

Mexico Economic Outlook

We anticipate a prolonged period of below-potential growth

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Upward revision to the economic growth forecast for 2025

Weak growth, but lower inflation and interest rates

	Economic activity	Domestic demand continues to slow down; private consumption fell by 0.1% in June (cumulative), and investment by 6.4%. We revised upwards our 2025 growth forecast to 0.7%, due to the favorable performance of the economy in 1H25, but with expectations of a slowdown in the second half of the year.
	Employment	Weak economic dynamism is limiting the creation of formal jobs, while the formalization of digital workers has only had a statistical effect. The total wage bill is growing at a moderate pace, which will continue to weigh on consumption. Under this scenario, formal employment is expected to grow by just 0.8% in 2025 and 1.7% in 2026.
	Inflation	We expect that, with weak demand, services inflation will tend to moderate. We anticipate headline inflation to end the year at 3.8% and reach 3.5% in 2026. Upward bias for 2026 due to tax increases and tariffs
	Monetary policy	Banxico still has room to continue normalizing its monetary stance. Following this week's 25bp cut, we anticipate two additional ones in November and December, and another two in Q1 2026.
	Interest rates	Long-term rates maintain room to fall, supported by the Banxico cycle and the moderation of country risk premia. We estimate that the 10-year M Bond yield will close at 8.6% in 2025 and 8.2% in 2026.
	Public Finance	The Historical Balance of Public Sector Financial Requirements will rise to 52.3% in 2025 from 51.3% of GDP in 2024.
	Exchange Rate	The exchange rate is very likely to be around 19.44 pesos per dollar by the end of 2025

Weakness in domestic demand in 2025

Domestic demand continues to show weakness in the face of the extended context of uncertainty and slow growth in the real wage bill. According to INEGI data, private consumption fell by 0.1% in cumulative terms up to June (compared to the same period last year), while gross fixed investment fell by 6.4% during the same period. The lower dynamism of household spending is derived, among other factors, from the slowdown in the real wage bill, which as of August reported an annual variation of 3.9% (from its all-time high of 9.8% in June 2023). This is compounded by the deterioration in consumer expectations, as indicated by the INEGI Consumer Confidence Index. This indicator has fallen for eight consecutive months since January (with a variation of -1.5% y/y in August).

With regard to gross fixed investment, the context of high uncertainty surrounding the new trade policy framework in the U.S. has added to the reduction in government spending in the construction sector since 2024, which has resulted in the closure of major federal government projects. As of June, investment in construction has fallen for eleven consecutive months (y/y), reaching a level in June this year that is 6% below that recorded in January 2024. Meanwhile, the machinery and equipment sector has seen its momentum dampened by companies rethinking their investment strategies in the face of ongoing uncertainty surrounding the scope and duration of the new tariffs. Investment in machinery and equipment has fallen for six consecutive months on a year-on-year basis, reaching a level in June that was 8% lower than that recorded in January 2024.

In terms of the supply-side production, the industry continues to impact economic activity, with a y/y, cumulative decline of 1.2% registered in July. The component with the greatest decline is mining, with a cumulative contraction of (-)7.8% (Jan-Jul vs the same period in 2024); it is followed by construction with a decrease of (-)1.5%, and manufacturing that registers stagnation (0.0%). The tertiary sector, on the other hand, is the component of supply that has kept economic activity afloat, with a growth of 1.1% (Jan-Jul vs. the same period of the previous year). Among the subcomponents of the tertiary sector, retail trade has provided the greatest boost, with a cumulative variation of 4.2% in the seventh month of the year (vs. the same period in 2024).

Although the advance of export orders in the first half of the year provided a positive boost to growth, evidence suggests that this effect was transitory. The moderation in the pace of job creation – particularly in the industrial sector – suggests that private consumption will tend to slow down in the second half of the year, in a context in which investment shows a clear loss of dynamism.

Stagnation of formal employment despite the temporary rebound from digital platform workers

Based on INEGI's National Occupation and Employment Survey (ENOE), the labor market shows a degree of stability, though this stability is fragile given the weak pace of formal job creation reported by the Mexican Social Security Institute (IMSS). In July, the labor participation rate reached 60.2%, up 0.8 percentage points compared to the average of

previous months. This increase in participation did not push unemployment higher; the unemployment rate remained at 2.6%, in line with the annual average and well below the historical average of 4.0% since 2005. However, stronger labor force growth translated into more informal employment, which rose 1.1 percentage points—from an annual average of 54.6% to 55.7% in July.

According to IMSS figures, formal employment in Mexico hit a record high in July at 23.59 million jobs. This was largely explained by the one-time incorporation of 1.29 million digital platform workers, which boosted annual formal job growth to 5.6%. Yet this was mostly a statistical effect, reflecting the formalization of existing jobs rather than the creation of new ones. By August, most of these workers were no longer classified as formal employees, since they did not exceed the legal net income threshold and were only counted as IMSS affiliates. As a result, annual formal job growth dropped sharply—from 5.6% in July to 0.5%—and remained weak in August, at just 0.3%, despite the continued inclusion of 133,178 digital workers who did surpass the threshold.

On wages, real earnings grew 3.7% year-on-year in August, while the real wage bill expanded 4.0%. Both indicators are on a downward trend, with wage-bill growth below the 2012–2024 average.

Overall, the data point to a fragile stability: unemployment remains low, but informal employment is rising, formal job creation is limited, and wage growth is moderate—factors that directly weigh on consumption.

Looking ahead, the formalization of digital workers does expand social security coverage, but its effect is largely statistical and does not alter the weak trend in formal job creation. Under this scenario, formal employment is expected to grow by just 0.8% in 2025 and 1.7% in 2026, confirming that slower economic growth will continue to constrain job creation, wages, and consumption ([Figure 2](#)).

The rebound in inflation in Q2 has begun to reverse in Q3; services inflation will continue to moderate

Due to a slower pace of increase in goods inflation, a slowdown in services inflation, a decline in non-core inflation, and favorable base effects, the upturn in headline inflation observed during the second quarter reversed during the first two months of the third quarter. Thus, as we anticipated, the rebound in the second quarter was transitory. After staying below 4.0% in 4Q24 y/y and averaging 3.7% y/y in the first quarter, inflation rebounded to an average of 4.2% y/y in the second quarter, before falling back to 3.5% y/y during July-August. An unfavorable base effect in September — given that inflation rose just 0.05% m/m in September 2024 — will cause inflation to spike to 3.7% y/y. After the volatility observed in the second and third quarters, we expect inflation to stabilize around an average of 3.7% y/y in the fourth quarter, closing the year at 3.8% y/y.

Core inflation, which best reflects the trend in medium-term inflation, had already returned to

price stability levels. It remained below 4.0% y/y during the fourth quarter of 2024 and the first quarter of 2025, averaging 3.7% y/y during that period. However, it rebounded in the second quarter, reaching 4.2% y/y in June. Although it did not register additional increases in July-August, inflation remained stable at that level, slightly above the upper limit of the range of variability around Banxico's target of 3.0% y/y.

What has caused this spike in core inflation? Two factors explain this: (i) a greater-than-expected acceleration in the monthly rate of increase in goods inflation: after averaging 0.20% m/m in 2024, it rose to an average of 0.50% m/m during the first half of this year; and (ii) the persistence of services inflation, which showed stickiness to the downside despite weakening demand and the widening of the negative output gap: after averaging 0.40% m/m in 2024, it fell slightly to an average of 0.34% m/m during the first half of this year. Although there are signs that both factors began to moderate in July and August — goods inflation rose by an average of 0.2% m/m, at a similar pace to last year, and services inflation rose by 0.3% m/m, 0.1 pp less than in July-August 2024 — core inflation has not declined and remains stable at 4.2% y/y. On a positive note, service inflation slowed from an average of 4.6% y/y in Q2 to 4.4% between July and August, with widespread declines in its main components: housing inflation fell from 3.6% to 3.4% y/y, tuition fees fell from 5.8% in June to 5.3% in August, and the year-on-year rate for other services —the category with the greatest relative weight and the best indicator of the trend in services— fell from 5.5% in June to 5.2% y/y in August.

Looking ahead, we expect weak demand to continue pushing service inflation down, offsetting the return of goods inflation to levels of around 4.0% y/y. Thus, toward the end of this year and throughout next year, we anticipate the process of rebalancing between goods and services inflation will consolidate: while the former will stabilize at current levels, the latter will decline significantly, approaching 3.0% y/y by the end of next year. For 2025, we anticipate only a slight decline in core inflation by year end, to 4.1% y/y.

We maintain our forecast that the disinflation process will be complete by 2026, at which point inflation will enter a new phase and fall below the historical average observed since the 3.0% y/y target was adopted. In this scenario, we anticipate that headline and core inflation will both reach 3.5% y/y by the end of 2026, which we consider to be consistent with long-term equilibrium. Due to the weakness of the economy, downside risks have become more relevant. In an environment of a weaker dollar and greater global risk appetite, the upside risk associated with a possible depreciation of the peso looks increasingly unlikely. The imposition of tariffs on non-treaty trading partners and tax increases on certain products introduce upside risk to our inflation projections for 2026 ([Figures 3–4](#)).

Banxico continues to have room to continue normalizing its monetary stance in a context of weak domestic demand

Last week, the Federal Reserve (Fed) resumed its easing cycle by cutting the reference rate by 25 bps, to 4.00-4.25%. The decision was in response to a change in the balance of risks:

although the central bank acknowledged for the first time this year a rebound in inflation, associated with tariffs, it placed greater emphasis on the weakness of the labor market reflected in recent employment figures. The question now is whether this decision will mark the beginning of a sequence of rate cuts or whether the transition to a neutral stance will be more gradual. Although Chairman Powell left open the possibility of pausing at the next meeting, he stressed that a more balanced risk profile means the Fed should move toward neutrality—a clear signal that further cuts are on the horizon. Although an inflation surprise or a rebound in the labor market could justify a pause, neither scenario seems likely in the short term. Thus, the likelihood of a second consecutive cut in October increases, shifting our baseline scenario toward two additional rate cuts this year.

In Mexico, weak domestic demand continues to justify further monetary policy easing. Banxico applied a 50bp cut in June and moderated the pace in August with a 25bp reduction. Another 25bp cut is widely anticipated this week, which would put the target rate at 7.50%. With this reduction, the rate would accumulate 250 bps so far this year (375 bp since the peak in March 2023) and would be just 18 bps above the upper range of the central bank's estimate for the neutral rate. Even so, we believe that there is still room for Banxico to continue taking the rate toward a more neutral stance, in a context of marked weakness in economic activity and low dynamism in formal employment, factors that should favor a firmer slowdown in services inflation. Other elements also support the continuity of the cycle: the relative strength of the peso, low volatility in financial markets and the resumption of rate cuts by the Fed, which reduces pressure on the rate differential.

We maintain our forecast of two additional 25 bp cuts in November and December, which would bring the reference rate to 7.00% by the end of this year. Subsequently, we estimate that it will reach a neutral level of 6.50% in the first quarter of 2026 ([Figure 5](#)).

Long-term rates maintain room to continue falling, supported by the Banxico cycle and the correction in country risk premia

In the U.S., short-term government bond yields have declined significantly following the recent shift in expectations for the Fed's monetary policy, while longer-term yields maintain a relatively high risk premium linked to renewed economic policies. Since the end of July, the yield on the two-year Treasury note has declined by just over 30 bps to 3.6%. The yield on the 10-year note has declined by about 20 bps, and the yield on the 30-year bond has declined by just over 10 bps. The lower sensitivity at the long end of the curve reflects lingering doubts about the U.S. trade relationship with the rest of the world, as well as growing concerns about the lack of fiscal action to address the unsustainable trajectory of public debt. We expect this uncertainty, associated with higher term risk premia, to persist in the coming quarters. As a result, we estimate that the yield on the 10-year Treasury note will continue to oscillate slightly above 4% in the coming months.

In Mexico, rates along the curve have declined as expected in our previous scenario, and we anticipate that there is still room for additional adjustments as Banxico's cut cycle progresses.

Although long-term yields will continue to show a high correlation with U. S. Treasury yields, in recent weeks they have been favored by a correction in country risk premia. This improvement has been supported both by a global environment of greater risk appetite and by local factors, including fiscal discipline, the presentation of a financial plan for Pemex and the likely moderation of some concerns about the institutional framework after the recent entry of the new court.

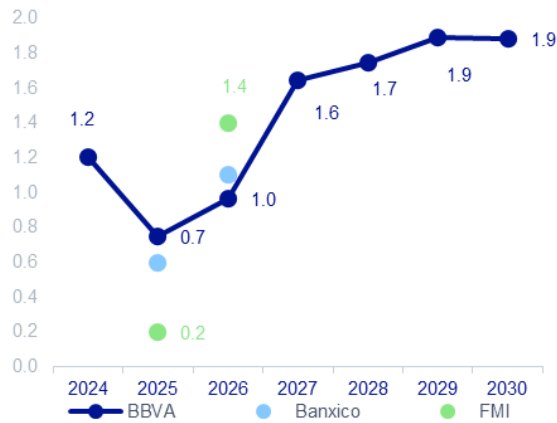
In our baseline scenario, we project that the yield on 10-year M-Bonds will decline from its current level of 8.8% to 8.6% by the end of 2025 and to 8.2% by the end of 2026 ([Figure 6](#)).

The Historical Balance of Public Sector Borrowing Requirements will rise to 52.3% in 2025 from 51.3% of GDP in 2024

After having known the General Economic Policy Criteria for 2026 presented by the federal government to Congress, the Historical Balance of Public Sector Borrowing Requirements (SHRFSP) is expected to reach 52.3% of GDP by the end of 2025 vs. 51.3% in 2024. Although the fiscal consolidation proposed for 2026 is only two-tenths of a percentage point, as the PSBR would go from -4.3% to -4.1% of GDP, public spending pressures and the increasingly limited fiscal space to cut it lead us to predict that this consolidation will continue to advance slowly over the coming year. Due to the expected fragility of public finances in the coming years, resulting from the expansion of social programs, federal government support to Pemex and public pensions, and debt servicing, as well as the limited scope for growth in tax revenue without a fiscal reform, the federal government will most likely have to adjust its discretionary spending in order to generate public deficits of around 2.0% of GDP. This will prevent public debt from resuming its upward trajectory and represent a complex fiscal policy challenge. If fiscal discipline were not enough and the federal government could only reduce the public deficit to average levels of around 3.7% of GDP in 2025-2030, then debt could approach 58.1% of GDP in 2030. This possibility could lead rating agencies to reduce the sovereign credit rating and the probable loss of the investment grade.

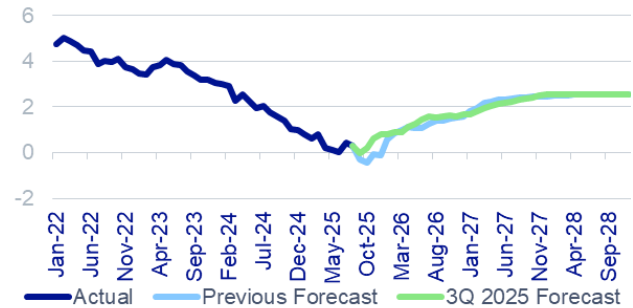
As for the Mexican peso, it is anticipated that it will show a slight depreciation in the following months as it is affected both by the very likely lower rate differential between Mexico and the United States and by the national economic slowdown. The exchange rate is expected to be around 19.44 pesos per dollar by the end of 2025 after reaching an average monthly peak of 20.55 in January 2025.

FIGURE 1. GDP



Source: INEGI, BBVA Research

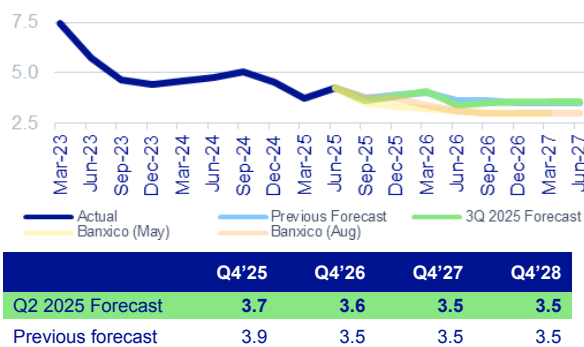
FIGURE 2. FORMAL EMPLOYMENT OUTLOOK



	25	26	27	28
Thousands, EoP				
Q2 2025 Forecast	177	380	578	594
Previous forecast	-25	356	556	556
Annual Change, % EoP				
Q2 2025 Forecast	0.8	1.7	2.5	2.5
Previous forecast	-0.1	1.6	2.5	2.5

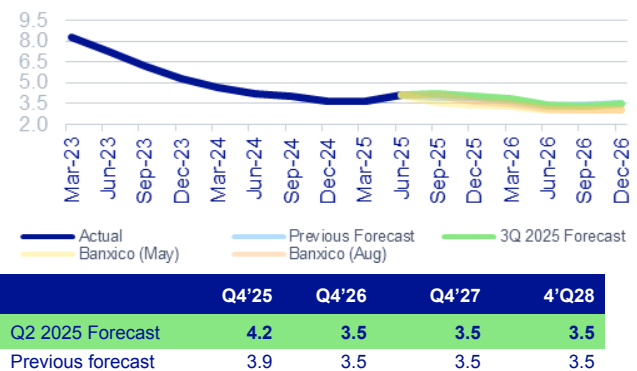
Source: BBVA Research, IMSS

FIGURE 3. HEADLINE INFLATION (VAR. % CHANGE)



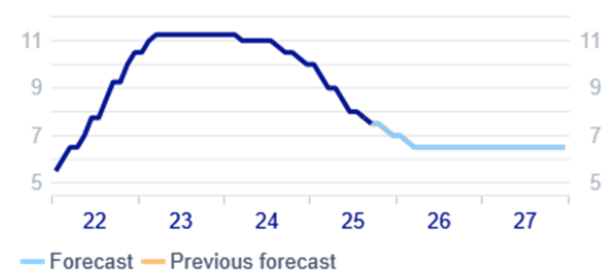
Source: BBVA Research, INEGI

FIGURE 4. CORE INFLATION (VAR. % CHANGE)



Source: BBVA Research, INEGI

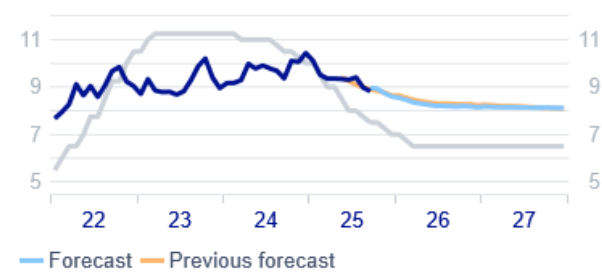
FIGURE 5. BANXICO POLICY RATE (%)



	25	26	27
Q3 2025 Forecast	7.00	6.50	6.50
Previous forecast	7.00	6.50	6.50

Source: BBVA Research / Banxico

FIGURE 6. 10-YEAR GOVERNMENT YIELD (%)



	25	26	27
Q3 2025 Forecast	8.6	8.2	8.1
Previous forecast	8.7	8.2	8.1

The gray line indicates Banxico's policy rate. Source: BBVA Research / Banxico / Macrobond

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