

Banxico delivers final cut, reinforces prolonged pause

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Weak domestic demand outweighed concerns about global risks and price pressures stemming from one-off shocks

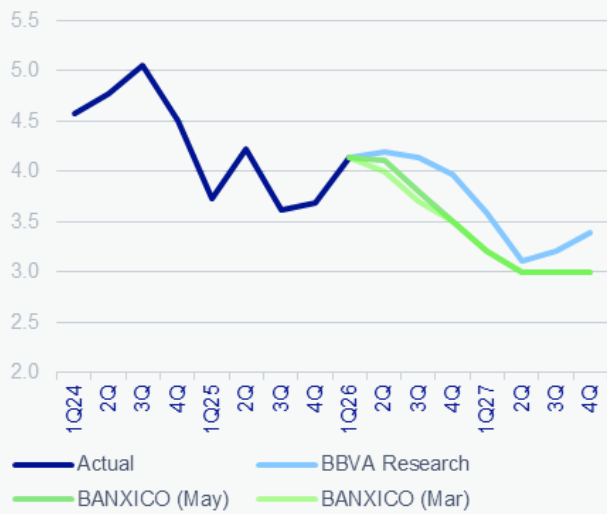
Banxico cut the policy rate by 25bps to 6.50% and confirmed the end of the easing cycle, although the decision once again revealed a divided Board. Deputy Governors Jonathan Heath and Galia Borja voted to keep rates unchanged, resulting in the same 3-2 split seen at the late-March meeting. We had expected the recent moderation in the Middle East conflict—also acknowledged in the statement, which noted that the still-elevated “uncertainty associated with the Middle Eastern conflict eased” during the intermeeting period—to lead Borja to follow through on the slightly dovish tone expressed in the minutes, where she stated that “the determinants of inflation continue pointing towards convergence.” The statement also referred to the 1Q26 GDP contraction, with Banxico downgrading its assessment of the growth outlook by stating that “economic slack is expected to be greater than previously anticipated” and stressing that “looking ahead, significant downward risks persist,” signaling increased concern about domestic demand conditions. Market reaction was limited, with the peso broadly unchanged following the decision and the 10-year M Bond yield rising by only around 5 bps, suggesting that markets had largely priced in both the decision and the prospect of a prolonged pause ahead.

The Board’s inflation assessment suggests that policymakers continue to view recent price pressures as largely temporary and supply-driven. Inflation forecasts saw only minor revisions. Banxico raised its headline inflation projections for 2Q26 and 3Q26 by 0.1pp, to 4.1% and 3.8%, respectively ([Figure 1](#)), likely in response to the recent deterioration in fruit and vegetable prices. In contrast to the previous statement—which noted that core inflation had “remained practically unchanged”—the Board noted the recent moderation “from 4.46 to 4.26%” between the first half of March and the second half of April. In this context, core inflation forecasts were left unchanged ([Figure 2](#)), still pointing to convergence to the 3.0% target by 2Q27. The Board also reiterated that “there is no evidence of second-round effects from the fiscal measures adopted at the beginning of the year,” signaling continued confidence in the one-off nature of IEPS changes. The balance of inflation risks changed only marginally. “Disruptions due to foreign trade policies or to an inflationary impact from geopolitical conflicts” remained the main upside risk, but Banxico elevated the “persistence of core inflation” to second place, ahead of “cost-related pressures.” This subtle reordering suggests the Board remains attentive to the stickiness of core services inflation.

The forward guidance leaves no doubt that Banxico intends to keep rates unchanged for an extended period, likely at least through year-end. The statement explicitly noted the Board’s decision to “conclude the cycle” and that “it will be appropriate to maintain the reference rate at its current level.” The policy rate is now broadly aligned with the central estimate of the neutral range. At this level, and broadly in line with the Fed’s message that the current stance is “in a good place”, the Board is effectively shifting toward a wait-and-see approach, judging that “the monetary policy stance is well-suited to face the challenges posed by the macroeconomic environment, including those associated with an extension and escalation of the Middle Eastern conflict and its repercussions.” The easing bias was effectively dropped, reflecting the view that, having reached neutral levels, the current environment of elevated global uncertainty calls for caution. At the same time, the lack of a tightening bias reflects Banxico’s still-pessimistic assessment of domestic demand conditions, with the wording explicitly noting that the continued weakness in activity “implies an absence of demand pressures in the economy.” Looking ahead, one question is whether the Board will continue to be split. Heath’s apparent discomfort with a neutral policy stance may push him to back rate hikes in upcoming meetings. **Looking further ahead, as core inflation converges toward 3.5% in 2027 and the Fed potentially resumes easing, Banxico could consider additional rate cuts, bringing the policy rate closer to 6.0%.**

Banxico fine-tuned its headline inflation forecasts for this quarter and next...

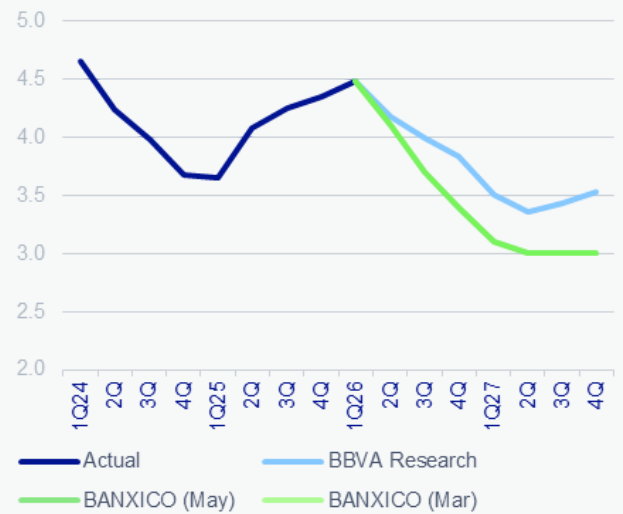
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research, Banxico, INEGI

... while leaving the expected path for core inflation unchanged

FIGURE 2. CORE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research, Banxico, INEGI

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