BBVA Research

Banxico explicitly signals room to diverge from the Fed

Javier Amador, Iván Fernández, Carlos Serrano

An orderly peso adjustment and minimal pass-through will be key as the rate spread narrows

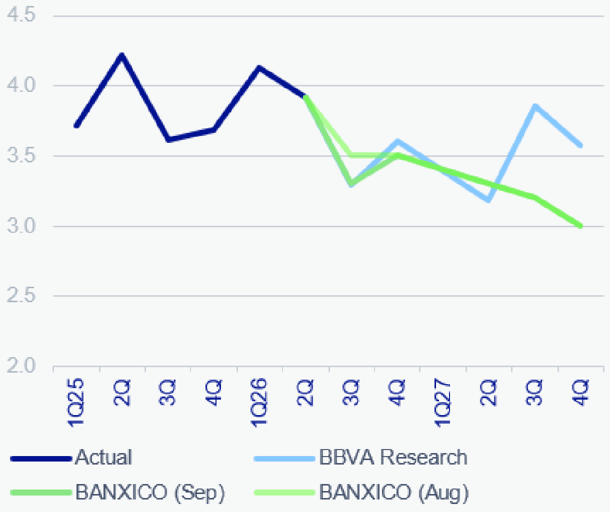
Banxico unanimously held its policy rate unchanged at 6.50% for a third consecutive meeting, maintaining its neutral tone but adopting a more cautious forward guidance. The Board dropped its reference to maintaining the reference rate "at its current level," stating instead that future decisions will consider "the ongoing disinflation process and the expected behavior of its determinants." The more cautious forward guidance likely reflects both market expectations for three additional Fed hikes and this week's exchange-rate developments. Indeed, Banxico acknowledged that the peso has "registered some volatility," a variable to which the Board is traditionally sensitive. In contrast, its assessment of the activity outlook remained broadly unchanged. The Board noted that the economy appears to have "moderated its rate of expansion" in 3Q following the solid 2Q rebound and reiterated that "economic slack is expected to continue throughout the forecast horizon." If anything, the language on growth became slightly less pessimistic: while Banxico continued to flag "downward risks to economic activity," it dropped the "significant" qualifier. Importantly, the policy statement twice stressed that macroeconomic conditions differ between Mexico and the United States, and that Banxico "would not have to react mechanically" to expected Fed rate hikes. Despite the unanimous vote, the upcoming minutes will be important for assessing the extent to which the Fed policy tightening has impacted Board members' views on the policy outlook.

Despite recent peso volatility, Banxico showed no heightened concern about its potential pass-through to domestic inflation. The Board revised its core inflation forecasts marginally higher for the remainder of 2026, a move that does not surprise us given that our own trajectory was already somewhat higher. They also left unchanged their expected convergence of headline inflation to the 3.0% target by 4Q27 and made no changes to the balance of risks, which remains biased to the upside. The persistence of core inflation continues to rank first among upside risks, reinforcing the view that Board members still need more evidence that the recent moderation in core services inflation will prove durable. Interestingly, despite acknowledging increased peso volatility, Banxico kept a "trend towards depreciation of the Mexican peso" at the bottom of its list of upside risks to inflation. We share this view. Not only does recent depreciation remain moderate—with the peso still up slightly year to date—but core goods inflation also continues to slow, currently running below its steady-state pace. We expect exchange-rate pass-through to be minimal, if not negligible, at this stage of the cycle, particularly in a context in which, according to our estimates, the MXN remains overvalued. Moreover, recent exchange-rate movements should pose limited financial-stability concerns, as banks and corporates do not have significant currency mismatches on their balance sheets.That said, peso dynamics could become more consequential if a pronounced risk-off shift in global financial markets leads to severe currency depreciation. Peso dynamics thus become increasingly relevant.

We share the view that monetary policy should not mechanically follow the Fed, as the two economies remain at different stages of their respective cycles. The Board provided useful insight into its reaction function by highlighting exchange-rate pass-through, economic slack and inflation expectations as key determinants of future decisions. With the latter two unlikely to shift abruptly, we view the peso as a key variable to watch as the rate differential narrows. Additional Fed hikes while Banxico stays in hold could further impact the peso, with some depreciation likely to accompany a narrower rate differential. Recent peso weakening is beneficial to the economy, as our estimates suggest the currency remains somewhat overvalued. Moreover, pass-through will likely remain muted with the economy still growing below potential. More broadly, Mexico is structurally better equipped than in previous cycles to manage FX volatility orderly, supported by a narrower inflation differential with the US and significantly deeper domestic financial markets that reduce vulnerability to shifts in foreign flows. Thus, the key for Banxico will not be whether the peso depreciates further, but whether that adjustment remains orderly and generates limited pass-through to consumer prices. Overall, subject to our review of the minutes, we maintain our baseline forecast for Banxico to remain on hold through year-end 2027.

Banxico left its 4Q27 inflation convergence timeline unchanged...

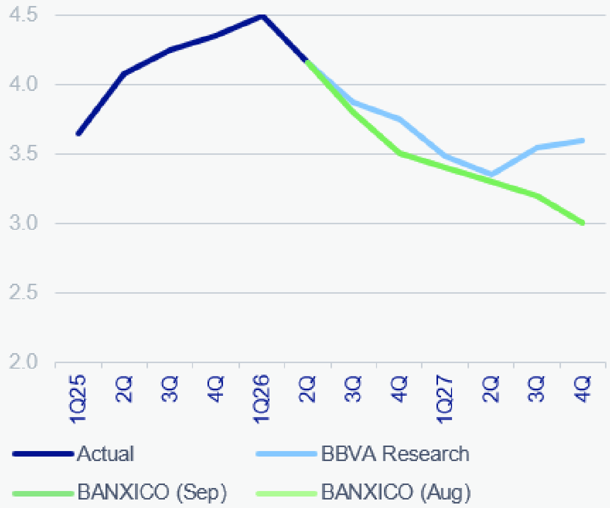
FIGURE 1. HEADLINE INFLATION OUTLOOK (YOY % CHANGE)



Source: BBVA Research, Banxico, INEGI

... and fine-tuned its 4Q26 core inflation forecast upward by 0.1 pp

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.