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Banxico Watch

Banxico speeds up easing pace, strikes a more dovish tone…

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February 6, 2025

… and keeps the door open to further 50bp rate cuts at upcoming meetings

- **Banxico lowered the policy rate by 50 bps to 9.50%, bringing the ex-ante real rate down to 5.6%, still 200 bps above Banxico's own 3.6% upper-bound estimate for the neutral rate.** With the recent appointment of Gabriel Cuadra as deputy governor, replacing Irene Espinosa, the vote was 4-1, with Jonathan Heath voting for a smaller 25bp cut. The tone of the statement turned somewhat more dovish despite the uncertainty surrounding recent tariff threats. Banxico noted last weekend's "significant depreciation" of the peso, which nevertheless "reverted once the agreement to pause the tariffs was negotiated," suggesting that exchange rate developments remain in its reaction function. However, the Board's attention seems to be more focused on "the weakness of the Mexican economy," which "registered a contraction" in 4Q24 and, in our opinion, is partly explained by the excessively restrictive monetary policy that has remained in place thus far. We could even talk about an intensification of the dovish tone in the statement: with inflation now back in the target range but above the point target, Banxico says it is moving from a phase of combating the "inflationary episode derived from the global shocks" to one in which its "aim is to bring inflation from its current level [...] to the 3% target," which requires a "lower" policy rate. The larger cut came as no surprise. Although two weeks ago only around ⅓ of analysts, us among them, were forecasting a larger 50bp cut at today's meeting, a weak 4Q24 GDP print (-0.6% QoQ) along with a relatively stable peso that continued to hold up after a pause to the tariff threat, led a majority of analysts to change their expectation. In the latest surveys, 22 out of 26 analysts surveyed by Bloomberg and 27 out of 35 surveyed by Citi, including us, were expecting a larger 50bp cut.

- **Banxico left both its headline and core inflation forecasts for this year and next broadly unchanged; it continues to expect inflation to fall below 3.5% from 3Q25 onwards and to drop to 3.0% in 2026.** This is not surprising as inflation dropped broadly in line with forecasts in the intermeeting period. Inflation dropped below 4.0% YoY for the first time in four years; core services inflation continued to ease. Besides, worsening growth prospects continue to point to the absence of demand-side price pressures and thus, lower inflation ahead. Banxico revised down by 0.1 pp their 1Q25 headline inflation forecast, but 0.1 pp up their core inflation forecast. Since the rest of the expected path for both was left unchanged, it signals only a fine-tuning for one quarter and continued confidence that inflation is set to slow further in coming quarters. Although Banxico is clearly sticking with reaching the 3.0% target, it pointed out that at 3.7% YoY core inflation is at the average level between 2003 and 2019, i.e., the period from the introduction of the 3.0% target until just before the beginning of the economic disruptions brought about by the pandemic. Overall, Banxico kept 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 a set of consecutive rate cuts ahead and keeps the door wide open for additional large cuts at "some meetings."** Consistent with a more dovish tone (see above), the forward guidance signaled that today's larger cut might not be the only of this size: looking forward, Banxico "[...] could continue calibrating the monetary policy stance and consider adjusting it in similar magnitudes." We think that Banxico is signaling that, with the real ex-ante rate still well above 5.0%, it sees scope to keep the foot on the pedal after speeding up the easing pace at today's meeting as long as the US tariffs' threats do not materialize (Banxico repeated that this global risks "added uncertainty to the forecasts"). It could be argued that even if (possible) tariffs weaken the peso further, Banxico should keep easing at a faster pace since the exchange rate (ER) would play its role as a shock absorber in a free-floating regime, and investment would be hit hard, softening demand further and thus, putting a downward pressure on inflation. In any case, it seems that Banxico is pointing to a faster easing pace in the short term. Banxico will probably find comfort in the muted reaction of the ER following the announcement of today's larger cut. Banxico will likely remain confident to bring down further the policy rate if the peso continues to hold up.
- **Today's larger cut supports our below-consensus 8.0% rate by the end of the year (150 bp worth of additional rate cuts), but we now think there's a bias towards more easing this year.** Banxico clearly turned more dovish today as it signaled continued confidence that inflation is set to ease further. It unequivocally signaled that it remains set to keep cutting rates steadily ahead, and (surprisingly) it hinted that in the absence of any major events, it is likely to consider additional 50bp cuts at upcoming meetings. Banxico could turn more cautious if the US imposes tariffs on imports from Mexico and hits the peso, but considering that the current level of the ER is likely pricing in a 10% blanket tariff, for the peso to significantly weaken further the tariff would need to be larger and long-lasting. That is not our baseline scenario. Thus, Banxico could end up easing 100 bp (to 9.00%) in the first quarter of the year with six meetings left over the rest of the year. With the economy set to grow below potential for the second year in a row and inflation likely to drop back to the average steady-state levels seen from 2003 to 2019, in our baseline scenario **we do not anticipate any reason for Banxico to skip cutting rates at any meeting this year. Thus, we now have a downward bias to our 8.00% year-end forecast.** We think that if Banxico cuts another 50 bps at the next meeting, it could bring the policy rate down to 7.50% by year end. We anticipate that consensus and market expectations are likely to fall to c. 8.00% levels in the days or weeks ahead.

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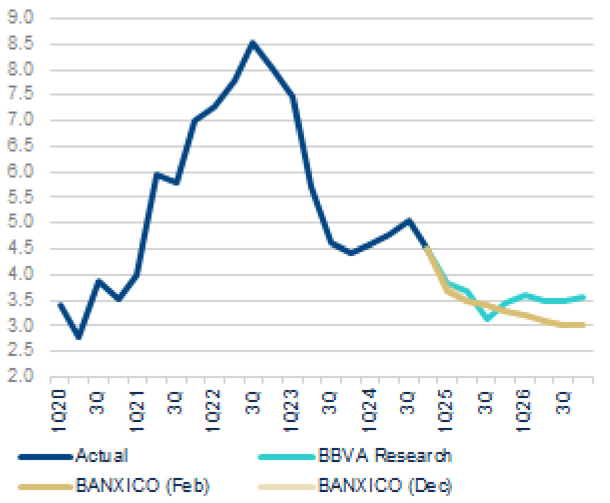
Banxico left its inflation forecasts broadly unchanged. It continues to expect inflation…

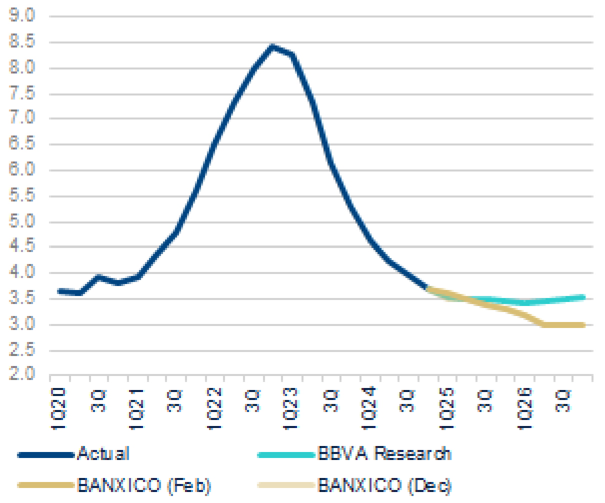
Figure 1. **HEADLINE INFLATION OUTLOOK**
(YOY % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research / Banxico / INEGI

… to stay below 3.5% from 3Q25 onwards and to converge to 3.0% in 2026

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



Source: BBVA Research / Banxico / INEGI

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