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Banxico Watch

All members are now on board with the rate cut cycle

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Banxico's forward guidance continues to suggest that a streak of consecutive rate cuts ahead remains the most likely scenario

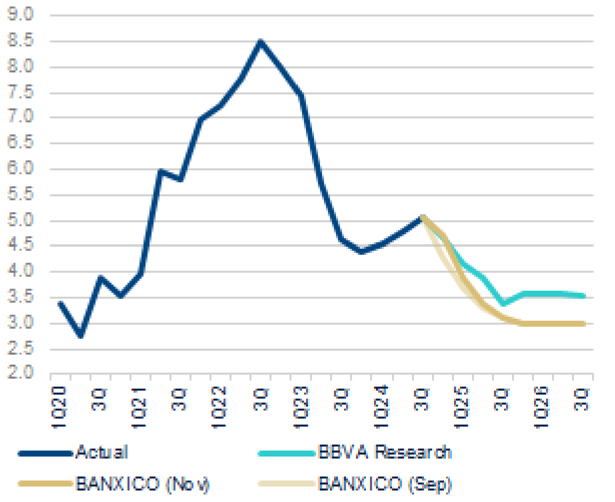
- **Banxico lowered its policy rate by 25 bps for the third consecutive meeting, to 10.25%.** The decision was unanimous this time, with Deputy Governor Heath joining the majority after having voted against the July and September cuts, which is a little surprising given his firm stance reflected in the September's meeting minutes on "avoid[ing] sending the message of complacency [...] by prematurely and automatically confirming a rate-cutting cycle." The recent evolution of core services inflation, which has been inching down since July, seems to have had more weight in his decision. As we argued earlier this week (see), the recent MXN depreciation and volatility—milder than feared—following the US elections was unlikely to prevent Banxico from cutting rates in the short term amid a still very restrictive real ex-ante rate. Board members also seem to agree with most market participants and analysts (us included) around the global challenges of a second Trump's term, which raises "the possibility of policies that revert global economic integration" as well as "higher levels of volatility in financial markets." The policy statement noted the peso has recently depreciated "markedly", but also noted that "financial markets have exhibited a relatively orderly behavior," which suggests that an eventual response from Banxico to tackle the negative effects of a sudden materialization of Trump-related risks will be determined more by the degree of financial instability, liquidity and functioning of the exchange rate market rather than by a specific level of MXN depreciation, with which we agree since, in our opinion, monetary policy shouldn't be used to try to offset negative shocks on the free-floating exchange rate.
- **Banxico revised up its headline inflation forecasts for 4Q24 and 1H25, moving them closer to ours, as we expected, and fine-tuned by -0.1 pp its core inflation forecast for 4Q24** (Figures 1 and 2)**.** This means that Banxico is now expecting headline inflation at around 4.5% YoY by the end of the year, in line with our forecast, and now thinks that core inflation will fall to 3.7%, somewhat below our 3.8% forecast. Banxico remains more optimistic about the scope for inflation easing by the end of next year. These revisions were not surprising as their previous headline inflation short-term forecasts were not likely to end up being accurate given that inflation in October came in at 4.8%, and it would have needed to average 0.3% MoM over the last two months of the year to meet their forecast, an unlikely scenario. The required change for 4Q24 was likely to drive up the 1Q25 forecast, and it did. We were not expecting notable changes to any other quarter of the projected headline inflation path. As to core inflation forecasts, in our view, there was no need to make any changes given that core inflation has eased broadly in line with the projected path, but we deemed possible that they might fine-tune 0.1 pp down this and next quarters' forecasts. They only brought down 0.1 pp this quarter's core inflation forecast.
- **The stronger-than-expected pace of economic activity in the third quarter does not seem to have affected the confidence of board members in the inflation outlook.** As noted in the policy statement,

INEGI’s preliminary data showed that “domestic productive activity would have grown at a higher rate than in the previous three quarters, when it remained practically stagnant” (real GDP scored a 1.0% QoQ change in 3Q24 supported by all major activity sectors, vs. -0.1, 0.1, y 0.2% in 4Q23, 1Q24 and 2Q24, respectively). However, the statement suggests that board members do not believe this strength will last, as economic activity “is expected to exhibit a lack of dynamism in 2025” amid the continued slowdown of employment and “the balance of risks to growth of economic activity,” which “remained biased to the downside.” We agree that it is still too soon to conclude that the GDP reading in 3Q marks the start of a sustained recovery. There are plenty of downside risks to economic growth on the horizon. The challenging context for economic activity in the near future would tend to further support the slowdown in core inflation (particularly core services inflation), which “is anticipated to continue decreasing.” Against this backdrop, the forward guidance remained unchanged: Banxico estimates that “although the outlook for inflation still calls for a restrictive monetary policy stance, [...] the Board expects that the inflationary environment will allow further reference rate adjustments.”

- **Banxico left the door wide open to rate cuts in upcoming meetings and signaled that the cycle has legs in a backdrop of a lack of growth dynamism next year (i.e., weakening demand).** We think that the exchange-rate volatility will remain relatively stable until Trump’s measures are formally outlined and become law. This, combined with a weak pace of job creation and the still excessively high ex-ante real rate, suggests that a majority of board members will remain determined to continue the easing cycle over the coming months. However, we now think that Banxico might be somewhat more cautious next year with the Fed probably halting its cycle sooner (at 4.00% after lowering the fed funds rate in March). Thus, we now expect Banxico to lower the policy rate to 8.00% by the end of next year (up from our previous 7.50% forecast). Risks could tilt to fewer cuts under a high-tariffs scenario, which could spike the exchange rate volatility, a more cautious Fed, and drive Banxico to take a breather in the rate cut cycle. Alternatively, the exchange rate volatility could come down under a no-tariff scenario: the peso could recover somewhat, and Banxico could speed up the rate cut cycle at some point next year to bring it more rapidly closer to the neutral range.

Banxico revised its headline inflation forecasts for 4Q24 and 1H25, moving them closer to ours…

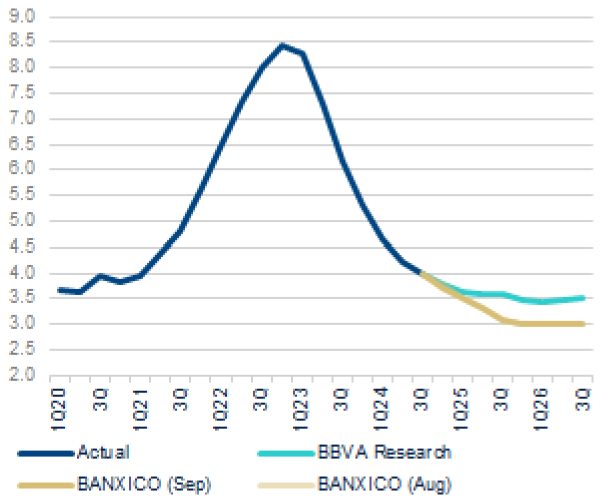
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

… and fine-tuned (-)0.1pp down its core inflation forecast for as we deemed possible

Figure 2. **CORE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

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