

# Banxico's easing window remains open despite mixed data

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## The Board will likely keep a strategically ambiguous forward guidance that reinforces a data-dependent approach

Last week, the Fed left rates unchanged ahead of a surprisingly weak jobs report that showed the labor market has slowed markedly over the last three months. The widely anticipated hold came alongside unsurprising dissenting votes from Bowman and Waller, who favored a 25bp cut. The policy statement reasserted still “elevated” uncertainty and downgraded the assessment of growth, which “moderated in the first half of the year.” With inflation running above target and maximum employment “right at target”, Powell continued to defend a “modestly restrictive” policy stance (click [here](#) and [here](#) for additional details on last week’s FOMC meeting). And while tariff-related inflationary pressures are likely to continue building in the coming months—justifying the Fed’s cautious stance—last Friday’s jobs report has bolstered the case made by last week’s FOMC dissenters. The report showed a below-consensus gain of 73,000 payrolls in July and, more concerning, downward revisions totaling 258,000 for May and June ([Figure 1](#)). These figures support the view that the labor market was not as solid as previously believed and could indeed be “on the edge,” as Waller warned. One more jobs report and two CPI releases are due before the next FOMC meeting, and they will be key in determining whether immediate easing is warranted. We now see a downward bias to our year-end fed funds rate forecast of 4.00-4.25%. That said, an earlier-than-expected Fed rate cut, or even the expectation that the easing cycle will resume soon, could ease pressure on Banxico as it continues its rate-cut cycle and approaches an historically narrow policy rate spread ([Figure 2](#)).

In Mexico, economic activity surprised to the upside in Q2, with GDP expanding 0.7% q/q—more than tripling Q1’s pace and beating market expectations. The rebound was driven by both industry and services, which grew 0.8% and 0.7% q/q, respectively. It is likely that this positive surprise largely reflects a temporary boost from net exports amid front-loading ahead of potential tariffs and a decline in imports due to the contraction in investment, rather than a fundamental improvement. Even so, assuming zero growth in 2H25, the Q2 figure places a 0.7% floor under 2025 GDP—matching the upper bound of Banxico’s latest forecast range and likely prompting the Board to upgrade its growth assessment. Yet, given that the economy is still set to grow below potential this year and likely next, we believe Banxico will stick to its view that “economic slack prevails” and that “the balance of risks to economic activity remains biased to the downside.” In fact, the latest GDP print likely masks ongoing weakness in domestic demand. Both fixed investment and household consumption remained sluggish

through May (-7.1% y/y and -0.88%, respectively). On the labor front, IMSS data showed a net loss of 46,000 formal jobs in June—the worst June outcome since 2010 (excluding the pandemic)—capping a historically weak first half for job creation. Losses were concentrated in construction and manufacturing, while the previously resilient services sector has begun to stagnate. Real wage growth has plateaued, and the total wage bill now sits below its historical average, pointing to weak consumption ahead. And some other growth headwinds remain in place. The lagged effects of past monetary tightening will likely continue to weigh on the economy. And although Mexico secured a 90-day delay in the implementation of 30% U.S. tariffs and optimism prevails over a relatively favorable trade deal, persistent uncertainty surrounding the future of USMCA could continue to dampen investment—alongside lingering concerns over the early steps of the new judiciary and the onset of electoral reform discussions. Taken together, these lingering challenges for the growth outlook should maintain Banxico's confidence that monetary policy can (and should) continue to ease.

**Headline inflation eased through the first half of July, supporting a continued, though more gradual, policy easing amid core inflation stickiness.** Annual headline inflation declined to 4.3% in June from 4.4% in May, driven mainly by a drop in non-core components—particularly agricultural prices—which pushed non-core inflation down from 5.3% to 4.3%. Mid-month data for July showed a sharper deceleration, with headline inflation falling to 3.5% y/y—the first decline in four months—bringing it back within Banxico's 2-4% target range for the first time since early May. The decline was mostly driven by favorable base effects, but also reflected a significantly softer-than-expected bi-weekly rise in fruits and vegetable prices that allowed annual agricultural inflation to drop to just 0.3% y/y from 5.0% in June along with a milder-than-expected increase in core services inflation. Core inflation remained unchanged at 4.2% y/y, as a welcome but modest slowdown in services inflation was offset by steady core goods inflation. Although Banxico will likely keep its average headline inflation forecast for 2H25 at 3.9%, it will most likely revise down its 3Q headline inflation forecast from 4.1% to around 3.8%, while raising its 4Q forecast from 3.7% to closer to 4.0%. Meanwhile, it is likely to revise its 2H25 core inflation forecasts upward. While a sharp rise in core goods inflation during the first half of July has not been offset by lower core services inflation, the resulting stickiness in core inflation increases the risk of a pause in the easing cycle later this year. Yet, we think Banxico will remain confident in further services disinflation ahead and will proceed with a rate cut this week. It has taken longer than expected for core goods and services inflation to reach a better balance, but the weak outlook for economic activity—particularly in the labor market—that is reflected in a clear negative output gap, should eventually help core services inflation resume a steeper downward trend.

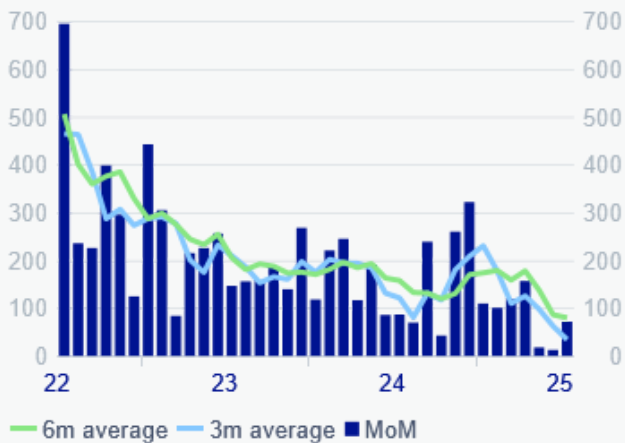
**Most Board members are likely to maintain the view that there is still room to ease, distancing themselves from Heath's more hawkish stance.** After a sustained appreciation, the currency has recently come under modest pressure, largely due to broad-based U.S. dollar strength. Still, volatility remains subdued—well below historical averages—and the peso continues to outperform most emerging market peers ([Figure 3](#)). Risk premia, which had recently been trending lower, have edged higher following Trump's letter threatening 30% tariffs on Mexican exports. Nonetheless, financial conditions remain broadly supportive of continued easing, taking into account that the policy stance remains clearly restrictive. The minutes from

the last meeting confirmed that a majority of the Board now favors a more cautious pace of rate cuts. A couple of members underscored the need to foster “an orderly and efficient convergence of inflation to the target”—a phrase historically associated with Banxico’s strategy of bringing inflation down without unnecessarily harming growth. In contrast, Deputy Governor Heath reiterated his call for a pause, and dismissed the weak outlook for activity as insufficient to bring inflation down to target, stating that “despite the economic stagnation, forecasts do not point to a recession that would weaken aggregate demand sufficiently” to ensure convergence.

**We expect Banxico to deliver a 25bp rate cut this week, signaling a shift toward a more gradual pace of monetary easing after four consecutive 50bp reductions.** While headline inflation has returned to the target range, core inflation remains sticky, and the Board will likely signal increased caution—likely influenced by the Q2 GDP surprise. We expect a 4-1 split vote, with Deputy Governor Heath dissenting in favor of a pause. Overall, the statement will continue to emphasize the need to assess incoming data before determining the pace of further adjustments. As we noted in our previous report, we do not expect Banxico to offer clear forward guidance at this stage. Instead, the Board is likely to continue adopting what we previously described as a strategically ambiguous forward guidance—one that reinforces its data-dependent approach while keeping all options on the table. The ex-ante real rate will remain in restrictive territory at 4.1% following this week’s cut, still about 50 bps above the upper bound of Banxico’s estimated short-term neutral range ([Figure 4](#)).

Friday's jobs report has bolstered the case made by last week's FOMC dissenters

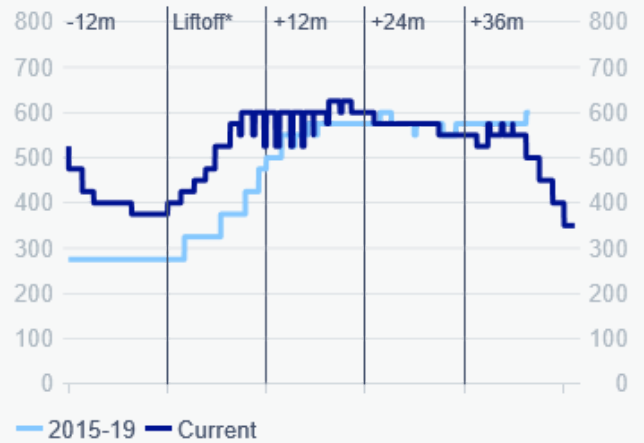
**FIGURE 1. CHANGE IN NONFARM PAYROLL EMPLOYMENT (THOUSANDS)**



Source: BBVA Research / BLS

Earlier Fed cuts could help Banxico as it approaches an historically low rate spread

**FIGURE 2. MEXICO-US POLICY RATE SPREAD IN TIGHTENING CYCLES (BPS)**



Liftoff indicates the date of Banxico's first rate hike in each cycle  
Source: BBVA Research / Banxico / Fed

The Mexican peso continues to outperform most emerging market peers

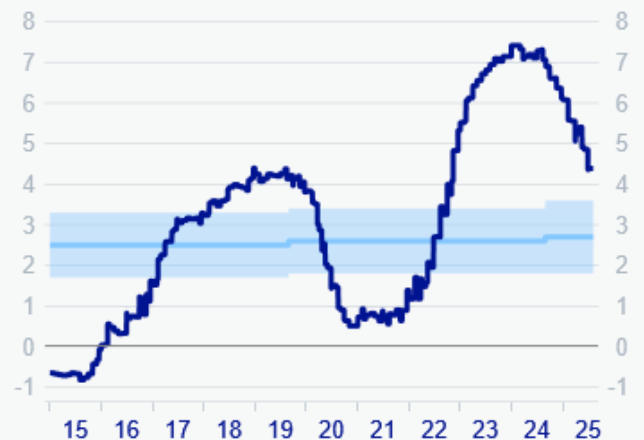
**FIGURE 3. USDMXN RELATIVE PERFORMANCE (01-JAN-25=100)**



\* Reweighted version of the Fed's Emerging Market Economies (EME) Dollar Index. Source: BBVA Research / Fed / Macrobond

The ex-ante real rate will remain in restrictive territory following this week's rate cut

**FIGURE 4. REAL EX-ANTE POLICY RATE (%)**



The shaded area indicates Banxico's estimated interval for the short-term neutral rate in the long term; the solid aqua line indicates the midpoint estimation. Source: BBVA Research / Banxico / INEGI

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