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Banxico's unchanged guidance signals more rate cuts ahead

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No shift in outlook from the Board despite sticky core inflation and activity rebound in Q2

Banxico cut the policy rate by 25bp to 7.75%, as widely expected. The decision was not unanimous: Jonathan Heath dissented once again, preferring to hold. The policy statement maintained the cautious tone from June and confirmed that Banxico has entered a more gradual phase of its easing cycle, which still appears to have room to continue. It highlighted the intermeeting "GDP's flash estimate," which showed that "the economy grew during [Q2] at a rate higher than in April." However, beyond this reference to incoming data, Banxico refrained from suggesting any significant improvement in its broader growth outlook. Instead, it reiterated that "economic slack prevails due to the weakness that the economy has been exhibiting," and that "the environment of uncertainty and trade tensions poses significant downward risks." There was no shift to a more cautious tone relative to June. This supports our view that the Board still sees room to continue normalizing monetary policy. That confidence is likely supported by an encouraging inflation print at the start of Q3, which showed core services is still easing, and by the favorable behavior of financial markets, with "interest rates [that have] decreased along the yield curve," and "the Mexican peso [that] has fluctuated without a definite trend," both of which have reduced the need for excessive caution. In addition, expectations that the Fed may soon resume its easing cycle could also be helping to alleviate pressure on Banxico, particularly as the policy rate spread with the U.S. approaches historically narrow levels.

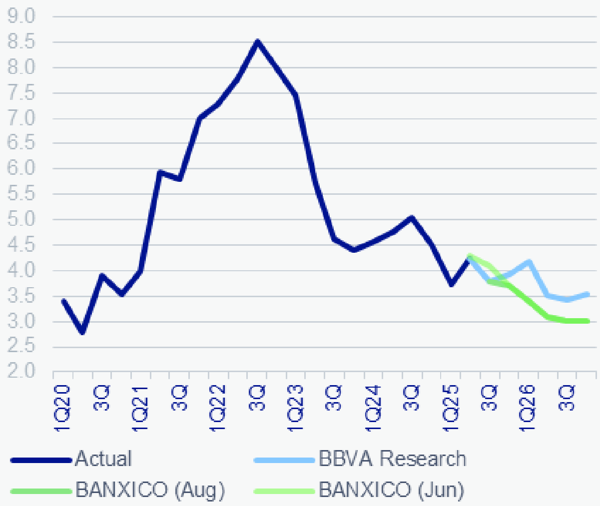
The inflation outlook was mostly unchanged, suggesting a low risk that Banxico will pause its rate-cutting cycle at the next meeting. The updated headline inflation forecasts captured the sharp drop in in July and, after being kept too low in June despite Q2 data pointing to upward pressures in the near term, core inflation forecasts for the next three quarters were revised up. The headline inflation projection for 3Q25 was revised down exactly as we anticipated—from 4.1% to 3.8%—following the sharp deceleration in July's print and acknowledgment of favorable base effects. However, the forecast for 4Q25 remained unchanged at 3.7%, which we view as somewhat optimistic. Core inflation projections for 3Q and 4Q25 were nudged upward to 4.1% and 3.7%, respectively (from 3.8% and 3.6%), reflecting persistent stickiness in core inflation. Services inflation continues to ease more gradually than expected, which has delayed the broader disinflation trend needed to offset the normalization of goods inflation, which had previously undershot its historical range. Even so, medium-term projections were left broadly unchanged, and Banxico still expects both headline and core inflation to converge to the 3% target by 3Q26. This suggests that recent inflation dynamics have not been disappointing enough to shake the Board's confidence in continued disinflation, particularly for services, amid a weakening labor market and softening demand.

The forward guidance retained the strategic ambiguity introduced in June, reinforcing a data-dependent approach, with no explicit preference for the next move. The Board again stated that "looking ahead, it will assess further adjustments to the reference rate." The absence of new language suggesting increased caution—despite recent core inflation stickiness—indicates that most members remain open to continuing the easing cycle, albeit at the current more gradual pace of 25 bps per meeting. The reiteration of the commitment to an "orderly and sustained convergence" of inflation to target suggests that the "efficient convergence" approach—historically associated with Banxico's strategy of bringing inflation down without unnecessarily harming growth—continues to enjoy broad support within the Board's majority. Banxico left the door wide open for more cuts ahead, but the absence of any reference to a preferred policy stance (i.e., restrictive, neutral or accommodative) suggests the Board seeks to preserve flexibility in this stage of policy normalization in the face of mixed signals—slowing core disinflation, easing headline inflation, and a bleak growth outlook that eases inflation concerns. For now, the outlook points to more cuts ahead, but the statement gives Banxico flexibility to pause at some point if incoming data warrants it. Only a pronounced deceleration in services inflation seems likely to shift Jonathan Heath's position, but his hawkish stance over the last two meetings has so far failed to influence the broader direction of the Board.

We continue to expect Banxico to deliver three additional 25bp rate cuts this year, bringing the policy rate down to 7.00% by year-end. The resilience of the peso and the lack of a meaningful improvement in the labor market should continue to support disinflation, particularly in core services. Although recent GDP data surprised to the upside, we believe this reflects temporary factors and does not change the underlying weakness in domestic demand. Formal job creation—excluding the administrative boost from last month's implementation of the labor reform benefiting digital platform workers—remains subdued, and real wage growth has softened, pointing to continued headwinds on household consumption. These dynamics are likely to sustain a negative output gap and help bring down services inflation as well as keep goods inflation in check, reinforcing the case for further, albeit gradual, easing. The upcoming minutes will be key to gauge how firmly the majority of the Board remains committed to additional cuts, and whether any members are starting to lean toward a pause.

Banxico keeps its expected headline inflation path mostly unchanged…

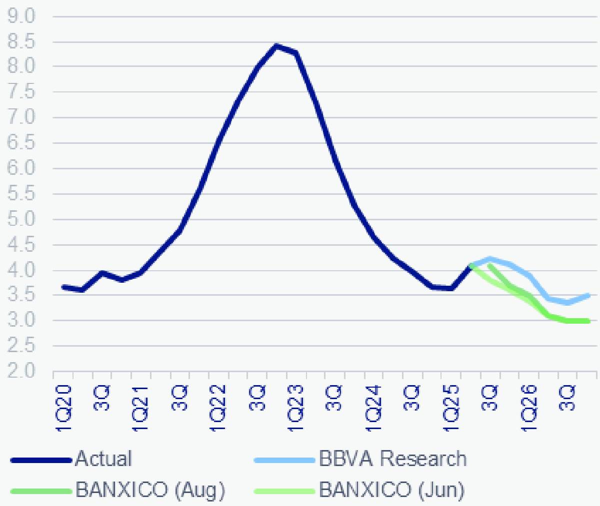
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

… but lifts up slightly its core inflation forecasts for the next three quarters

FIGURE 2. CORE INFLATION OUTLOOK (YOY % CHANGE)



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