

Banxico cuts, keeps easing bias and signals cycle nearing end

Javier Amador, Iván Fernández, Carlos Serrano

The timing of the final rate cut will depend on the trajectory of oil prices and the behavior of the peso amid the war in Iran

Banxico cut the policy rate by 25 bps to 6.75% as we expected, against consensus and market expectations, acknowledging soft activity and downside risks tied to the Middle East conflict. The decision was split (3-2), with Deputy Governors Jonathan Heath (who had dissented in recent cuts) and Galia Borja voting to hold, highlighting a growing split within the Board, in one of the most complex decisions of the current easing cycle. Following 4Q25 GDP growth, the statement noted that “economic activity showed significant weakness at the beginning of 2026” and reiterated that global uncertainty—now heightened by the Middle East conflict—“continues posing downward risks” to growth, implicitly pointing to limited demand-side inflation pressures. At the same time, the Board acknowledged a tightening in financial conditions since the last decision, citing higher “medium- and long-term government interest rates” and peso depreciation. This likely reinforced the view among some members that lowering the policy rate would have a limited impact on financial conditions under current circumstances. The decision surprised most analysts and the market. Yet, the peso weakened only modestly—by about 1.0%—following the release of the policy statement, and notably, broadly in the same direction of today’s moves in other emerging market currencies (c. 0.50%).

The decision came alongside a modest upward revision to its inflation forecasts, but Banxico does not appear overly concerned about the outlook. Headline inflation projections for the current and following two quarters were revised up by 0.1, 0.2, and 0.1 pp, to 4.1, 4.0, and 3.7%, respectively. Core inflation was also revised up by 0.1 pp over the same horizon, to 4.5, 4.1, and 3.7%. The revisions were attributed to a “higher trajectory for non-core inflation” and the still “more-gradual-than anticipated decline in services inflation.” Importantly, the Board noted that “as anticipated, there is no evidence of second-round effects” from the fiscal measures implemented earlier this year (IEPS and tariffs)—meeting a key condition previously conveyed for resuming the easing cycle. Broadly speaking, the inflation assessment suggests Banxico continues to view recent supply shocks as largely transitory, with limited risk of de-anchoring longer-term inflation expectations. In this context, Banxico likely remains confident that services inflation—so far keeping core inflation elevated—will eventually moderate, supported by the ongoing weakness in domestic demand, even if more slowly than initially expected. The majority appears to view the core inflation outlook consistent with the ongoing normalization of the policy stance toward more neutral levels. Following the recent increase in oil prices, “disruptions due to foreign trade policies or to an inflationary impact from geopolitical

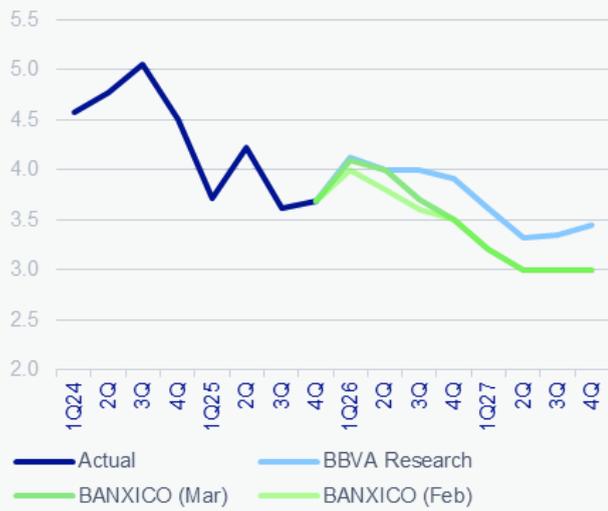
conflicts” now rank as the primary upside risk to inflation. The balance of risks remains tilted to the upside and is no longer described as “closer to balance,” although the statement still acknowledges that external developments “could imply pressures on inflation on both sides of the balance.”

Banxico kept an easing bias but clearly indicated that the easing cycle is near its end, with only one additional 25bp cut remaining to bring the policy rate to a terminal level of 6.50%. By dropping the reference to the “need to continue evaluating the impact of the fiscal adjustments implemented at the beginning of the year,” the Board conveyed that the test for second-round effects from this year’s fiscal changes has been largely met. At the same time, by noting that the “policy stance attained is adequate to face the challenges posed by an extension and escalation of the Middle Eastern conflict and its outcome,” Banxico is signaling that it thinks that the one-off effects of the war on inflation will prove transitory, and that policy lags justify bringing rates closer to neutral, with a high bar for any shift in the policy stance. Yet, the Board was more explicit about the limited remaining room for easing and more cautious on the timing of the final cut: the forward guidance now states that “depending on the evolution of macroeconomic and financial conditions, the Board will evaluate the appropriateness and timing for an additional reference rate cut,” while also noting that it “will monitor the evolution of external conditions.” Taken together, this suggests that the timing of the final cut will depend on the duration of the conflict and its impact on oil prices and the peso.

The outcome of this meeting reinforced our long-held view that the easing cycle will end at 6.50%, with the timing of the final cut dependent on the duration of the conflict. The combination of weak domestic demand, still-contained underlying inflation pressures, tighter financial conditions, and a still strong peso, supports completing the cycle, even amid heightened external uncertainty. In any case, higher global energy prices represent an external supply shock to which monetary policy is largely ineffective. Moreover, inflationary pressures in Mexico should be more contained than in most countries, as higher gasoline prices are unlikely to be passed through to consumers by the government. A negative output gap should continue to restrain demand-side pressures and drive disinflation in core services inflation. Domestic demand will continue to face headwinds—including ongoing, albeit softer, fiscal consolidation, as well as the uncertainty around upcoming USMCA revisions that is still likely weighing on most investment decisions. Looking ahead, we think the timing of the final rate cut will depend critically on external conditions, particularly the trajectory of oil prices and the exchange rate amid the evolving Middle East war. Under our baseline of a relatively short-lived conflict, and with Banxico’s test for second-round effects from this year’s fiscal changes now explicitly met, most Board members may prefer to wrap up the easing cycle and deliver the final 25bp cut in May. However, the risks are clearly tilted toward a delay should the conflict persist and lead to a more pronounced increase in energy prices and/or further peso depreciation.

Banxico's near-term inflation projections for both headline...

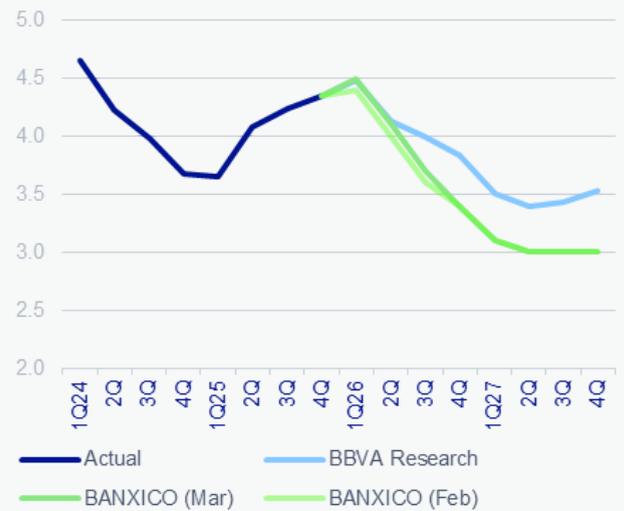
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

... and core inflation now match our own

FIGURE 2. CORE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research / Banxico / INEGI

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.

The content of this document is protected by intellectual property laws. Reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process is prohibited, except in cases where it is legally permitted or expressly authorised by BBVA on its website www.bbvarresearch.com.