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Banxico signals March is too soon to resume rate cuts

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Today's hawkish pause was underpinned by revised inflation forecasts that delayed the convergence to the 3% target to 2Q27

The Board unanimously decided to keep the policy rate unchanged at 7.00%, signaling that demand-side pressures are not a key driver behind its policy assessment. While the Board acknowledged that "economic activity expanded in the fourth quarter of 2025," it refrained from making any material upgrade to the growth outlook, continuing to stress that "the environment of uncertainty and trade tensions continues posing downward risks." It is true that Banxico softened its assessment of external downside risks, no longer characterizing them as "significant" and dropping the reference to "the possible impact of changes in trade policies worldwide" as a factor behind today's decision. However, the fact that the statement continues to cite "the weakness of economic activity" suggests that the Board still sees limited demand-driven price pressures.

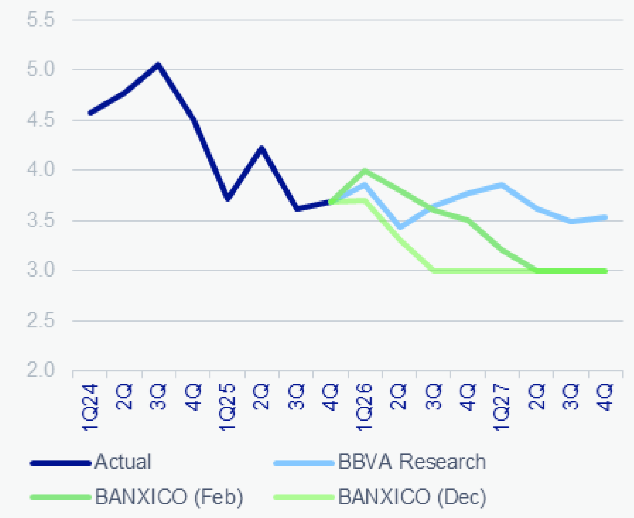
The decision was underpinned by upward revisions to Banxico's inflation forecasts, pushing the convergence to the 3.00% target back to 2Q27. The widely anticipated forecast revision responded "mainly to a higher-than-expected anticipated trajectory for core inflation." The statement also notes that "a more gradual decline in services inflation than previously foreseen" contributed to the revision. The central bank now expects headline and core inflation to average 4.0% and 4.4%, respectively, in 1Q26, up from 3.7% and 4.0% projected in December, with the revised inflation path now incorporating "the effects anticipated from fiscal adjustments" (IEPS and tariffs). Banxico's updated core inflation path now matches our forecasts for the first half of the year, while they turned less optimistic on non-core inflation over this period, as their forecasts are now above ours (Figures 1 and 2). The Board adopted a more cautious tone than in December by no longer stating that such fiscal adjustments "are estimated to have a temporary effect" on prices, while continuing to note that "the comprehensive assessment of [such effects] will require additional information as it becomes available." The minutes should shed further light into whether this change reflects a shift in the Board's assessment of this particular inflationary shock, but we think most members continue to view it as largely one-off. While Banxico still notes that "the risks for the trajectory of inflation […] remain biased to the upside," its new characterization of these risks as "closer to balance" points to a continued easing bias.

A hawkish tweak to the forward guidance reinforces our view that March would be too soon to resume the easing cycle. We had expected December's forward guidance ("looking ahead, the Board will evaluate the timing for additional reference rate adjustments") to remain unchanged, which alone would have been enough to keep our view that Banxico is in no rush to restart rate cuts. However, dropping the reference to "the timing for" additional adjustments points to a firmer commitment to the pause. We think this change narrows the scope for near-term easing and effectively rules out a rate cut in March. By avoiding any reference to timing, Banxico has clearly opted to buy time to assess incoming inflation data and the effects of recent fiscal measures, suggesting that any resumption of the easing cycle will require clearer evidence that inflation—particularly its core components—has resumed a sustained downward trend. At the same time, the Board's reference to "evaluat[ing] additional reference rate adjustments" points to a continued easing bias once core inflation resumes a downward trend, keeping the door open to a resumption of rate cuts later in the year.

We continue to expect Banxico to remain on hold in the coming meetings, as it assesses the effects of the temporary shocks to inflation. The outcome of this meeting was broadly in line with our pre-meeting expectations. While near-term inflation dynamics justify Banxico remaining on hold in the coming meetings, the Board will likely continue to keep the door open to renewed easing later in the year once the risks of second-round effects from the recent fiscal adjustments are ruled out. Besides, we continue to believe that a negative output gap will limit demand-side pressures and facilitate further disinflation in core services. Domestic demand will continue to face headwinds—including ongoing, albeit softer, fiscal consolidation, as well as the uncertainty around upcoming USMCA revisions. The continued strength of the MXN also provides an additional buffer against inflationary pressures. Thus, we believe the central bank will still have scope to resume gradual rate cuts later this year (in June and September, 25 bps each), ultimately bringing the policy rate closer to the midpoint of its estimated neutral range, around 6.50%.

Banxico's revised headline inflation forecasts now exceed ours in 1H26, while…

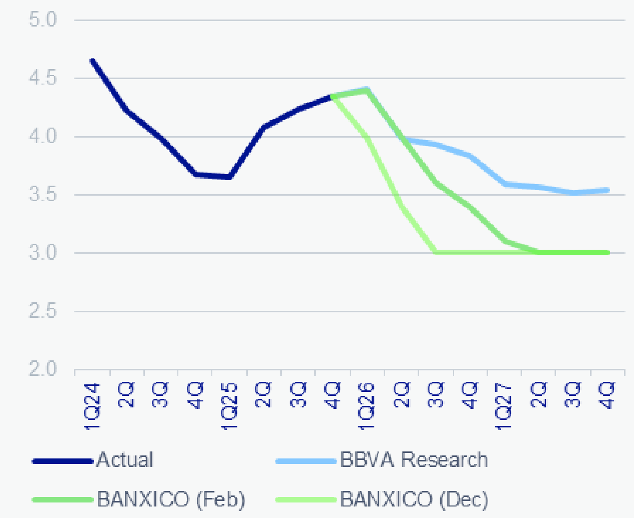
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

… their revised core inflation trajectory over this period is now in line with our forecasts

FIGURE 2. CORE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

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