

# Close call, but we expect Banxico to stick to its guidance and ease this week

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**It should stay the course toward neutral and look through the new supply shocks, given policy lags, a negative output gap, and anchored expectations**

**Last week, the Fed left rates unchanged at 3.50-3.75% and signaled limited scope for near-term easing amid increased geopolitical uncertainty.** The policy statement continued to note elevated uncertainty about the economic outlook, and added that “the implications of developments in the Middle East for the U.S. economy are uncertain.” The updated economic projections showed relatively limited changes, with participants expecting the main impact of the conflict to be on prices. Headline and core PCE inflation were revised up to 2.7% this year (by 0.3pp and 0.2pp, respectively), reflecting higher oil prices, the gradual unwinding of tariff-related effects, and persistent non-housing services inflation. The median path for the fed funds rate was left unchanged, still pointing to one rate cut this year and another in 2027. That said, the dot plot showed a slightly more hawkish tilt, with fewer participants projecting lower rates than in December ([Figure 1](#)). Powell emphasized that it is too early to assess the economic implications of the conflict, noting that the outcome will depend on its duration, its effects on prices, and how consumers respond. Taken together, last week Fed’s messages reinforced our view that it remains firmly on pause, with little urgency to resume easing in the near term (click [here](#) and [here](#) for additional details on last week’s FOMC meeting).

**In Mexico, 2025 GDP growth was revised slightly higher, confirming a somewhat stronger second half of the year, though underlying domestic demand dynamics remain weak.**

According to INEGI’s second estimate, 4Q25 real GDP expanded by 0.9% q/q (0.8% previously), with the revision mainly driven by a smaller contraction in primary activities. The report also included an upward revision to 3Q25 growth, from -0.3% to 0.1%, reflecting a softer contraction in industrial activities ([Figure 2](#)). The outlook for 2026 has thus improved due to the associated carryover effect, as well as from continued expectations of resilient consumption and a gradual recovery in fixed investment, supported by a likely successful USMCA review—with existing conditions broadly expected to remain unchanged even absent a formal renewal—, and less restrictive fiscal and monetary stances. In addition, the government’s announcement of mixed (public and private) infrastructure projects should be an additional boost to aggregate demand. Timely data, however, still point to weak momentum. Manufacturing remains soft, with

the latest estimate suggesting a 4.6% y/y contraction in February, despite some support from segments linked to AI-related investment in the U.S. Consistently, on the labor market side, formal employment has shown only little improvement. Around 175k jobs have been created through February, broadly in line with last year's pace, but largely reflecting the incorporation of digital-platform workers. Excluding this effect, employment growth remains weak (0.4% y/y), underscoring persistent fragility in key sectors such as construction and manufacturing. Overall, current conditions continue to point to a negative output gap, while renewed uncertainty related to the conflict in Iran could weigh on the recovery in investment despite the aforementioned tailwinds. As a result, domestic demand is likely to strengthen only gradually, remaining insufficient to generate meaningful demand-side inflationary pressures in the near term and leaving room for further monetary policy easing.

**Banxico is likely to stress increased risks amid higher oil prices, but the supply nature of recent shocks should not derail its plans to move rates further into neutral.** As expected, headline inflation continued to pick up since the last monetary policy decision, rising from 3.8% y/y in early January to 4.0% in February. Core inflation also edged higher, averaging 4.5% in January-February ([Figure 3](#)). In the first half of March, headline inflation increased by 0.62% f/f, above our 0.53% forecast, but well-above consensus expectations (0.35%), pushing the annual rate to 4.6%. This was mainly driven by a renewed spike in non-core inflation, which rose by 1.9% f/f (5.2% y/y), largely explained by an 8.3% f/f increase in fruit and vegetable prices. By contrast, core inflation remained broadly unchanged, edging down a bit from 4.48% to 4.46% y/y. Core goods inflation also edged down slightly (from 4.5% to 4.4%), while core services inflation held steady at 4.5%, reflecting continued stickiness in services inflation other than housing and tuitions (0.34% f/f, 5.2% y/y). This year's increase in core inflation reflects the pass-through from IEPS-related tax adjustments implemented at the start of the year. The latest three biweekly readings confirm that the IEPS tax increases only led to a one-off relative price adjustment, as both we and Banxico had expected. With null second-round effects now confirmed, and amid still weak domestic demand, we expect both headline and core inflation to resume a gradual downward trend from 2Q26 onward. The still-negative output gap should help contain demand-side pressures and support further disinflation in core services, despite its persistent stickiness.

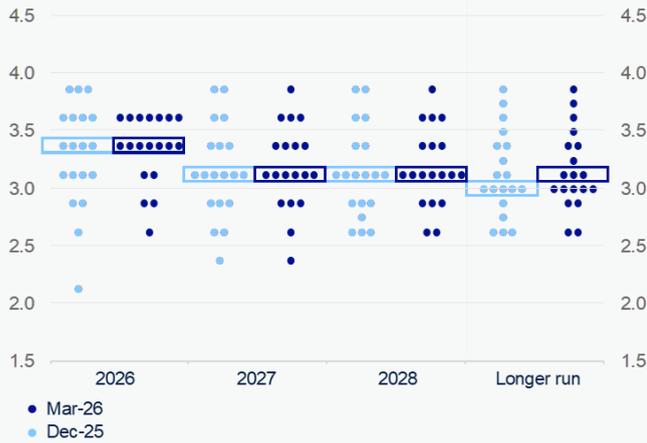
**Banxico's minutes showed a clear dovish bias, paving the way for a rate cut this week, before long-term yields moved higher amid rising global risk premia.** 10-year M Bond yields have increased by around 70 bps so far this month, reaching 9.4%, with more than half of the change explained by the increase in the equivalent U.S. Treasury yield (around 40 bps, to 4.4%). The remaining increase appears to reflect higher currency risk, while country risk has remained broadly stable, suggesting that recent market movements are not reflecting a deterioration in domestic fundamentals. The peso has depreciated in recent weeks, reflecting its typical sensitivity to periods of global risk aversion, during which it tends to be among the most affected EM currencies due to its high liquidity. However, despite increased FX volatility, it remains relatively strong compared to last year's levels and continues to outperform its EM peers year to date ([Figure 4](#)). Regardless of the source of volatility, financial conditions have already tightened through higher long-term yields, which may lead Banxico to conclude that further tightening via the policy rate—even by keeping it unchanged—is not warranted. In our

assessment of the February decision, we noted that changes to the policy statement signaled that most Board members viewed March as too soon to resume the easing cycle. However, the meeting minutes revealed a stronger dovish bias, with most members assessing that the inflationary impact of recent fiscal measures had been limited, with a one-off effect on goods inflation, and already largely reflected. This ongoing willingness to resume the easing cycle was reinforced during Banxico's quarterly press conference. That said, this took place before the conflict in the Middle East, and it is not known what is the assessment of Board members on its potential effects on inflation and growth.

**We expect Banxico to resume the easing cycle this week with a 25bp rate cut, to 6.75%, although we see this as a close call (60-40).** While Banxico could prioritize caution amid renewed global risks, our thinking is that the Board is more likely to emphasize that, although upside risks to inflation have increased due to higher energy prices and recent FX volatility, it can look through this shock and stay the course toward the midpoint estimate of the neutral rate. The Board is unlikely to materially revise its assessment of economic activity and will likely continue to highlight domestic weakness. With the policy stance still closer to the upper limit of the neutral range, and considering the transitory nature of recent shocks, Banxico should conclude that underlying inflation pressures remain contained. At the same time, tighter financial conditions—driven by higher long-term yields—reduce the need for additional restraint, while the relative strength of the peso points to limited FX risks. Moreover, recent communication—including the meeting minutes and subsequent remarks—suggests strong conviction within the Board that the easing cycle has not concluded and that further adjustments are warranted. Importantly, if inflation expectations remain well anchored, a pause driven by a supply-driven shock could prove counterproductive given policy lags, potentially leaving the stance tighter than desired once these pressures dissipate. Overall, while heightened uncertainty may warrant a cautious tone, we expect Banxico to stick to its conveyed plan and ease this week.

Dots showed a slightly hawkish tilt, with fewer participants projecting lower rates than in Dec

**FIGURE 1. FOMC PARTICIPANTS PROJECTED FEDERAL FUNDS RATE (%)**



Cells with borders indicate the position of the median projection  
Source: BBVA Research / Fed

2025 GDP growth was revised slightly higher, confirming a somewhat stronger 2H

**FIGURE 2. REAL GDP (Q/Q%)**



Source: BBVA Research / INEGI

The uptick in headline inflation this year is due to two supply shocks

**FIGURE 3. INFLATION AND BANXICO POLICY RATE (%)**



The shaded area indicates the inflation target variability range  
Source: BBVA Research / INEGI / Banxico

The Mexican peso continues to outperform its EM peers year to date

**FIGURE 4. USDMXN RELATIVE PERFORMANCE (01-JAN-26=100)**



\* Reweighted version of the Fed's Emerging Market Economies (EME) Dollar Index. Source: BBVA Research, Fed, Macrobond

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