

# Mexico Economic Outlook

We anticipate a gradual recovery of economic activity in 2026, with a better performance of domestic demand and the export sector

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# Upward revision of expected economic growth for 2026

## Core inflation should resume easing in Q2 after a temporary Q1 shock

	<b>Economic Activity</b>	We upgraded our 2026 GDP growth forecast to 1.8% (1.2% previously), supported by the sustained resilience of consumption and the anticipated gradual recovery in investment.
	<b>Employment</b>	After a weak performance in 2025, formal employment is showing signs of improvement. The total wage bill continues to grow, driven by rising real wages. Looking ahead, we expect a gradual recovery in employment, supported by stronger economic dynamism and investment. Formal employment is expected to grow by 2.1% in 2026.
	<b>Inflation</b>	We expect core inflation to resume a downward trajectory from the second quarter onwards. We forecast headline inflation to close 2026 at 3.9%, +0.1pp from our previous forecast, with core inflation at 3.8%.
	<b>Monetary Policy</b>	We anticipate that Banxico will resume cuts this month, with one more adjustment in May that will take the target rate to a terminal level of 6.50%.
	<b>Interest Rates</b>	Assuming the conflict in Iran is short-lived, we expect a pullback in the recent rise of long-term rates.
	<b>Public Finance</b>	The Historical Balance of Public Sector Borrowing Requirements will increase to 54.9% of GDP in 2026.
	<b>Exchange Rate</b>	We anticipate that the exchange rate will likely be 18.0 and 18.2 pesos per dollar by the end of 2026 and 2027, respectively.

## More favorable outlook for economic activity in 2026

Economic activity shows dynamism in 4Q25 (0.9% q/q) and points to an improvement in 2026, with prolonged resilience of the tertiary sector and recovery of the industry. According to INEGI data, the trade and services sector as a whole grew 1.5% in 2025 (boosted by professional and business support services), while industry contracted (-)1.1% during the same period (due to the fall in construction and manufacturing). We anticipate that the resilience of the tertiary sector will extend this year, with the favorable effect of the World Cup on the tourism segment.

Manufacturing will show signs of recovery going forward, driven by sectors associated with the development of artificial intelligence in the U. S. (computer equipment, communications, and electronic accessories). The construction segment, on the other hand, will gradually reverse its slowdown process, as the negative base effect dissipates, in an environment of less fiscal consolidation.

On the demand side, consumption remains the strongest component of economic activity, with growth of 1.2% as of December (y/y, acum.), favored by higher spending on imported services and goods (1.4% and 3.5% y/y, respectively). Investment, on the other hand, showed a significant contraction in 2025, with an annual change of (-)6.6% as of December (cumulative), due to a decline of (-)8.6% in the machinery and equipment segment and (-)4.6% in the construction sector. By 2026, we anticipate a gradual improvement in gross fixed investment, with increased expenditure in the manufacturing sector linked to the external demand and higher public expenditure (with a crowding-in effect on the private sector). With regard to private consumption, we estimate that it will gain greater momentum supported by gradual gains in the real wage bill. As regards the external sector, we expect the stronger momentum in the manufacturing segment linked to growth in artificial intelligence investment in the U.S. to continue. (data centers and equipment for information processing). This will reshape domestic manufacturing, increasing the share of segments outside the automotive industry.

Considering the aforementioned factors, we estimate a gradual recovery in economic activity in 2026 (BBVA 1.8%), with a better performance of domestic demand and the export sector. GDP is expected to grow 2.0% in 2027, given the successful revision of the USMCA, with a positive carry-over effect from 2H26 ([Figure 1](#)).

## Signs of a recovery in formal employment and a resilient wage bill, driven by solid real wages. The reactivation of investment will be key to consolidating this improvement.

Formal job creation started the year with mixed signals. According to figures from the Mexican Institute of Social Security (IMSS), formal employment grew by 1.2% year-on-year in February, with a 0.25% month-on-month increase in seasonally adjusted terms. This marks a significant shift in employment dynamics following the 0.17% decline recorded in the previous month. Overall, these figures point to an improvement after the weak start to the year and suggest a gradual rebound in formal employment.

In cumulative terms, around 175 thousand formal jobs have been created as of February, a

level close to that recorded in the same period last year (193 thousand). However, this trend is influenced by the inclusion of digital platform workers; excluding this effect, annual employment growth falls from 1.2% to 0.4%. This confirms that formal job creation remains heavily influenced by these workers and underscores the need for a recovery in key sectors of the economy, such as construction and manufacturing, which posted negative formal job creation last year.

On the other hand, real wage growth has been more favorable. In February, real wages grew by 3.0% year-on-year, remaining above their historical average (2012–24) of 2.0%. This has allowed the wage bill to continue expanding, maintaining relatively solid annual growth of over 4.0% on average since July last year and reaching 4.2% in February. The resilience of real wages has been important, as it has supported household consumption.

Looking ahead, a gradual improvement in formal employment is expected. Greater dynamism in economic activity, together with a recovery in the industrial sector and in productive investment, will be key to consolidating a more robust recovery in the formal labor market. In this context, we have revised our 2026 formal employment growth forecast upward, from 1.9% to 2.1%, in an environment where the wage bill continues to expand and support consumption, and where overcoming the lag in investment will be key ([Figure 2](#)).

## **Headline inflation will average below 4.0% during all quarters of the year, while core inflation will resume a downward trajectory starting in the second quarter**

Core inflation, which better reflects the medium-term price trend, has shown an upward trajectory since Q2 25. After averaging 3.6% y/y in the first quarter, it increased to 4.1% in the second, 4.2% in the third and 4.3% in the fourth, closing the year at the same level. In Q1 2026, it rebounded further, averaging 4.5% in January–February.

What drove the spike in core inflation? Three main factors. First, goods inflation accelerated more than expected, rising from an average of 0.20% m/m in 2024 to 0.35% in 2025. However, 2H25 averaged 0.20% m/m, down from 0.50% in 1H25. Second, services inflation has remained persistent, showing limited adjustment despite weaker demand and a widening negative output gap, easing only marginally from 0.40% m/m in 2024 to 0.36% in 2025. Third, increases in the IEPS on certain core food goods exerted upward pressure on prices. Although goods inflation had returned in the second half of last year to levels consistent with price stability, the pass-through of these tax hikes led to a 0.9% m/m increase in January, pushing the annual rate up to 4.56%. Despite this additional rebound—expected to be temporary—goods inflation shows two encouraging signs. First, food commodity inflation in February remained in line with its typical seasonal pattern. Second, inflation in other goods has followed a favorable trend in the first two months of the year, contributing to a moderation in the annual rate of this sub-index from 3.5% at the end of 2025 to 3.2%.

Although services inflation has moderated slowly, a negative output gap and a still weak labor market should exert downward pressure on this component. Also, after the transitory increase observed in January, these conditions should continue to favor moderate increases in goods inflation. Accordingly, in the absence of additional shocks, we expect macroeconomic conditions to support a downward path for core inflation going forward, starting in the second quarter. We anticipate that, after rebounding to 4.5% y/y in Q1 26, core inflation will decline to 4.1% y/y in Q2. Subsequently, we expect it to moderate to 4.0% y/y in Q3 and to an average of 3.8% in Q4, which is the level we estimate it will close the year.

For its part, after fluctuating in a narrow range during Q3 and Q4 25, headline inflation shows a rebound in Q1 26, explained by a further increase in goods inflation after the increase in the IEPS in some products. Thus, after averaging 3.7% y/y in the fourth quarter of 2025 and closing the year at that level, headline inflation rebounded to 3.8% in January and 4.0% in February. Non-core inflation has helped to contain a further increase in headline inflation. We expect inflation to rise further to 4.1% in March, before resuming a downward trend starting in the second quarter, partly supported by favorable base effects. On average, we estimate that headline inflation will be below 4.0% during all quarters of the year, while core inflation will resume a downward trend starting in Q2 26. We forecast headline inflation to close 2026 at 3.9%, with core inflation at 3.8%. By the end of 2027, we expect both to reach 3.5%. This is below the historical average seen since the target of 3.0% y/y was adopted. We believe this level aligns with the long-term equilibrium.

While downside risks from the negative output gap and weak labor market remain, upside risks have also risen again. In particular, the risk associated with a possible additional depreciation of the peso – which seemed increasingly unlikely – has once again become relevant in the context of the war in Iran and greater risk aversion at the global level, which has affected financial variables. In addition, the persistence of services inflation, which continues to show more rigid behavior than expected despite weak demand, continues to represent an upside risk to our forecasts ([Figures 3 and 4](#)).

## **We anticipate that Banxico will resume rate cuts this month, with one more adjustment in May that will bring the target rate to a terminal level of 6.50%**

In January, the Fed decided to pause its rate-cutting cycle and kept the policy rate within a 3.50-3.75% target range. The policy statement reflected a more favorable view of the economic outlook and highlighted signs of stabilization in the labor market. At the press conference, Powell pointed out that this evolution allows for a "wait and see" approach, although he emphasized that upside risks to inflation persist due to the possibility that the costs associated with tariffs will gradually be passed on to consumer prices. The minutes of the meeting reinforced this cautious assessment by revealing growing concerns about the inflationary outlook. Several members warned that the disinflation process could be slower and more uneven than anticipated, and some even began to assign some probability to eventual rate hikes if inflation remained persistently above target. Taken together, these signals suggest that the FOMC is firmly in pause mode as it assesses the evolution of the balance of risks. In

our baseline scenario, we expect this pause to extend through the first half of 2026. Going forward, we expect the rate-cutting cycle to resume in the second half of 2026, with two 25bp reductions that would bring the reference rate to a terminal range of 3.00-3.25%.

In February, Banxico decided to keep the reference rate unchanged at 7.00%, after having reduced it by 300 bps during 2025. The decision was supported by the upward revision of its inflation forecasts, which implied a higher trajectory of core inflation due to the anticipated effects of the fiscal adjustments that came into effect this year. The policy statement struck a more cautious tone, removing the explicit reference to the "timing" of future rate adjustments, a modification that initially seemed to signal that March would be too early to resume the rate-cutting cycle. The meeting minutes, however, revealed a strong dovish bias. Most members agreed that, with the information available so far, the inflationary impact of recent changes to excise taxes (IEPS) and tariffs had been softer than expected and only concentrated in some goods. This diagnosis has been reinforced by more recent public interventions by some members of the Board, who seem to retain a firm conviction that, in the face of a transitory supply shock, macroeconomic conditions still leave room for further cuts.

Despite our upward revision to GDP growth, we believe that the economy continues to navigate amid a negative output gap and a still weak labor market, suggesting limited demand-side inflationary pressures. Added to this is the relative strength of the peso, which has remained firm despite recent global volatility. In this context, we now anticipate that Banxico will resume the rate-cutting cycle this month and will continue it in May, bringing the reference rate to a terminal level of 6.50% ([Figure 5](#)).

### **Assuming the conflict in Iran is short-lived, we expect a pullback in the recent rise of long-term rates**

In the U. S., Treasury yields have rebounded from their late-February lows so far this month, in response to the recent episode of global market volatility driven by the escalating conflict between the U. S. and Iran. This movement mainly reflects an increase in global risk premia due to the uncertainty surrounding the magnitude and persistence of the impact on the energy sector, which has more than offset the downward pressure on rates derived from the search for safe-haven assets. The prevailing trend in recent weeks, however, had been a moderate downward correction in yields following January's inflation data. That drop pushed the yield on the 10-year Treasury note to 3.94% by the end of February, its lowest level since April last year, and was partly due to a moderation in implied inflation expectations and a compression of the term premium, causing a downward shift in the yield curve.

In Mexico, M Bond yields have closely followed these global movements. Long-term rates recently experienced a significant rebound associated with the external shock described in the previous paragraph. As usual in episodes of greater global risk aversion, this was also reflected in the depreciation of the peso and falls in the local stock market. However, the dollar-denominated sovereign bond yield spread, along with other measures of country risk, has remained relatively stable, suggesting that these movements have been mainly due to

global factors rather than changes in the perception of domestic risk. This leads us to conclude that, under the assumption of our base scenario of a short-term conflict, these variables will experience a correction in the very short term.

In our baseline scenario, we continue to consider that rates along the yield curve still have some room to decline. We estimate that the yield on the 10-year M Bond will resume a downward trajectory that would take it to 8.3% by the end of this year and 8.0% in 2027 ([Figure 6](#)).

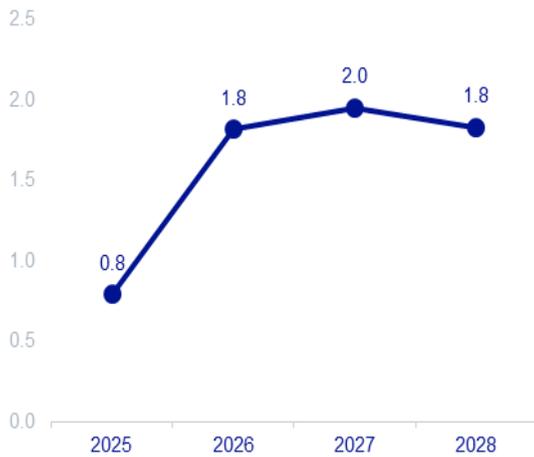
## **The Historical Balance of Public Sector Borrowing Requirements will increase to 54.9% in 2026**

After having analyzed the Report on Public Finances for the Fourth Quarter of 2025 submitted by the SHCP, we forecast that the Historical Balance of Public Sector Borrowing Requirements (HBPSBR) will be 54.9% of GDP at the end of 2026 vs. 53.2% in 2025. Although the fiscal consolidation proposed for 2026 amounts to only two-tenths of a percentage point, as the PSBR is expected to improve from -4.3% (excluding support to Pemex in 2025) to -4.1% of GDP, the pressures on public spending, the increasingly limited fiscal space, and the absence of a tax reform to increase revenue lead us to anticipate that this consolidation will hardly advance next year.

Given the expected fragility for public finances in the coming years due to the expansion of social programs, the patrimonial support to Pemex from the federal government, the payment of public pensions, debt service and the little margin for growth in tax collection without a fiscal reform, the federal government would most likely have to make adjustments to discretionary spending to generate public deficits of around 2.5% of GDP to keep public debt at 53.2% during the 2026-2030 period, which would represent a huge fiscal policy challenge that would result in downward pressures 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 60.0% of GDP by 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 gradual and moderate depreciation starting in the second quarter of 2026 as it is affected by the lower economic growth projected for Mexico in relation to the United States. The exchange rate is expected to be around 18.0 and 18.2 pesos per dollar at the end of 2026 and 2027, respectively.

**FIGURE 1. GDP**  
(ANNUAL % CHANGE)



Source: BBVA Research, INEGI

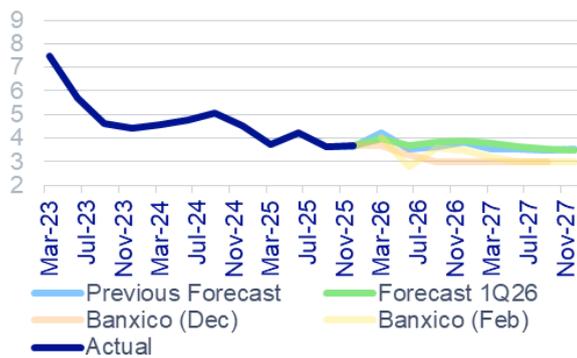
**FIGURE 2. FORMAL EMPLOYMENT OUTLOOK**  
(ANNUAL % CHANGE)



Forecast	26	27	28	29
Thousands, EoP				
Q1 2026 Forecast	470	611	608	623
Previous forecast	436	579	598	609
Annual Change, % EoP				
Q1 2026 Forecast	2.1	2.7	2.6	2.6
Previous forecast	1.9	2.5	2.5	2.5

Source: BBVA Research, IMSS

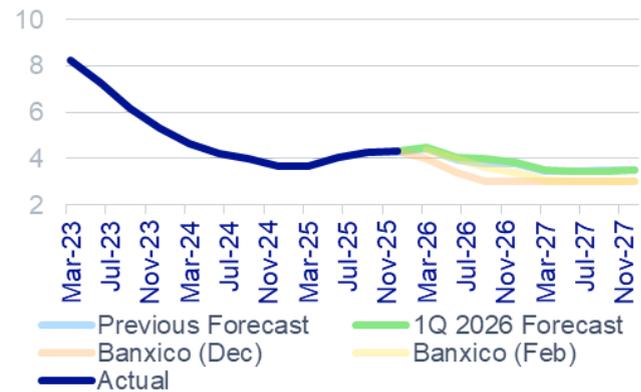
**FIGURE 3. HEADLINE INFLATION**  
(ANNUAL % CHANGE)



	26	27	28
Forecast Q1 26 (eop)	3.9	3.5	3.5
Previous forecast	3.8	3.6	3.5

Source: BBVA Research, INEGI

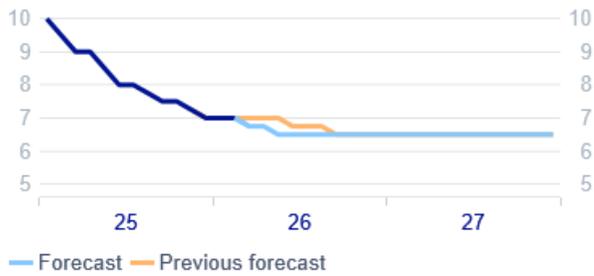
**FIGURE 4. CORE INFLATION**  
(ANNUAL % CHANGE)



	26	27	28
Forecast Q1 26 (eop)	3.8	3.5	3.5
Previous forecast	3.8	3.5	3.5

Source: BBVA Research, INEGI

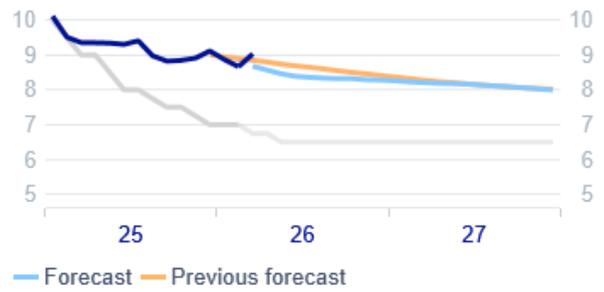
**FIGURE 5. BANXICO POLICY RATE (%)**



	26	27	28
Forecast 1Q26 (eop)	6.50	6.50	6.50
Previous forecast	6.50	6.50	6.50

Source: BBVA Research, Banxico

**FIGURE 6. 10-YEAR GOVERNMENT YIELD (%)**



	26	27	28
Forecast 1Q26 (eop)	8.3	8.0	8.0
Previous forecast	8.4	8.0	8.0

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

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