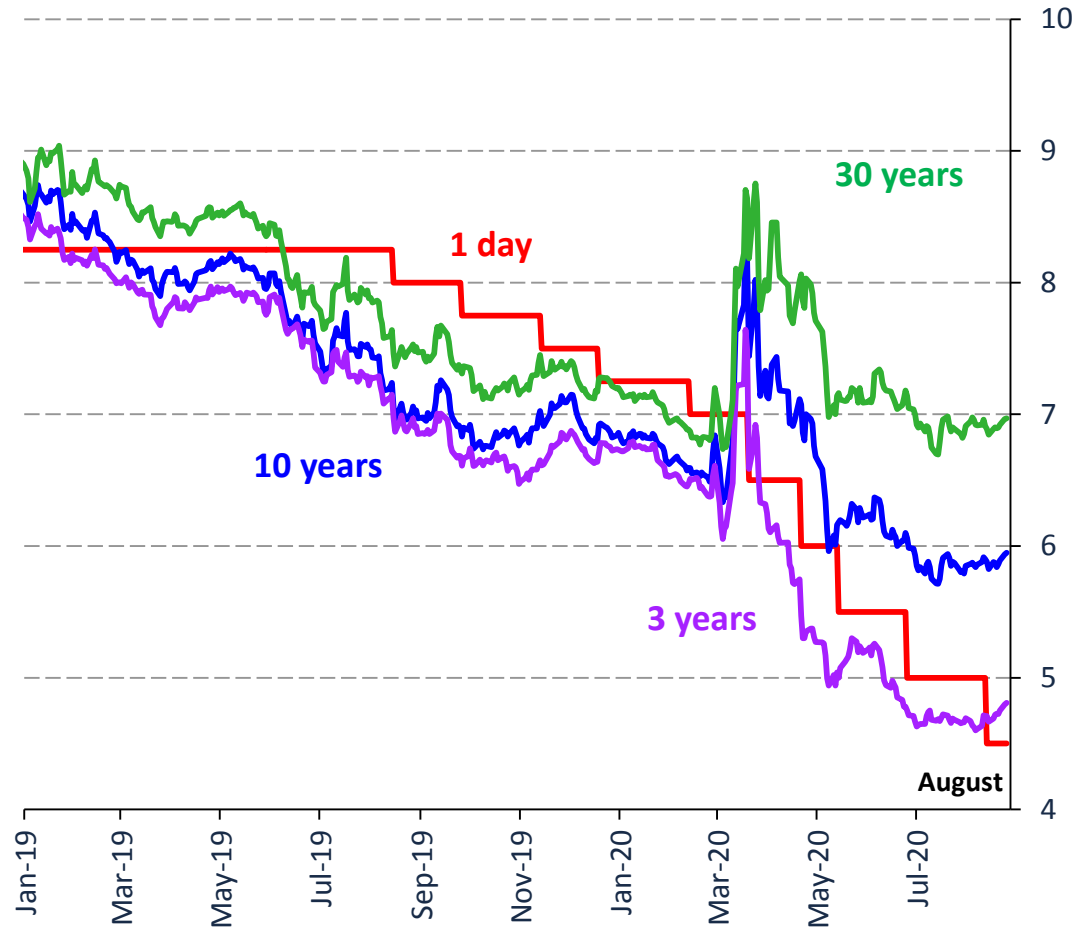
5/ Observed exchange rate refers to the daily FIX exchange rate. Figures aside analysts' expectations correspond to the medians of Banco de México's survey for July and the Citibanamex survey for August 20, 2020.  
Source: Banco de México and Citibanamex.



From the end of March to date the yield curve shifted downwards in all of its nodes. In particular, short term yields reflected the monetary policy adjustments, while medium- and long-term yields reflected the improvement in global risk appetite and contained inflationary risk premia.

Government Bond Interest Rates In Mexico

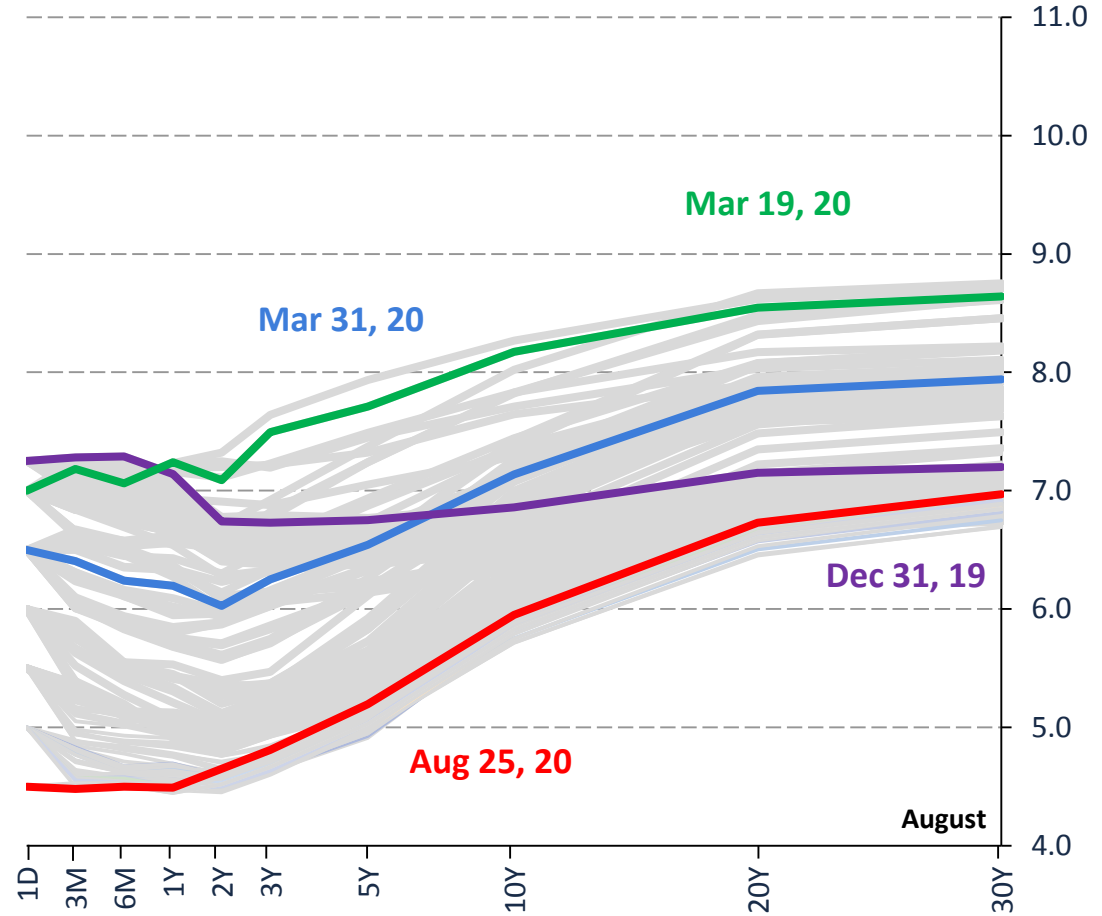
%



Source: Proveedor Integral de Precios (PIP).

Yield Curve of Mexico

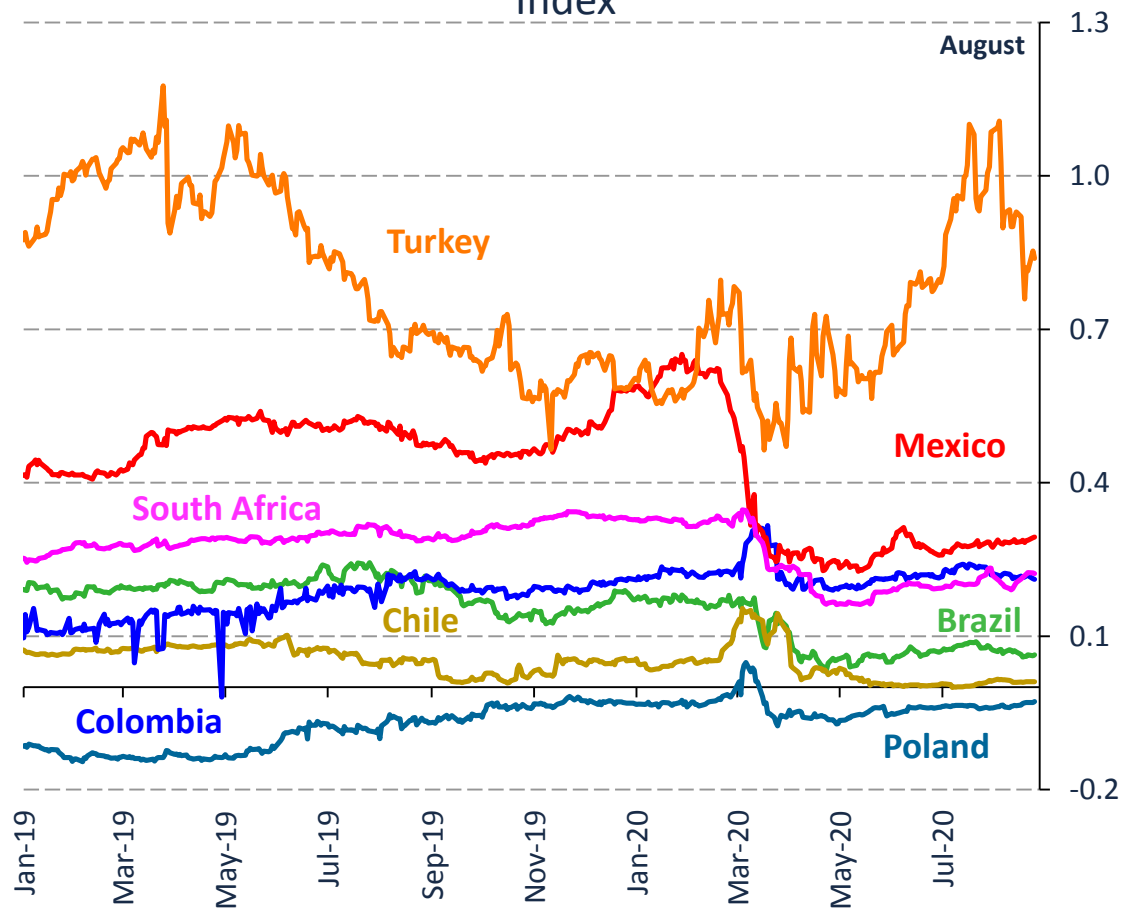
%



Note: The gray lines refer to the daily yield curves since December 31, 2019. Source: Proveedor Integral de Precios (PIP).

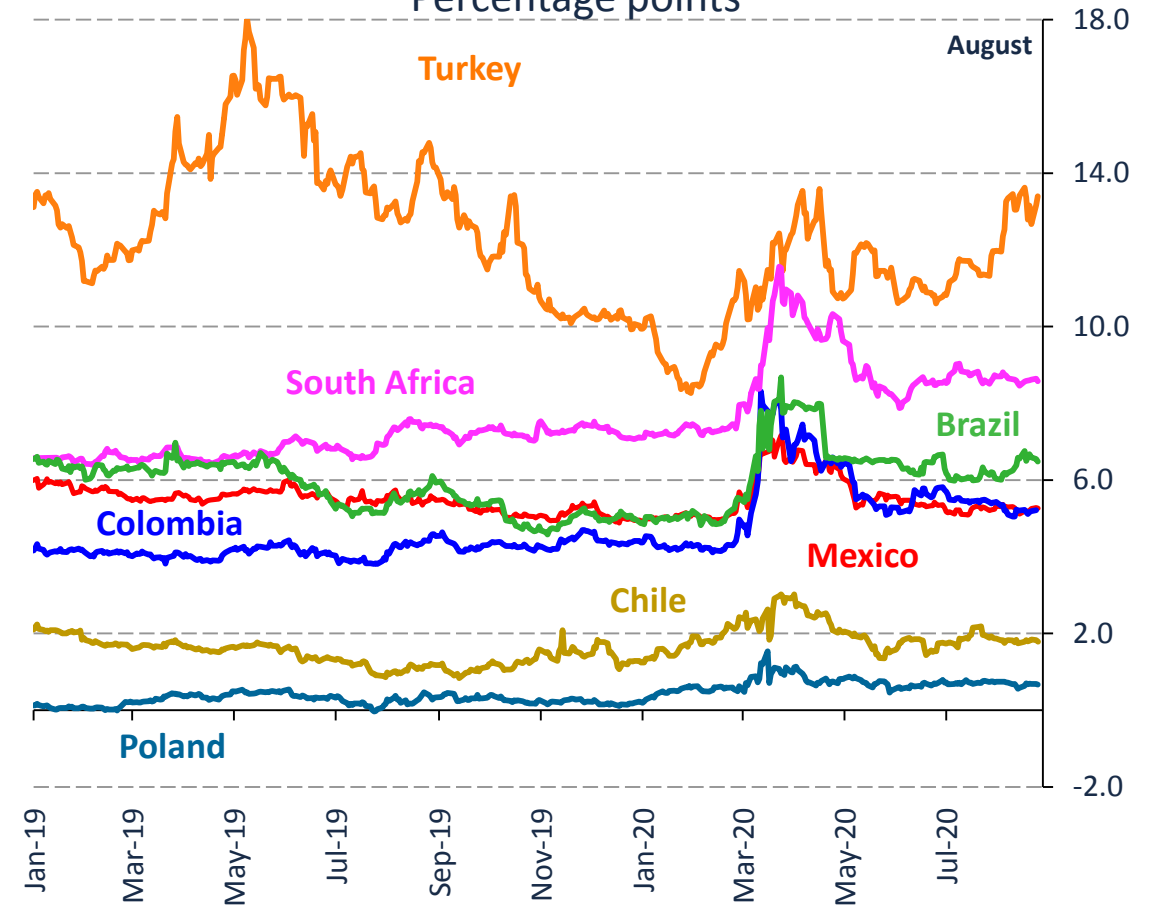
After having declined significantly in March, interest rate spreads have remained relatively stable.

**Volatility-adjusted Spreads between US 1-year Interest Rates and those of Emerging Economies Index**



Note: Estimates calculated with the spread implied in 1-year foreign exchange forwards, adjusted for the implied volatility in the same term. Source: Prepared by Banco de México with data from Bloomberg.

**Interest Rate Spreads between US 10-year Interest Rates and those of Emerging Economies Percentage points**



Source: Bloomberg.

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## Economic Activity Outlook

- The evolution of the **COVID-19 pandemic is still underway**, at both global and domestic levels and, thus, there is **still a high level of uncertainty** around any forecast of economic activity in Mexico:
  - ✓ *Uncertainty prevails as to the **duration of the pandemic**, which, in turn, implies uncertainty about the **duration and depth of the lockdown and social distancing measures** that will be necessary, and of their medium- and long-term repercussions on the economy.*
  - ✓ *The **risk of additional outbreaks** continues.*
  - ✓ *The term for the development of an **effective treatment** or a **vaccine** is still uncertain.*

- In the current juncture, **it is not convenient to present a central baseline scenario** of economic activity forecasts in Mexico, as it could imply a higher level of precision than the one that the current environment or available information would allow to attain.
- **The consideration of contemplating different scenarios**, as in the previous Quarterly Report, **continues to be relevant** in order to have a **broad outlook** on the possible performance of GDP in 2020 and 2021.

# Economic Activity Forecasts

Following the same approach of the previous Quarterly Report, the presented scenarios differ in terms of the rate of recovery of economic activity.

GDP Growth Scenarios  
%

	2020		2021	
	Previous Report	Current Report	Previous Report	Current Report
V-shaped	-4.6	-8.8	4.0	5.6
Deep V-shaped	-8.8	-11.3	4.1	2.8
Deep U-shaped	-8.3	-12.8	-0.5	1.3

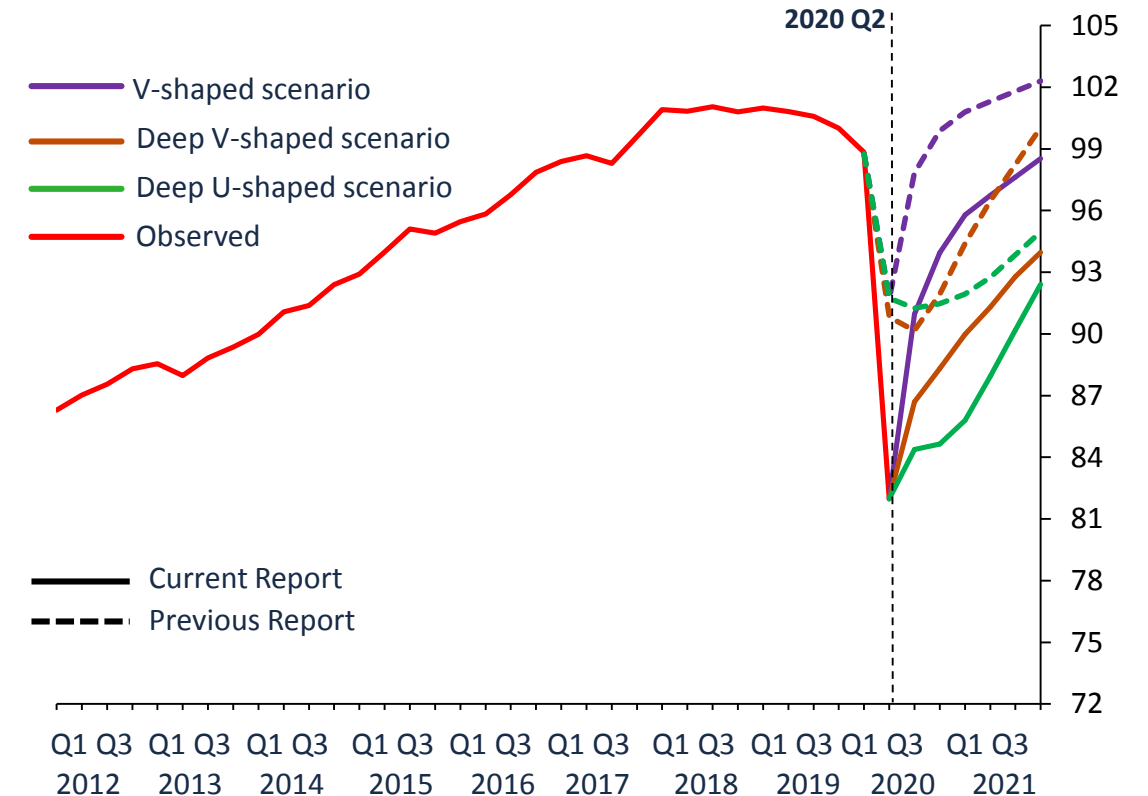
Increase in Number of  
IMSS-insured Jobs  
Thousands

Report	2020	2021
Previous	-1,400 to -800	-200 to 400
Current	-1,100 to -750	100 to 450

Current Account  
% of GDP

Report	2020	2021
Previous	-1.5 to -0.3	-1.8 to -0.5
Current	-0.6 to 0.5	-1.5 to -0.2

Estimates of Mexico's GDP  
Base indices Q4-2019 = 100, s. a.



s. a. / Seasonally adjusted series.

**Note:** Part of the difference in the new trajectories with respect to the previous ones is due to the change in the official seasonal adjustment model applied by INEGI. In the Current Report, forecasts begin in Q3-2020 and in the previous report, in Q2-2020.

Source: Prepared by Banco de México with INEGI data.

## Risks to Growth

### To the downside

- ↓ That social distancing measures are extended or become tighter.
- ↓ Additional episodes of financial volatility.
- ↓ That the adopted relief measures are not effective.
- ↓ That the pandemic's repercussions on the economy are more permanent.
- ↓ That sovereign and Pemex's credit ratings are further downgraded.
- ↓ That the weakness of aggregate demand components persists.

### To the upside

- ↑ That the pandemic dissipates earlier than expected, possibly as a result of new treatments or the implementation of an effective vaccine.
- ↑ That the stimuli provided are effective in offsetting the effects of the pandemic and to support global economic recovery.
- ↑ That the entry into force of USMCA fosters greater-than-expected investment.

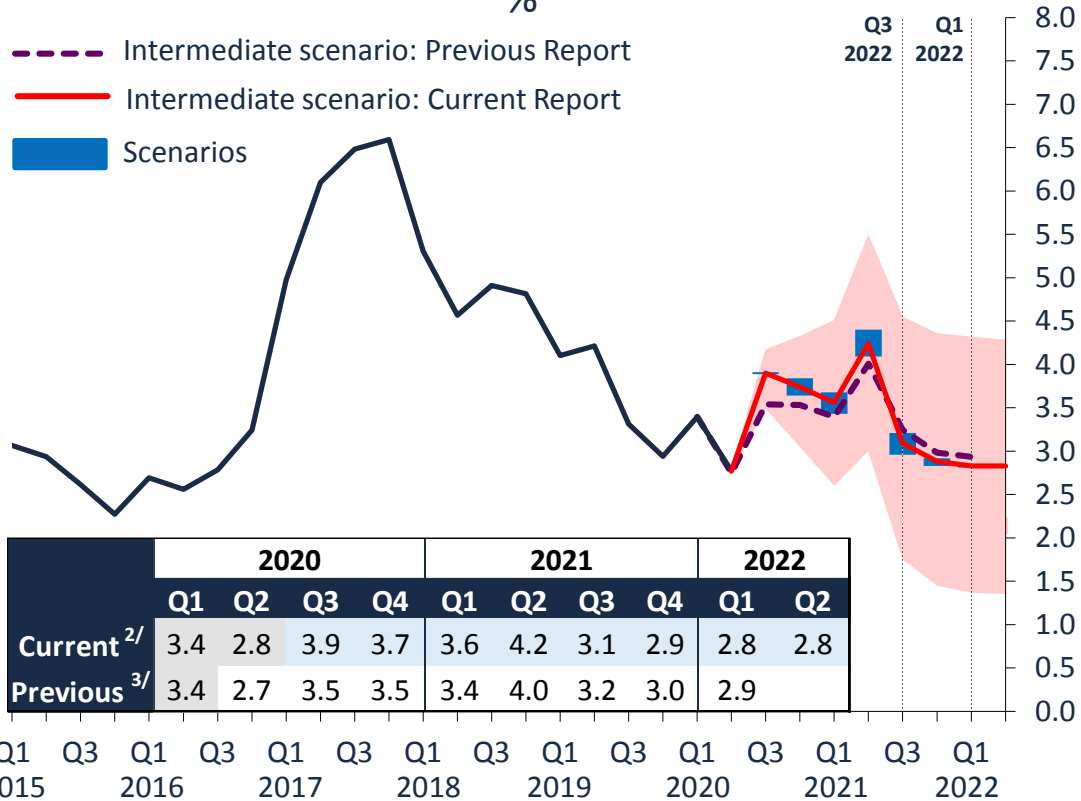
- For headline inflation: The recent pressures generate a slight and temporary increase in the foreseen short-term trajectory. Within the 12-24 month horizon, it is anticipated to lie at similar levels, around 3%.
- For core inflation: The forecasts remain at levels close to those in the previous Quarterly Report, although with a slight upward adjustment starting from Q2-2021. The 12-24 month forecast is expected to lie at around 3%.

### Fan Charts<sup>1/</sup>

#### Annual Headline Inflation

%

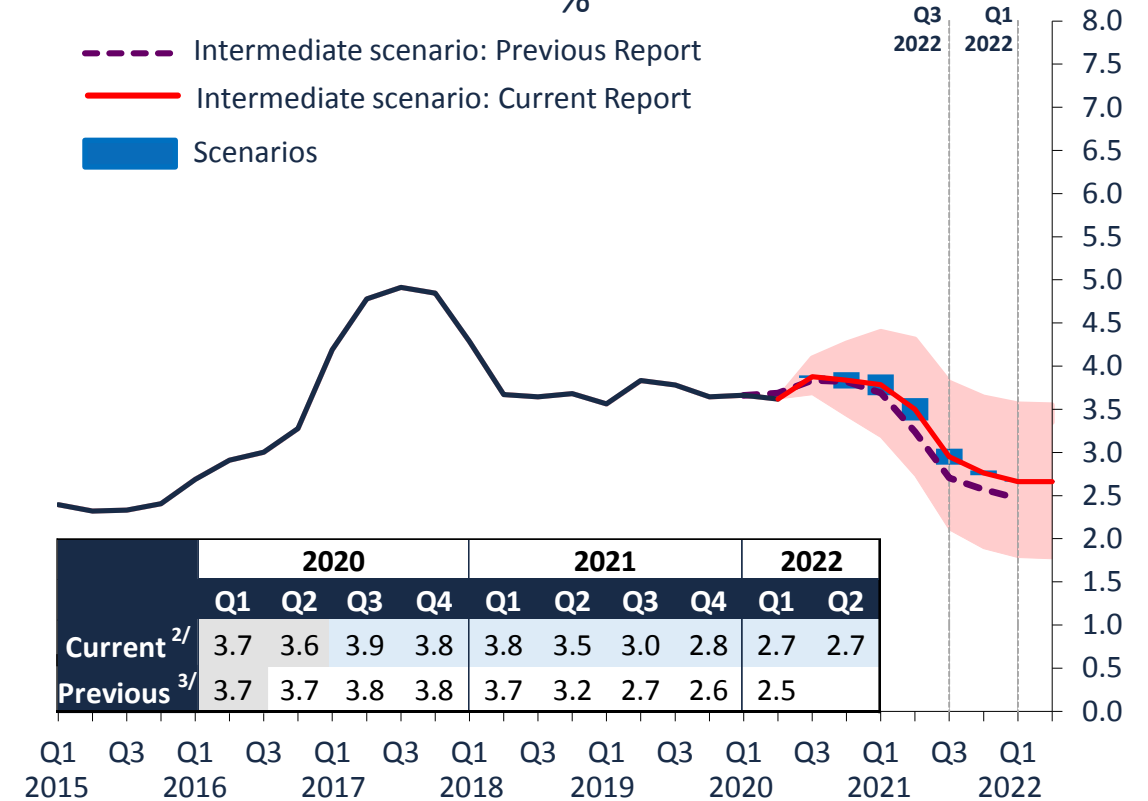
- Intermediate scenario: Previous Report
- Intermediate scenario: Current Report
- Scenarios



#### Annual Core Inflation

%

- Intermediate scenario: Previous Report
- Intermediate scenario: Current Report
- Scenarios



<sup>1/</sup> Quarterly average of annual headline and core inflation. If inflation locates at the center of these intervals, the trajectories would be those reported in the boxes inside the graphs. <sup>2/</sup> Forecast since August 2020. <sup>3/</sup> Forecast since May 2020. **Note:** Blue bars are presented to indicate the minimum and maximum levels that inflation would reach in the estimated scenarios for each quarter. Uncertainty is represented by the shaded area in red. The next four and six quarters are shown in vertical dotted lines as of the third quarter of 2020, that is, the third quarter of 2021 and the first quarter of 2022, respectively; periods in which the monetary policy transmission channels fully operate. The core and headline inflation trajectories were estimated based on the evolution of the macroeconomic variables for the three scenarios presented in this report. Source: Prepared by Banco de México with INEGI data.

## Risks to Inflation Outlook within the Forecast Horizon

Considering the shocks to inflation, the balance of risks for its forecast remains uncertain.

### To the downside

- ↓ A greater-than-expected impact of a wider negative output gap.
- ↓ Lower inflation pressures at the global level.
- ↓ A lower demand for certain goods and services, in light of social distancing measures and concerns about contagion.
- ↓ That the exchange rate is below the anticipated level.
- ↓ That the recent increases in energy prices are reversed.

### To the upside

- ↑ Additional episodes of exchange rate depreciation.
- ↑ Logistical problems and others related with the supply of certain goods and services, and higher costs associated with the sanitary measures.
- ↑ That the relative demand for certain goods increases in a context of the health emergency.
- ↑ A higher persistence of core inflation.
- ↑ Higher increases in energy prices.



# Final Remarks

- The **Governing Board will take the necessary actions**, on the basis of incoming information and considering the deep impact on economic activity, as well as the evolution of the financial shock, so that **the reference rate is consistent with the orderly and sustained convergence of headline inflation to Banco de México's target**, during the time frame in which monetary policy operates.
- Looking ahead, **the available room for maneuver will depend on the evolution of the factors that have an incidence on outlook for inflation and its expectations**, including the effects that the pandemic may have on both factors.
- 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**.
- Likewise, it remains necessary to continue working on **correcting the institutional and structural problems** that have led to low investment levels and have prevented the country from increasing its productivity.

# Annex – Boxes

**1** Effects of Lockdown Measures on Global Economic Activity

**2** The COVID-19 Pandemic and Economic Activity

**3** Evolution of Monetary and Credit Aggregates in Different Economies

**4** The Adoption of Special Accounting Criteria and their Effects on Bank's Credit Portfolio to the Non-financial Private Sector

**5** Greater Volatility of Inflation and its Expectations in the Context of the COVID-19 Pandemic

**6** Developments in Inflation in Different Countries in the Context of the COVID-19 Pandemic

**7** Evolution of Capital Flows and Risk Aversion



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