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Banxico Watch

Banxico remains focused on growth headwinds; signals another 50bp cut in June…

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… after sticking to its recent dovish shift and delivering a third consecutive outsized rate cut

- **Banxico lowered the policy rate by 50 bps to 8.50%, marking the third consecutive cut of this magnitude and thus bringing the cumulative easing this year to 150 bps.** The decision was unanimous. Contrary to our expectations of a slightly more cautious tone, Banxico reaffirmed its dovish guidance, maintaining the same forward-looking language from March: "the Board estimates that looking ahead it could continue calibrating the monetary policy stance and consider adjusting it in similar magnitudes." This suggests that Board members remain confident that policy can continue to ease from its still highly restrictive levels. This is a very welcome surprise, particularly given our long-held view that the current degree of monetary restriction is unwarranted. Today's rate cut drove the ex-ante real policy rate to 4.75%, still well above Banxico's estimated neutral range (1.8-3.6%).
- **Stronger-than-expected core goods inflation in April led Banxico to revise its short-term inflation forecasts, but the central bank's confidence in further disinflation remains intact.** Rather than overreacting to a few recent pieces of disappointing inflation data, Banxico chose not to conclude that disinflation progress has stalled. While it explicitly acknowledged that "both headline and core inflation came in at 3.93% in April," it limited to describing that core inflation increased "at the margin," and instead emphasized that "core inflation [has] accumulated eight consecutive months below 4%." Core inflation is now projected by the central bank to average 3.9% and 3.6% in 2Q25 and 3Q25, respectively, up from 3.5% and 3.4% in the March forecast, but medium- and long-term projections were left unchanged, with core inflation still expected to converge to 3.0% by 2Q26. The fact that Banxico did not revise its guidance or tone in response to April's inflation figures suggests Banxico does not view recent inflation data as a significant disruption to the disinflation path as recent dynamics are most likely not demand-driven, but rather part of a temporary adjustment of relative prices. This adjustment likely reflects the ongoing rebalancing between goods and services inflation, after two years of historically atypical dynamics. Banxico also maintained that the balance of inflation risks has "improved." Notably, a key indication that Banxico's primary concern has shifted from inflation to growth is its acknowledgment, for the first time, that "the inflationary episode has been left behind", as we have said before.
- **A worsening outlook clouded by concerns about the pace of economic activity appear to be weighing heavily on the Board's judgment in favor of continued easing.** Alongside the "environment of uncertainty and trade tensions [that] poses significant downward risks," Banxico noted unambiguously that the "Mexican economy exhibited weakness again during the first quarter of 2025 [...] after having contracted in the previous quarter." Importantly, it continued to list "lower-than-anticipated economic activity" as the first downside risk to the inflation outlook. This supports our view that, even though a technical recession was avoided in 1Q25, the ongoing weakness in formal employment, investment, and household spending offers no indication of

demand-driven inflationary pressures, on the contrary, we are observing a growing negative output gap. Instead, this backdrop justifies the continued unwinding of an overly restrictive stance—a stance that, in good part, is contributing to such weak demand. Whether the unanimous decision to cut rates also reflected consensus on maintaining the dovish tone in the statement will become clear when the minutes are released in two weeks.

- **Banxico's decision to retain its dovish tone reinforces the message that the easing cycle remains firmly in place and that the door to another 50 bp rate cut in June remains wide open.** Banxico reiterated that its current objective is to "bring inflation from its current level, around its pre-pandemic historical average, to the 3% target," and reaffirmed that although a restrictive stance remains appropriate, maintaining rates at such elevated levels is no longer warranted. The combination of a strong peso, continued economic weakness, and manageable external risks—including those stemming from trade policy—leaves room for further rate cuts without destabilizing local financial markets or long-term inflation expectations, which remain "relatively stable." As core services disinflation offsets higher core goods inflation and allows core inflation to stay below 4.0% on average over the following quarters while growth concerns persist, today's announcement notably increases the chances of another 50bp rate cut in June. Looking further ahead, if Banxico transitions to a slower 25 bp pace from July onward—as we expect—and cuts at every remaining meeting this year, the policy rate could easily reach 7.00% by year-end. We now have a strong downward bias to our 7.50% year-end forecast.

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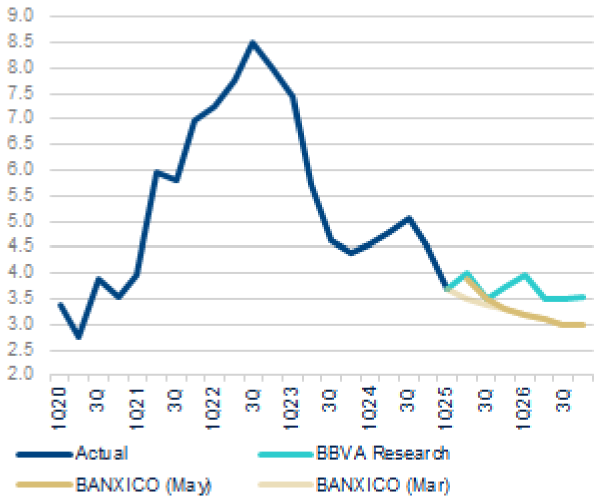
Banxico made a slight upward revision to its short term inflation forecasts, …

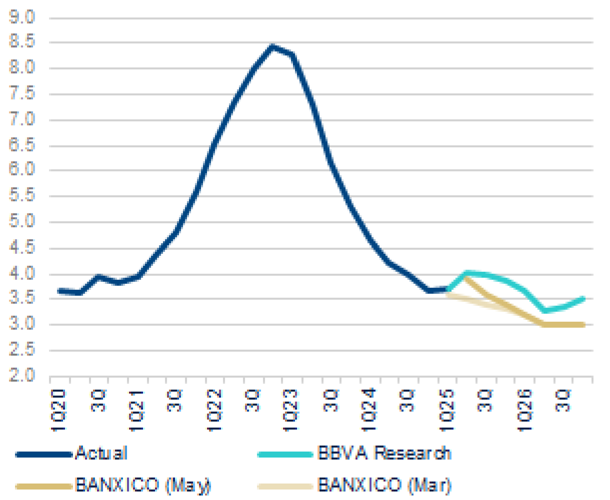
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

… but left the headline inflation projected path unchanged from 4Q25 onwards

Figure 2. **CORE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

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