BBVA Research

Mexico Economic Outlook

The peso appreciates on the expectation that Mexico will continue to export a high percentage of goods to the United States free of tariffs and due to the attractiveness of the risk-adjusted carry trade

Javier Amador, David Cervantes, Iván Fernández, Arnulfo Rodríguez, Saidé Salazar, Carlos Serrano
Mexico City, December 2025

Marginal upward revision of expected economic growth for 2026

We expect Banxico to pause its rate-cutting cycle in Q1 2026

Economic activity	Although we kept our growth forecast for 2025 unchanged at 0.7%, INEGI's recent downward revision of the previously announced growth from Q1 2025 to Q3 2025, especially that of Q2 2025, gives it a downward bias.
Employment	Formal employment growth remains stagnant, at its lowest level since 2010 (excluding 2020). The uptick driven by the incorporation of digital workers proved temporary. As a result, total wage bill growth is being constrained by weak employment dynamics. Formal employment is projected to increase by 0.9% in 2025 and 1.9% in 2026.
Inflation	Headline and core inflation are expected to remain within the variability band at end-2026, albeit at 3.8%, which is 0.3 pp above our previous forecast. Weak aggregate demand should put downward pressure on services inflation.
Monetary policy	The continuity of Banxico's rate-cutting cycle will face a more constrained environment next year. We anticipate a pause in 1Q26 followed by two additional cuts that would take the rate to 6.50%.
Interest rates	We expect the yield curve to have more limited room for additional downward adjustments than it did this year, because the rate-cutting cycle will be less steep. We project an 8.2% yield for 10-year M-Bonds by the end of 2026.
Public Finances	The Historical Balance of Public Sector Financial Requirements will remain stable at around 51.4% of GDP in 2025.
Exchange Rate	We anticipate that the exchange rate will likely be in the region of 18.50 to 19.20 pesos per dollar by the end of 2025 and 2026, respectively.

Weakness in domestic demand in 2H25

GDP fell (-)0.3% q/q in Q3 2025, due to the prolonged weakening of domestic demand. Private consumption is losing momentum amid limited growth in the total wage bill and declining consumer confidence (private spending grew by only 0.1% year on year in September, with year-to-date cumulative growth 3.3 pp below the figure recorded in the same period in 2024). According to the latest IMSS data, the real total wage bill grew to 4.2% (sa) in October, which is 5.5 pp below the historic high of 9.8% recorded in June 2023. Meanwhile, gross fixed investment contracted by 7.3% y/y in September (cumulative), due to prolonged uncertainty surrounding the recently implemented judicial reform, reforms to the Amparo Law, the possibility of reopening previously tried cases, and uncertainty regarding U.S. trade policy. Added to the above is the consolidation of public spending, the base effect derived from the completion of the federal government's flagship works, and the effects of a highly restrictive monetary policy, considering the lags with which this policy operates. According to the latest INEGI data, public investment fell by 21.9% y/y as of August (cum.), while private investment declined by 8.7% over the same period. This is a cause for concern given that the fall in investment not only affects contemporary growth but also compromises the capacity for future growth.

On the supply side, the tertiary sector is propping up the economy, achieving 1.2% y/y growth by the end of Q3 2025 (cum.), with professional and business support services showing the strongest dynamism. Tourism services (hotels and restaurants) and wholesale trade (more closely linked to industry) are the only components that registered contraction (-3.0% and -5.3%, y/y, cum., respectively). Industry, meanwhile, reported a decline of (-)1.5% y/y at the end of Q3 2025 (cum.), with mining reporting the largest decline (-8.5% y/y, cum.), followed by the construction segment (-2.8% y/y, cum.). Manufacturing has stagnated (0.0% y/y, cum.). The automotive segment has reported a 4.6% decline so far this year (cum.). We anticipate that the weakness in the construction sector will extend into the coming months, responding to the contraction of the non-residential segment, in an environment of high uncertainty, both internal and external. Manufacturing, on the other hand, will maintain modest growth, given the lower dynamism of demand from the automotive sector in the U.S.

Although the advance of export orders in the U.S. avoided a slump in economic activity in the first half of the year, the most recent data suggest that this effect was only temporary. Total output lost momentum during the second half of the year due to the prolonged deterioration in domestic demand and the slowdown in external demand. In addition to the above, INEGI revised downwards growth for the first three quarters of this year, which imprints a downward bias on our growth estimate for 2025 (BBVA 0.7%). We anticipate a gradual recovery in 2026 (BBVA 1.2%), supported by improving employment conditions and the consequent favorable effect on the real wage bill. Significantly more moderate fiscal consolidation, and less uncertainty, would gradually support the recovery in investment.

The labor market continues to show some degree of stability, with low unemployment rates, but in a context of rising informality and clear weakness in formal job creation

Based on information from the National Occupation and Employment Survey (ENOE) of the National Institute of Statistics and Geography (INEGI), in October, the labor force participation rate stood at 59.9%, which represented a decrease of 0.32 percentage points year-on-year. This lower pressure on the labor market contributed to the unemployment rate remaining at 2.6% (seasonally adjusted), significantly below the historical average of 4.0% since 2005. However, labor informality increased markedly, reaching 55.4% in October (seasonally adjusted), 1.5 percentage points above the previous year's level. This implies that the relative stability of the unemployment rate is largely linked to weak labor force growth and rising informality, rather than stronger job creation.

On the other hand, figures from the Mexican Institute of Social Security (IMSS) point to a pronounced slowdown in formal employment. In November, formal employment grew 0.9% year-on-year, while the seasonally adjusted monthly increase was only 0.04%, the third lowest reading since 2010. From January to November, 599,000 formal jobs were created, a figure 3.2% lower than in the same period last year, which had already shown weakness, and 30.3% below the average of the previous three years. This highlights a deeper deceleration and recent stagnation, even considering the contribution of digital platform workers who meet the income threshold required to be registered as formal.

On the wage front, real wages grew 3.5% year-on-year in October, while the real wage bill increased 4.2%. With our inflation forecast for November (0.56% month-on-month), we estimate that real wages will grow 3.1% annually, while the total real wage bill will increase 4.1%. Both indicators show clear signs of deceleration and incipient stagnation.

Taken together, recent data point to a weakening labor market: low unemployment, but accompanied by higher informality, limited creation of formal jobs, and more moderate real wage growth, which continues to constrain the dynamics of the total wage bill. Under this scenario, we estimate that formal employment will grow 0.9% in 2025 and will show a gradual recovery toward 2026, when it could advance 1.9%, in a context in which economic activity will continue to limit job creation and labor income performance (Figure 2).

Headline inflation continues to fluctuate within the variability, while the upward trend in core inflation has come to a halt

As a result of a slower pace of increase in goods inflation, a slight slowdown in services, a decline in non-core inflation, and favorable base effects, the pickup in headline inflation observed during the second quarter was reversed in the third quarter. Thus, as we anticipated, the rebound in the second quarter was transitory. After hovering below 4.0% 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 3.6% y/y in the third quarter. In October it stood at 3.6% y/y, and we expect it to average 3.7% y/y in the fourth quarter. Thus, we maintain our expectation that, following the volatility observed in the second and third quarters, inflation will stabilize at an average of 3.7% y/y in the fourth quarter, closing the year at 3.8% y/y, within the Bank of Mexico's target range.

Core inflation, which best reflects the trend in medium-term inflation, exhibited an upward trend in the second and third quarters, which stopped at the beginning of the fourth quarter. After averaging 3.6% y/y in the first quarter, it increased to 4.1% y/y in the second quarter and 4.2% in the third. At the end of the third quarter, it stood at 4.3% y/y, the same level at which it remained in October. We forecast an average of 4.3% y/y in the last quarter and that it will stand at 4.2% y/y at the end of the year (+0.1 pp compared to our previous forecast), slightly above the upper limit of the variability range around Banxico's 3.0% y/y target.

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 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. While the pace of goods inflation eased to 0.24% m/m between July and October, services inflation has not moderated: its average of 0.33% m/m in this period is practically identical to that of the first half. However, the slower pace of increase in goods inflation has allowed the upward trend in core inflation to be halted.

Although services inflation has moderated slowly, weakness in aggregate demand should exert downward pressure on services inflation and should continue to lead to moderate increases in goods inflation. In the absence of shocks, this would cause a downward trend in core inflation going forward. However, the increase in the IEPS on some products, as well as the application of tariffs to products from countries with which Mexico does not have free trade agreements, will cause an additional increase in the first quarter of next year, which should be transitory. We anticipate that after stabilizing at 4.3% y/y in the fourth quarter of this year, it will increase to 4.5% y/y in January and 4.4% y/y on average in the first quarter of 2026. Then it will moderate to 4.0% y/y in the second quarter of next year, and decline to an average of 3.8% in the second half of 2026. This is the same level at which we anticipate it will be in December of next year.

Thus, the transitory increase in Q1 2026 will temporarily interrupt the disinflation process next year. Before the increase in IEPS on certain products was announced, we expected inflation to enter a new phase, settling below the historical average observed since the adoption of the 3.0% y/y target. In this scenario, we anticipated that both headline and core inflation would close 2026 at 3.5% y/y, a level that we consider consistent with the long-term equilibrium. We now anticipate that the effect of the increase in these taxes will imply 0.3 pp more inflation, so our new forecasts for both headline and core inflation are 3.8% for the closing of 2026.

In our opinion, downside risks remain more relevant due to the weak economy. The upside risk associated with a possible peso depreciation seems increasingly unlikely, especially since the degree of exchange rate pass-through to prices is usually close to zero when the output gap is negative. However, the persistence of services inflation despite weak demand continues to surprise and represents an upside risk to our forecasts. (Figures 3 and 4).

With monetary policy already in the neutral range, the continuity of Banxico's rate-cutting will face more limited space next year

In October, the Fed cut its reference rate by 25 bps for the second consecutive meeting, bringing it to a range of 3.75-4.00%. The statement again noted that downside risks to employment have increased in recent months. Even so, Powell, the Fed's Chair, cautioned that a December cut was not assured, in an attempt to temper market expectations that were then pricing in a linear cycle of rate cuts. Recent data—though still limited after the government shutdown—suggest that U.S. activity remains resilient thanks to AI-related investment. At the same time, uncertainty around the labor market persists. Against this backdrop, although the vote will likely be divided, the most recent stances from some key FOMC members and the weak labor market point to majority support for a third consecutive 25 bp cut this week. Going forward, we anticipate that the Fed will take some time to assess the cumulative effects of the cuts before resuming the cycle towards mid-2026, when we expect the rate to converge toward a terminal level of 3.25%.

In Mexico, Banxico's monetary policy stance finally entered the neutral range after the November decision, a relevant milestone after three years of restrictive stance and more than two and a half years of restriction since the rate reached 11.25% in March 2023; it now stands at 7.25%. The November statement was, however, less dovish: it underscored the risk of persistence of core inflation and adjusted the forward guidance by indicating that "the Board will evaluate reducing the reference rate," replacing the previous message of considering "further adjustments." The minutes also reflected less consensus on the future path of the policy stance, with only one member explicitly supporting that the real rate "should move further inside that [neutral] range." Even so, during the Quarterly Report, it was reiterated that the expected slack for economic activity would allow the rate-cutting to gradually continue in 2026, even after the inflationary impact derived from the changes to the IEPS.

In this context, and given the low dynamism of activity and formal employment, as well as the stability of the peso, we continue to anticipate a 25bp rate cut this month. However, we now estimate that Banxico could pause in 1Q26 before implementing two additional cuts that would bring the policy rate to 6.50% (Figure 5).

We expect the yield curve to continue to approach their equilibrium levels, although the room for further downward adjustments has been reduced

In the United States, government bond yields rebounded moderately in November following the Fed's "hawkish" rate cut and the consequent revision of expectations regarding the monetary policy path. The yield curve shifted almost parallelly, with relatively stable term spreads, suggesting that the recent move did not respond to significant changes in risk premia associated with the perception of fiscal and institutional risks. Inflation expectations implied by Treasury bonds have remained well anchored. Conversely, some emerging signs of stress in the money market led the Fed to announce the end of the reduction of its balance sheet, considering that bank reserves have gone from being “abundant” to “ample”. We continue to anticipate that the yield on the 10-year Treasury bond will continue to oscillate slightly above 4% in the coming months.

In Mexico, the decline in yields along the curve stopped in recent months after the accumulated correction during the year. This cumulative decline was primarily driven by a substantial decrease in country risk premia, which were also likely linked to the favorable performance of the peso and stock market in 2025. Looking ahead, we expect rates to gradually approach their long-term equilibrium levels. However, Banxico's limited scope for further easing naturally restricts the potential for additional declines across all maturities. In this context, we expect additional, but more limited, adjustments, consistent with an easing cycle that will advance at a more gradual pace as monetary policy moves into neutral territory.

In our baseline scenario, we project that the yield on 10-year M-Bonds will close 2025 at around 8.8% and 8.2% by the end of 2026 (Figure 6).

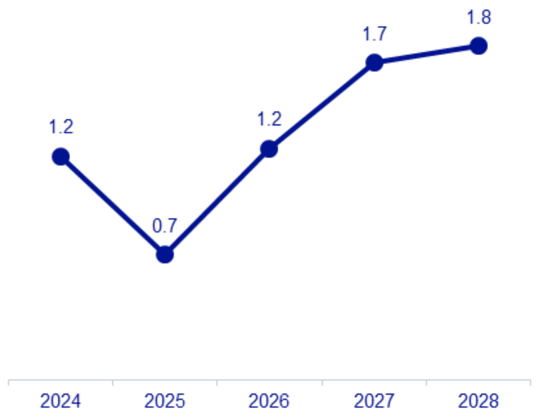
The Historical Balance of Public Sector Borrowing Requirements will remain stable at around 51.4% in 2025

After having analyzed the Report on Public Finances for the Third Quarter of 2025 presented by the SHCP, we forecast that the Historical Balance of Public Sector Borrowing Requirements (SHRFSP) will be 51.4% of GDP at the end of 2025 vs. 51.3% in 2024. Although the fiscal consolidation proposed for 2026 is only two-tenths of a percentage point, since the PSBR would go from -4.3% to -4.1% of GDP, the pressures of public spending, the increasingly limited fiscal space, and the absence of a tax reform to boost tax revenue lead us to expect that this consolidation will hardly advance next year. Due to the expected fragility of public finances in the coming years, which is caused by the expansion of social programs, federal government support to Pemex, pension payments for public and private sector workers, 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 discretionary spending in order to generate public deficits of around 2.5% of GDP. This will help maintain public debt at 51.4% during the period from 2026 to 2030. However, this will present an enormous fiscal policy challenge and result in downward pressure on economic growth. 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 2026-2030, then debt could approach 57.6% 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 2026 as it is affected by the lower economic growth projected for Mexico compared to the United States. The exchange rate is expected to be around 18.50 and 19.20 pesos per dollar at the end of

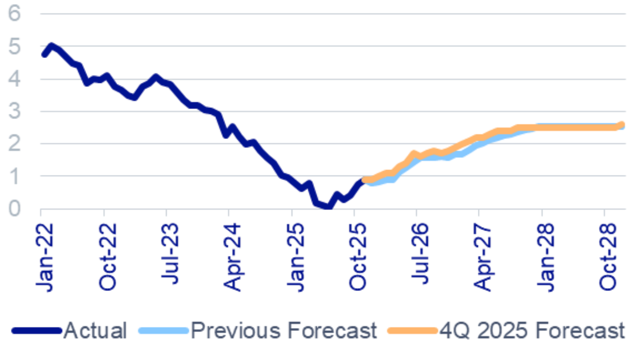
2025 and 2026, respectively.

FIGURE 1. GDP



Source: INEGI, BBVA Research

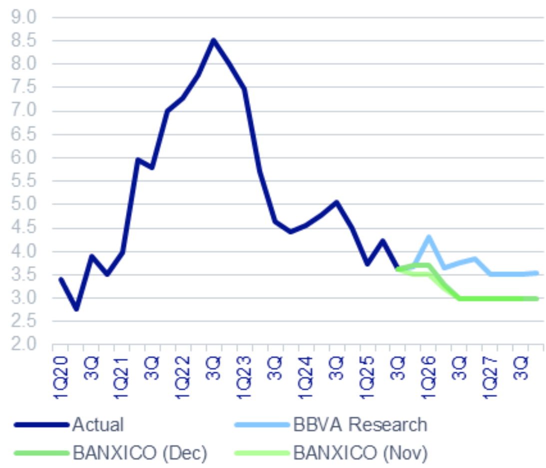
FIGURE 2. FORMAL EMPLOYMENT OUTLOOK



	25	26	27	28
Thousands, EoP				
Q4'25 Forecast	**200**	**436**	**579**	**598**
Previous forecast	177	380	578	594
Annual Change, % EoP				
Q4'25 Forecast	**0.9**	**1.9**	**2.5**	**2.5**
Previous forecast	0.8	1.7	2.5	2.5

Source: BBVA Research, IMSS

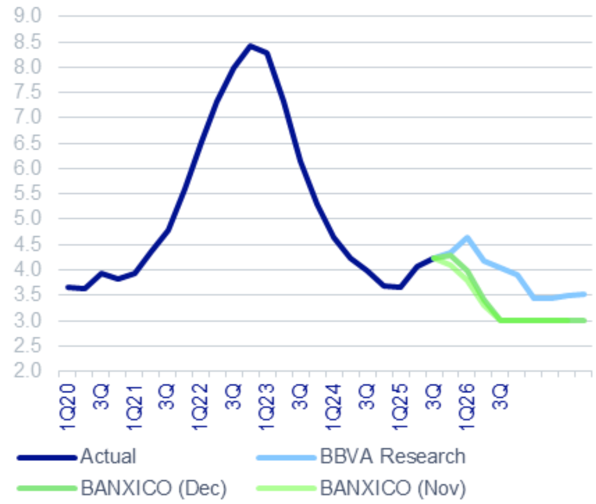
FIGURE 3. HEADLINE INFLATION
(ANNUAL % CHANGE)



	25	26	27
Q4'25 Forecast (fdp)	3.8	3.8	3.6
Previous forecast	3.7	3.5	3.5

Source: BBVA Research, INEGI

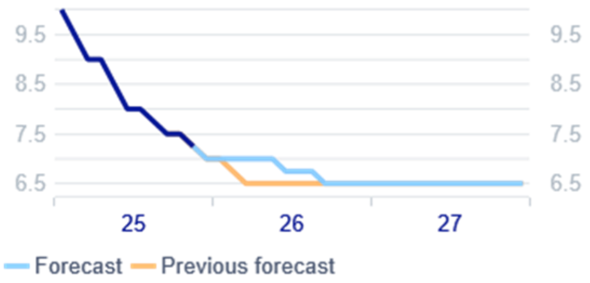
FIGURE 4. CORE INFLATION
(ANNUAL % CHANGE)



	25	26	27
Q4'25 Forecast (fdp)	4.2	3.8	3.5
Previous forecast	4.1	3.5	3.5

Source: BBVA Research, INEGI

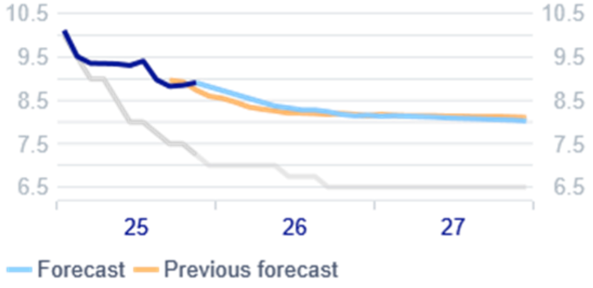
FIGURE 5. BANXICO POLICY RATE (%)



	25	26	27
Q4'25 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
Q4'25 Forecast	8.8	8.2	8.0
Previous forecast	8.6	8.2	8.1

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

BBVA Research

DISCLAIMER

The present document does not constitute an “Investment Recommendation”, as defined in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (“MAR”). In particular, this document does not constitute “Investment Research” nor “Marketing Material”, for the purposes of article 36 of the Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (MIFID II).

Readers should be aware that under no circumstances should they base their investment decisions on the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

This document has been prepared by BBVA Research Department. It is provided for information purposes only and expresses data or opinions regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.