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Mexico—Banxico Delivers Another 25bps Cut, in Line with Analysts' Expectations

- **Banxico's Governing Board decided to cut the target interest rate by 25 basis points to 10.00%. Most analysts expected a cut of this magnitude, while a minority anticipated a 50bps move.**
- **Headline and core inflation forecasts were revised upwards starting from the second quarter of 2025, expected to converge to the 3.0% target in the third quarter of 2026.**
- **We consider that the monetary policy decision shows a less restrictive stance, given the unanimity of the decision, despite the revision of expectations.**
- **We maintain our forecast of an 8.50% rate by the end of 2025, given the upside risks to inflation.**
- **The USDMXN saw a volatile session, in a range of $20.30–$20.50, owing to the market's expectation of a larger cut in this monetary policy meeting.**

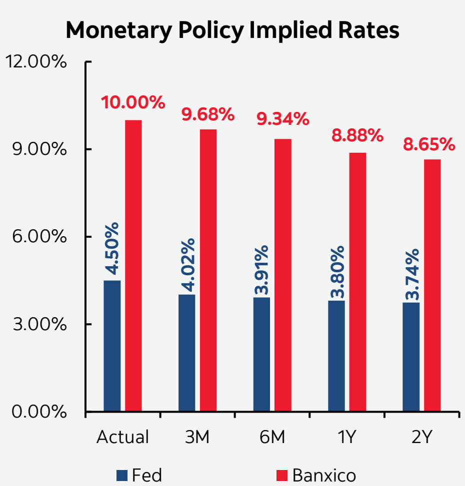
For the fourth consecutive meeting, Banco de México decided to cut its target interest rate by 25 basis points to 10.00% (chart 1). Most analysts expected a cut of this magnitude, while a minority anticipated a 50bps move. Notably, this time, the Board voted unanimously in favour of a 25bps cut, in contrast to markets that had anticipated a split decision given that a couple of board members had opened the door to increasing the magnitude of cuts. The Board revised upwards the expectations for headline and core inflation for 2025, expecting to converge to the 3.0% target in Q3-2026.

In the statement, the Governing Board noted that the pace of global economic activity growth had been similar to the previous quarter, while inflation in developed countries had increased and core inflation had shown persistence. Looking ahead, among global risks, the statement points to some policies that may reverse global economic integration, increase geopolitical tensions, expand inflationary pressures, and increase financial market volatility.

The statement highlighted the steepening of the local curve, as well as the depreciation of the peso against the U.S. dollar due to the possibility of measures that weaken Mexico's integration with the U.S. Regarding local economic growth, they see a slight rebound during Q3 compared to previous quarters; however, they anticipate sluggishness for next year and believe that the balance of growth risks remains tilted to the downside.

Regarding inflation, the Board restated that it expects headline and core inflation to maintain a downward trend. However, given the price frictions in services, the forecasts for the following quarters were revised upwards again, starting from Q2-2025. The Board now expects inflation to converge to the 3.0% target in Q3-2026, instead of by the end of 2025 as previously expected (table 1). Additionally, it highlighted that the possibility of

Chart 1



Sources: Scotiabank Economics, Bloomberg.

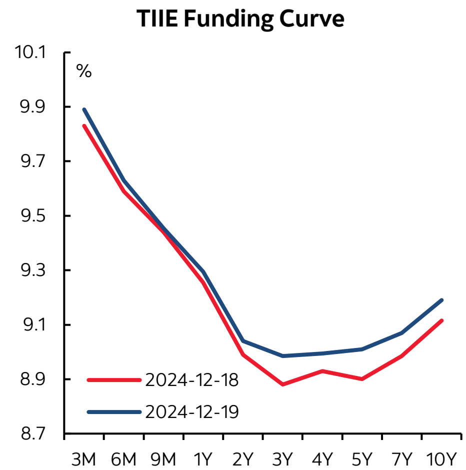
Table 1: Mexico - Banxico's Headline & Core Inflation Forecasts

Headline Inflation	24-Q1	24-Q2	24-Q3	24-Q4	25-Q1	25-Q2	25-Q3	25-Q4	26-Q1	26-Q2	26-Q3	26-Q4
Current (Dec. 24) a.o.p.	4.6%	4.8%	5.0%	4.6%	3.8%	3.5%	3.4%	3.3%	3.2%	3.1%	3.0%	3.0%
Previous (Nov. 24) a.o.p.	4.6%	4.8%	5.0%	4.7%	3.9%	3.4%	3.1%	3.0%	3.0%	3.0%	3.0%	-
Var. Current - Previous	0.0%	0.0%	0.0%	-0.1%	-0.1%	0.1%	0.3%	0.3%	0.2%	0.1%	0.0%	-
Core Inflation	**24-Q1**	**24-Q2**	**24-Q3**	**24-Q4**	**25-Q1**	**25-Q2**	**25-Q3**	**25-Q4**	**26-Q1**	**26-Q2**	**26-Q3**	**26-Q4**
Current (Dec. 24) a.o.p.	4.7%	4.2%	4.0%	3.6%	3.5%	3.5%	3.4%	3.3%	3.2%	3.0%	3.0%	3.0%
Previous (Nov. 24) a.o.p.	4.7%	4.2%	4.0%	3.7%	3.5%	3.3%	3.1%	3.0%	3.0%	3.0%	3.0%	-
Var. Current - Previous	0.0%	0.0%	0.0%	-0.1%	0.0%	0.2%	0.3%	0.3%	0.2%	0.0%	0.0%	-

Sources: Scotiabank Economics, Banxico.

tariffs on U.S. imports results in a greater degree of uncertainty to the outlook. As for the balance of inflation risks, it remains skewed to the upside. Among upside risks, the Board mentioned the persistence of core inflation; greater exchange rate depreciation; higher cost pressures; climatic impacts; and disruptions due to geopolitical conflicts or trade policies. Downside risks include lower-than-anticipated economic activity; lower pass-through of some cost pressures; and that the effect of exchange rate depreciation on inflation is lower than anticipated.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

In our opinion, the monetary policy decision shows a less restrictive bias, but with mixed signals. On the one hand, the unanimity of the decision and the final paragraph where the members mention that given the progress in disinflation they could consider larger downward adjustments in some meetings, while maintaining a restrictive stance, shows a less restrictive board. However, the upward revision in headline and core inflation expectations, as well as considering that inflationary pressures on the services side will persist and that the balance of risks remains skewed to the upside may be seen as contradictory to a dovish stance. In this sense, we agree that it will be extremely important to monitor global shocks (a possible contraction of global trade and increased geopolitical tensions), as well as the effects of local economic weakness on inflation. Thus, we anticipate that 2025 will be a very challenging year for Banco de México, as there are global and local risks that can impact price formation higher and that would define the path of monetary policy.

It is also worth mentioning that this is the last meeting for Deputy Governor Irene Espinosa, so the Board could have a less restrictive or "dovish" majority if her replacement aligns with Governor Rodríguez and Deputy Governor Mejía. Among the names being considered by analysts to join the Board are Lucía Buenrostro, Vice President of Regulatory Policy at CNBV (Mexico's banking regulator); Alejandrina Salcedo, General Director of Economic Research at Banco de México; and María del Carmen Bonilla, Head of the Public Credit Unit at SHCP (Finance Ministry). All of them have different trajectories and skills; however, there could be a surprise with an unmentioned name. Considering the above, we expect that the target interest rate could end 2025 at 8.5%. For a further analysis of each member's stance, it will be important to review the minutes of this decision, which will be published on January 9th, 2025.

The exchange rate was volatile during the session, in a range of $20.30–$20.50 USDMXN, reaching its highest level before the statement was released, given the expectation that the Board might have opted for a 50bps cut. Moments after the decision, USDMXN was trading at $20.33. In line with the above, the TIIE funding curve rose by an average of ~8bps in the 2 to 10-year nodes since yesterday, while the implied curve differs from analysts' forecasts as it stands at 8.88% in one year, about one fewer 25bps cut than in the latest Citi survey that showed economists expect an end-2025 policy rate of 8.50% (chart 2).