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Banxico adopts cautious tone as remaining easing room narrows

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We still think Banxico will lower the policy rate to 6.50% in 2026, but now think it will pause its easing cycle in 1Q

Banxico delivered a widely expected 25bp rate cut, bringing the policy rate to 7.25%, with the tone of the policy statement turning slightly less dovish. The central bank continued to highlight domestic economic weakness, referring to the contraction in Q3 GDP and reiterating that “the environment of uncertainty and trade tensions continues posing significant downward risks.” However, some tweaks to the statement conveyed a slightly less dovish tone. First, Banxico appeared to acknowledge the possible reduced room for maneuver implied by the Fed’s recent shift in tone, noting that it “lowered its reference rate by 25 basis points,” while removing the previous reference to the expectation that the Fed would “implement further reductions in the remainder of the year.” The Board also noted that longer-term government bond yields “increased moderately” and that “the Mexican peso depreciated slightly,” signaling some caution toward recent financial developments. It also noted the “minor variation” in core inflation in the first half of October. Besides, its continued stickiness likely prompted a reordering of perceived inflation risks—with the “persistence of core inflation” now ranked second, ahead of global risks but still below the exchange rate depreciation risk. Taken together, these subtle changes indicate a somewhat more cautious tone than previous statements. Deputy Governor Heath once again dissented in favor of keeping the policy rate unchanged.

Banxico made moderate changes to its inflation projections, keeping headline forecasts nearly unchanged while revising core inflation slightly higher through mid-2026. The central bank lowered its projection for average headline inflation in the last quarter of 2025 by 0.1pp (to 3.5%), while raising it by the same magnitude for the following two quarters to 3.5% and 3.2%, both target-range-consistent. Adjustments to core inflation were all upward: 0.1pp for the final quarter of this year (to 4.1%) and the second quarter of 2026 (to 3.3%), and 0.2pp for the first quarter of 2026 (to 3.8%). These revisions likely reflect the expected one-off price pressures stemming from recently approved excise taxes in the 2026 fiscal package—such as the new levy on sugary beverages—and the recently authorized increase in public transport fares in Mexico City, although they likely fall short of fully capturing their impact. Nevertheless, Banxico continues to expect that inflation will converge to its 3.0% target by the third quarter of 2026, reflecting the Board’s view that weak domestic demand will continue to support disinflation through next year.

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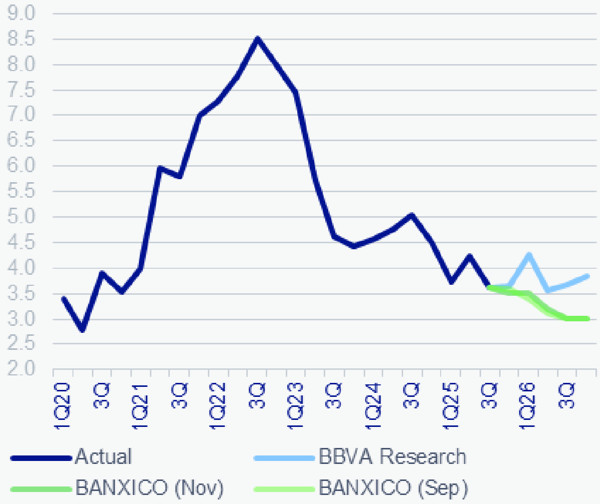
Banxico signaled that the easing cycle now has less room to run after bringing the policy stance into the neutral range—an important milestone following a long-lasting overly restrictive phase. Despite a still-gloomy domestic economic outlook, the combination of slightly higher core inflation forecasts, the Fed's more cautious tone, and real rates finally reaching the neutral range, likely led the Board to change its forward guidance. The statement now says that "looking ahead, the Board will evaluate reducing the reference rate," replacing the previous plural phrasing in which Banxico said it would "assess further adjustments." This change indicates a more cautious approach ahead after today's cut moved real rates into the neutral range. It hints that we enter a new data-dependent phase in which the Board monitors core inflation before signaling it may lower the ex-ante real policy rate close to the 2.7% midpoint of its estimated neutral range (1.8% to 3.6%).

We continue to think that Banxico should bring the policy rate toward the midpoint of its estimated neutral range. Domestic demand remains very weak and should lead to lower core services inflation even if it has remained puzzlingly sticky through October. Accordingly, we expect Banxico to proceed with another 25bp cut at its December meeting, to 7.00%, and to deliver two additional 25bp cuts in 2026, which in our view should take place in the first quarter. Yet, today's change to the forward guidance indicates the Board now prefers a more data-dependent approach. Given that we expect inflation to stay above Banxico's projected path in early 2026, we now think that Banxico could pause its easing cycle at the start of next year. Once the temporary supply shock anticipated in January fades, Banxico may resume rate cuts, bringing the policy rate down to 6.5%. In view of the Board's cautious stance, we have removed our bias toward rates falling below that level.

Banxico's inflation forecasts remain on the optimistic side…

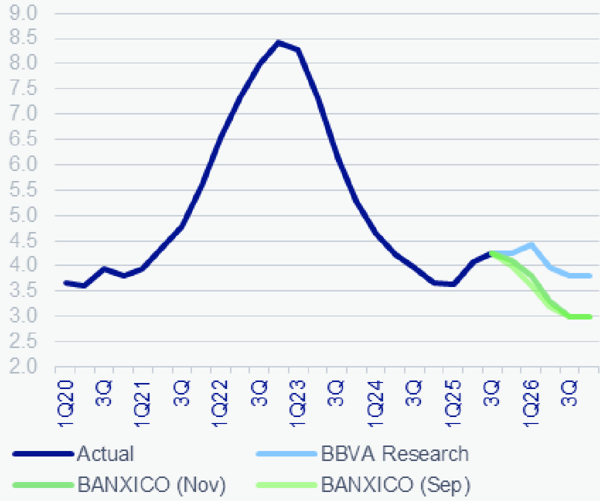
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

… and do not (yet?) reflect the (likely) temporary uptick we expect in 1Q26

FIGURE 2. CORE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

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