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Banxico Watch

Banxico opens the door to a 50bp rate cut at the next meeting

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Banxico's forward guidance continues to point to a streak of consecutive rate cuts ahead despite a more cautious Fed

- **Banxico lowered the policy rate by 25 bps for the fourth consecutive meeting, to 10.00%, bringing the ex-ante real rate down to ~6.1% from the 7.4% peak reached earlier this year.** All board members supported the decision again. Although none ventured to support a 50bp cut, the policy statement reflects Banxico's increased confidence around the ongoing disinflation process as core inflation has "continued its clear downward trend" and is "still foreseen to follow" it. However, even if some caution remains as "services inflation has only declined moderately," it is the first time that Banxico acknowledges this. It took services inflation to moderate for four months in a row, pointing to a turning point. Indeed, the expected "greater persistence in services inflation" drove Banxico to revise its inflation forecasts upwards, which, in our view, is not convincing as the driver of the revision (see explanation below). In line with the US inflationary risks that have arisen from Trump's potential global trade policies to be implemented next year—which prompted a hawkish change of tone from the Fed yesterday (see)—Banxico now explicitly states that "the possibility that tariffs on US imports from Mexico are implemented has added uncertainty" and "could imply pressures on inflation on both sides of the balance" of risks. But for now, Banxico seems to be overweighting the local developments that will likely keep the balance of risks to economic growth biased to the downside (particularly a weakening labor market): even though "the Mexican economy registered a greater rate of expansion during" 3Q, Banxico expects "a lack of dynamism [in the pace of economic growth] for the remainder of 2024 and in 2025." While Banxico still describes the balance of risks for inflation as "biased to the upside," we think that sooner rather than later, Banxico will have to recognize that inflation risks are now more balanced given the continued weakness of aggregate demand, even more so when the ex-ante real rate will continue to constrain economic activity.
- **Banxico revised up both its headline and core inflation forecasts for next year and now expects them to hit the 3.0% inflation target until 3Q26 and 2Q26, respectively (vs. 4Q25 previously).** These revisions are at odds with the recent core inflation performance, which evolved somewhat better than what Banxico forecasted in November. In fact, Banxico revised down by 0.1 pp their end-2024 headline and core inflation forecasts to 4.6% and 3.6%, respectively, as we anticipated. Banxico explains that the upward revision for next year was made on the grounds of "a greater persistence of services inflation," but this is puzzling, bearing in mind that services inflation started to show signs of easing in the inter-meeting period, an improvement now acknowledged for the first time in the statement and also considering the weakness of the labor market. Yet, it is not unusual for Banxico to delay the timing of the expected convergence of inflation to target (in today's forecast update, until 3Q26 for headline inflation and 2Q26 for core inflation). Overall, Banxico moved its 2025 expected inflation paths close to ours (see Figures 1 and 2), but is still estimating that both measures of inflation will reach 3.0% at some point in 2026, as opposed to our view that inflation is more likely to hover

around 3.5% as it has never consistently hit the 3% target.

- **The statement's forward guidance signals that a string of consecutive rate cuts is set to continue ahead and opens the door for considering larger cuts at "some meetings."** The somewhat puzzling revision of next year's inflation forecasts described above clashes a bit with the slightly more dovish tone of the statement and the forward guidance, which opened the door to the possibility of speeding up the rate-cut cycle at some point in the next meetings. The continued cautiousness of some Board members had driven them to describe their rate cuts as a recalibration of the monetary policy stance rather than a rate-cut cycle, but the disinflation progress has now taken them to state that "continuing the rate-cutting cycle and reducing the level of monetary restriction is adequate." Even though the Fed signaled yesterday that it will likely skip cuts in coming meetings, scaling back its projected rate cuts for 2025, Banxico sent two very clear signals today: i) the cycle is most likely set to continue steadily in 2025 with no pauses (the Board "expects that the inflationary environment will allow further reference rate reductions"), and ii) it is more likely than not that a 50bp cut will win significant support at the next meeting, since the Board also thinks that "in view of the progress on disinflation, larger downward adjustments could be considered in some meetings, albeit maintaining a restrictive stance." The most hawkish member of the Board, Irene Espinosa, will leave her position by the end of this month, and there is a chance that at the next meeting, the Board will only have four members, increasing the chances of a 50bp cut.
- **We feel more confident in our baseline scenario for the policy rate to be lowered at all meetings next year, but we also think that the best time to cut the policy rate by 50 bps was today.** Banxico clearly signaled that it expects inflation to ease further in 2025, is set to keep cutting rates steadily ahead, and it could even consider larger cuts at some point in the next meetings. However, we continue to think that the best time to cut the policy rate by 50 bps was today—as we argued in our preview (see)—since the window will likely close early next year if, as we expect, Trump imposes tariffs and a context of global risk aversion hits the peso, turning Banxico even more cautious. However, the risks to our end-2025 8.00% below-consensus forecast for the policy rate could even lie to the downside, not to the upside, if tariff risks materialize, considering that they would hit economic activity and that the effect of a possible exchange-rate pass-through (which is uncertain since it likely is already partially priced in) would be more than offset by weaker demand in a backdrop of easing core inflation. Overall, although we now feel more confident in our 8.00% policy rate forecast, we also consider that the door to step up the pace of policy easing could have already closed. If Banxico is increasingly confident that the excessively tight monetary policy is now unwarranted, as today's statement hints, the Board should have voted for a larger cut today instead of signaling that it could lean to step up the pace in upcoming meetings. In any case, a still very elevated ex-ante real rate gives Banxico room to keep easing policy even if the Fed decides to pause rate cuts.

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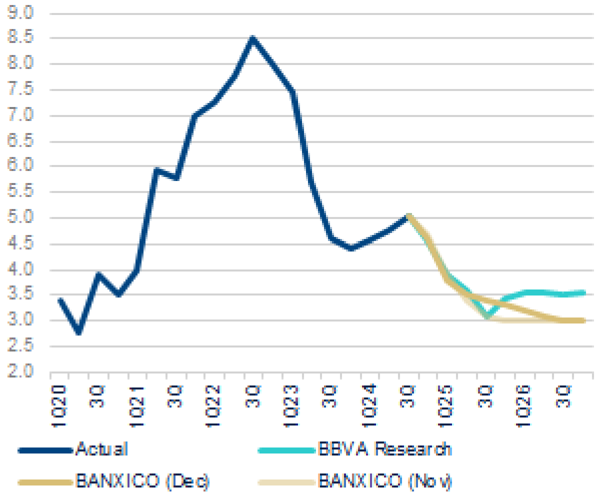
Banxico revised its headline inflation forecasts for 4Q24 and 1H25, moving them closer to ours…

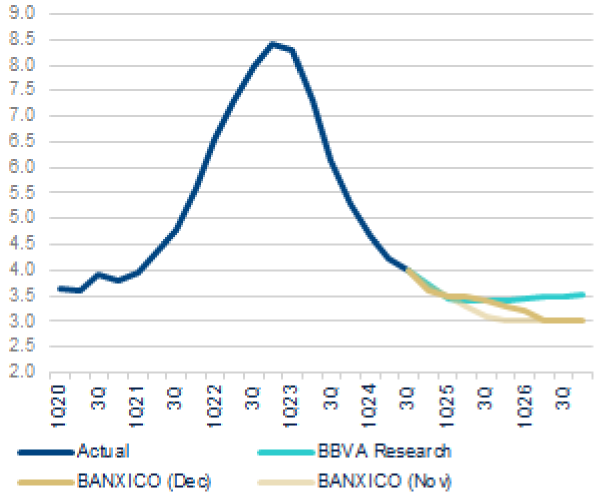
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

… and fine-tuned 0.1 pp 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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