

# Mexico Economic Outlook








We expect the economy to grow by 1.2% in 2026, amid weaker expected growth in consumption and investment

**Javier Amador, David Cervantes, Iván Fernández, Arnulfo Rodríguez, Saidé Salazar, Carlos Serrano**

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# Weak domestic demand continues to delay the economic recovery

**Core inflation is expected to resume its downward trend in the second quarter of the year following the temporary shock in the first quarter**

	<b>Economic Activity</b>	We have revised our 2026 GDP growth forecast downward to 1.2% (from 1.8% previously), reflecting weak domestic demand—particularly investment—and a prolonged environment of uncertainty.
	<b>Employment</b>	Formal employment growth remains subdued, consistent with a weakening business sector and rising informality. We have revised down our formal employment growth forecasts to 1.4% for 2026 and 2.0% for 2027.
	<b>Inflation</b>	Following a first-quarter pickup, inflation is cooling down in Q2, though sticky services continue to stall a faster slowdown. We project headline and core inflation will end 2026 at 4.1% and 3.9%, respectively.
	<b>Monetary Policy</b>	Banxico wrapped up its easing cycle and its forward guidance suggests it will keep the policy rate unchanged at 6.50% through at least year-end.
	<b>Interest Rates</b>	A prolonged conflict in Iran suggests that local long-term rates will take longer to converge toward their equilibrium levels.
	<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 probably be around 17.8 and 18.0 pesos per dollar by the end of 2026 and 2027, respectively.

## **Moderate growth amid weak domestic demand and elevated uncertainty**

The Mexican economy faces a moderate growth outlook in 2026, characterized by weak domestic demand, a gradual slowdown in the labor market, and private investment that remains constrained by domestic, trade, and energy price uncertainty. After expanding by just 0.7% in 2025, economic activity contracted by 0.6% QoQ in Q1 2026, reflecting weaker momentum in both private consumption and gross fixed investment. According to the latest data from INEGI, investment declined by 1.3% QoQ in Q1 2026, while private consumption fell by 0.8% QoQ over the same period.

On the supply side, manufacturing activity continues to be affected by the slowdown in sectors that are most closely integrated with the U.S. industrial cycle, as well as by business caution amid a prolonged period of uncertainty. In addition, tariffs on automobiles have weighed on Mexico's export capacity in the automotive sector. As of April, manufacturing output had declined by 1.4% YoY, with automotive production contracting by 4.5% YoY.

We expect the underlying weakness in the key components of domestic demand to limit the positive impact of the FIFA World Cup. The gradual deterioration of labor market conditions remains one of the main downside risks. At the same time, firms continue to postpone capital expenditure decisions amid uncertainty surrounding the new judicial system, the upcoming USMCA review, the evolving regulatory environment, and recent volatility in energy prices. In addition, fiscal consolidation is expected to reduce the contribution of public spending to economic activity.

Against this backdrop, we have revised our 2026 GDP growth forecast downward to 1.2% (from 1.8% previously), while maintaining our 2027 forecast at 1.8% ([Graph 1](#)). Although Mexico's productive integration with the United States, the ongoing nearshoring process, and rising demand associated with technology infrastructure and artificial intelligence represent important medium-term opportunities, the realization of these projects will depend on greater regulatory and trade certainty over the coming quarters, as well as the successful execution of public-private infrastructure projects.

## **Slower economic growth points to weaker formal employment growth. A weakening business sector is driving higher informality, while the real wage bill remains relatively resilient.**

Formal employment remained relatively weak in May 2026. According to data from the Mexican Social Security Institute (IMSS), IMSS-affiliated employment declined by 29.9 thousand jobs during the month, largely reflecting seasonal factors. As a result, cumulative formal job creation reached 202 thousand jobs between January and May, only 9.4 thousand more than in the same period of 2025. On an annual basis, formal employment grew by 1.5%; however, excluding digital platform workers, growth falls to 0.7%, less than half the reported rate, confirming that the recovery of the formal labor market remains limited.

The moderation in formal employment is consistent with other indicators pointing to a

weakening business sector. Results from the Business Demography Study (EDN), based on the 2019–2023 Economic Censuses, show rising business mortality, particularly among SMEs and manufacturing establishments. In addition, the National Occupation and Employment Survey (ENOE) reports a decline in the number of formal employers alongside an increase in informal employers, suggesting a gradual shift in business activity toward less formal arrangements. This evidence is consistent with the evolution of IMSS<sup>1</sup> employer registrations, which have recorded nearly two consecutive years of annual declines.

Taken together, these indicators point to a less favorable environment for the creation and survival of formal businesses, particularly smaller firms. This shift toward greater informality is also consistent with recent labor market developments. In April, the labor informality rate increased by 0.5 percentage points relative to the same month a year earlier, reaching 55.1% on a seasonally adjusted basis. At the same time, the unemployment rate remained at historically low levels, standing at 2.6%, 0.1 percentage points below its level a year earlier. This suggests that part of the labor market adjustment is taking place through a greater absorption of workers into informal activities rather than through higher open unemployment.

Meanwhile, the real wage of formal workers registered with the IMSS increased by 2.5% YoY, contributing to a moderate expansion of the real wage bill, which grew by 4.1%. However, excluding digital platform workers, real wage bill growth falls to 3.2% YoY, suggesting more moderate dynamics and a pace below the average observed between 2012 and 2024.

Looking ahead, the outlook for formal employment has weakened amid a lower expected economic growth environment. While activity associated with the 2026 FIFA World Cup could provide a temporary boost to job creation in some sectors, this effect is likely to fade toward year-end. In addition, starting in July, a less favorable base effect associated with the incorporation of digital platform workers will begin to weigh on annual employment growth rates. Against this backdrop, we have revised down our formal employment growth forecasts to 1.4% for 2026 and 2.0% for 2027([Chart 2](#)).

## **Inflation is starting to cool after Q1 supply shocks, though sticky services suggest a gradual convergence toward lower levels**

Following a first-quarter rebound driven by supply shocks, inflation began cooling down during Q2 2026. Annual headline inflation fell from near 4.6% in March to 3.9% in May, helped primarily by slowing non-core inflation. In May, the non-core component dropped 1.7% month-on-month, reflecting a 3.2% decline in fruit and vegetable prices and a 1.7% dip in energy and government-regulated tariffs—the latter driven by seasonal electricity rate cuts. Consequently, annual non-core inflation slowed to 3.1%, paving the way for a more pronounced moderation in headline inflation.

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<sup>1</sup> While the IMSS has noted that employer registrations correspond to administrative units rather than unique firms or establishments, implying that part of the decline may reflect administrative updates or data-cleaning processes, it is difficult to attribute the entire trend to these factors, particularly given that the decline in employer registrations has persisted for nearly two years. Distinguishing between administrative removals and the effective closure of business units would be essential to determine what share of this decline reflects actual business exits and to strengthen policies aimed at preserving formal business activity.

Meanwhile, annual core inflation has also trended downward this quarter, following a Q1 rebound. After averaging 4.5% from January to March, it slowed to 4.3% in April and 4.2% in May. This deceleration was mostly driven by cooling goods inflation, which dropped to 3.8% in May from 4.4% in March. Processed food prices moderated from 5.8% to 5.1% during this span, while other goods fell 0.6 percentage points to 2.6%. Conversely, annual services inflation ticked up 0.1 pp to 4.6%, remaining the primary headwind to a faster slowdown in core inflation. However, weaker expected economic activity and a cooling labor market should help services inflation moderate gradually moving forward.

We expect both headline and core inflation to average 4.0% year-on-year during the second half of 2026. We project headline inflation will end the year at 4.1%, with core inflation at 3.9%. By year-end 2027, we anticipate both will converge to 3.5%. Although sluggish demand continues to represent a downside risk to inflation, upside risks remain highly relevant. Specifically, activity surrounding the 2026 FIFA World Cup could extend the stickiness of services inflation, while the recent spike in international prices for fertilizers and other agricultural inputs could trigger fresh supply shocks for some foods. In short, while we consider that inflation peaked in March, the disinflationary process will continue to be gradual and prone to temporary episodes of volatility ([Charts 3 & 4](#)).

## **Banxico wrapped up its easing cycle and its forward guidance suggests it will keep the policy rate unchanged at 6.50% through at least year-end**

The Fed kept its policy rate steady at 3.50-3.75% this month, while stripping away both its easing bias and any explicit forward guidance on the future path of interest rates. The policy statement showed little change in the Fed's assessment of economic activity, employment, and inflation; however, the SEP revealed a substantial upward revision to inflation forecasts alongside a decidedly hawkish shift in the dot plot. In the press conference, newly appointed Chair Warsh refrained from signaling a preference for future hikes or cuts, centering his remarks instead on a broader agenda to overhaul the Fed's analytical and communication frameworks.

Taken together, these elements suggest that the FOMC is firmly on hold in the short term, but with a much lower willingness to contemplate rate cuts than at the beginning of the year. A significant part of that assessment will depend on the persistence of inflationary pressures associated with the conflict in the Middle East. A definitive resolution to the conflict and a sustained drop in energy prices would alleviate a major source of concern for the most hawkish members. Similarly, a faster moderation in inflation and consumption could ultimately prevent the hiking scenario currently suggested by the dots from materializing.

Under our baseline scenario, we still expect the Fed to keep rates steady throughout the rest of 2026. That said, the balance of risks has tilted to the upside, and our interest rate forecast now carries a hawkish bias.

In May, Banxico wrapped up its easing cycle and signaled it would keep its policy rate steady

at 6.50% through at least year-end, a level that now sits right at the midpoint of the estimated neutral range. The majority vote for the final rate cut indicated that slowing domestic demand continues to outweigh anxieties over global risks and inflationary pressures from transitory shocks.

While weak domestic demand would be consistent with an accommodative monetary stance, the still-gradual moderation of services inflation and the upside risks to headline inflation—associated with high energy prices stemming from the Middle East conflict—warrant maintaining the monetary stance in neutral territory.

In addition, the relative monetary policy stance has narrowed to levels last witnessed in 2014-15. Consequently, a key argument for an extended pause is that the room for further compression of the interest rate differential has run out, meaning that any further cuts in 2027 would likely depend on the Fed cutting rates as well.

However, this does not necessarily mean the current spread is too tight. The positive trend in Mexico's macroeconomic fundamentals suggests that the economy could eventually support a narrower differential without putting significant pressure on the peso. For the time being, we expect Banxico to hold its policy rate at 6.50% for an extended period ([Chart 5](#)).

## **A prolonged conflict in Iran suggests that local long-term rates will take longer to converge toward their equilibrium levels**

In the United States, long-term Treasury yields have remained around 4.50%, reflecting both the uncertainty surrounding the conflict in the Middle East and the resilience of economic activity, which has reinforced expectations of a less accommodative monetary policy path than that observed over the previous decade. Nevertheless, should a lasting resolution to the conflict materialize, accompanied by the effective reopening of the Strait of Hormuz, oil prices could decline significantly over the coming months. Under this scenario, a major source of inflationary pressures and potential second-round effects would dissipate, reducing part of the global risk premium currently embedded in long-term interest rates.

Against this backdrop, relatively elevated U.S. 10-year Treasury yields remain the main factor keeping Mexican government bond yields close to 9%, while domestic factors continue to play a secondary role. The exchange rate volatility observed in recent months has largely reversed, and the stability of sovereign risk metrics suggests that investors continue to hold a favorable view of Mexico's macroeconomic fundamentals despite the turbulent global environment.

Although uncertainty remains elevated, we believe there is still room for long-term interest rates to move lower, a process that could accelerate if a definitive peace agreement is reached in the near term.

Under our baseline scenario, we expect the yield on the 10-year M Bond to resume its downward trajectory, reaching 8.7% by the end of this year and 8.2% by 2027 ([Chart 6](#)).

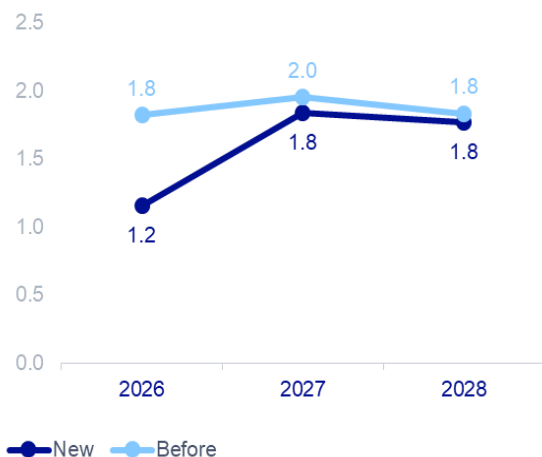
## **The Historical Balance of Public Sector Borrowing Requirements will increase to 54.9% in 2026**

After having analyzed the 2027 Preliminary General Economic Policy Guidelines 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 in the following years. The biggest consolidation challenge will be in 2027 given that SHCP has a -3.5% of GDP target for PSBR. We anticipate that, in the best possible scenario, the widest deficit will reach -4.0% of GDP.

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 2.4% of GDP (or run an average primary surplus of 1.2% 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.

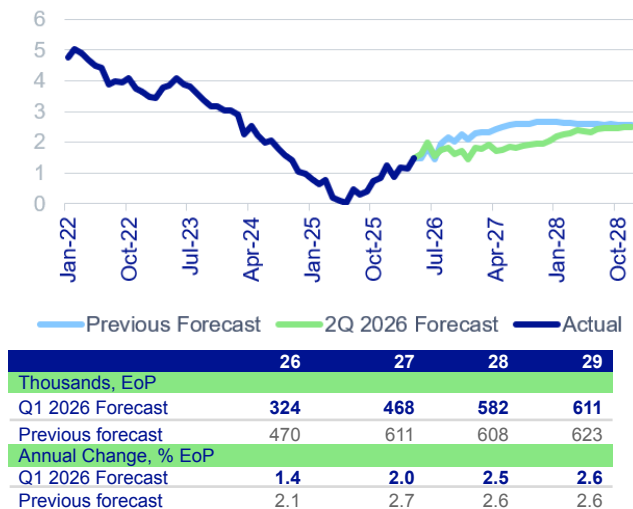
As for the Mexican peso, it is anticipated that it will show a gradual and moderate depreciation starting in the third quarter of 2026 as it is affected by the lower economic growth projected for Mexico in relation to the United States. The exchange rate is expected to be around 17.8 and 18.0 pesos per dollar at the end of 2026 and 2027, respectively.

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



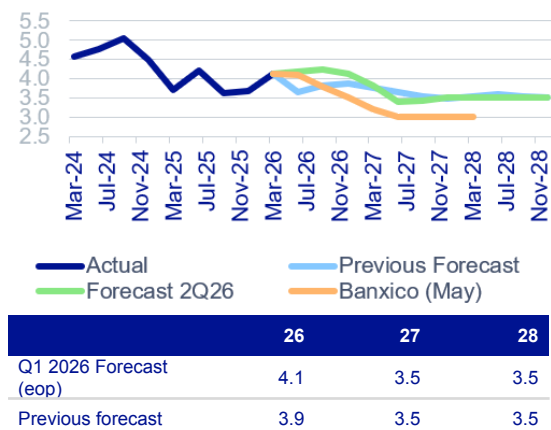
Source: BBVA Research, INEGI

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



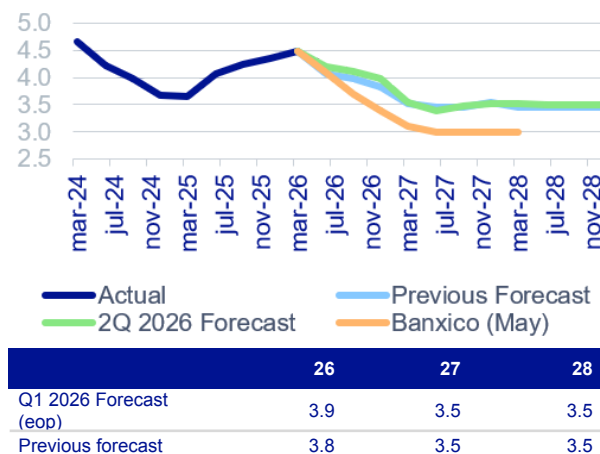
Source: BBVA Research, IMSS

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



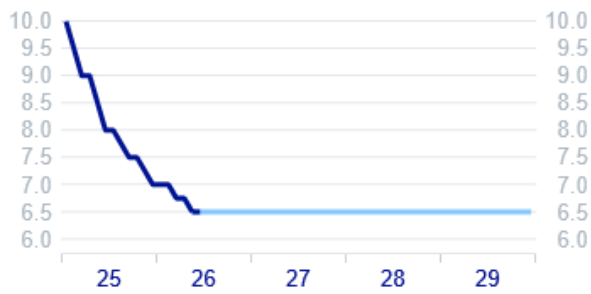
Source: BBVA Research, INEGI

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



Source: BBVA Research, INEGI

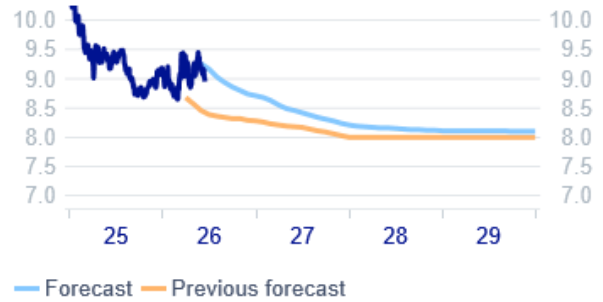
**GRAPH 5. BANXICO POLICY RATE (%)**



	26	27	28
2Q26 forecast (eop)	6.50	6.50	6.50

Source: BBVA Research, Banxico

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



	26	27	28
2Q26 forecast (eop)	8.7	8.2	8.1
Previous forecast	8.3	8.0	8.0

Source: BBVA Research, Macrobond

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