Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

February 6, 2025

Contributors

Rodolfo Mitchell
Director of Economic and Sectoral Analysis
+52.55.3977.4556 (Mexico)
mitchell.cervera@scotiabank.com.mx

Miguel Saldaña
Economist
+52.55.5123.1718 (Mexico)
msaldanab@scotiabank.com.mx

Mexico—With a Full Board, Banxico Enters New Stage in Its Fight Against Inflation

- **Banxico's Board cut the benchmark interest rate by 50bps to 9.50%, as expected. The meeting counted five members following the 'express' ratification of Gabriel Cuadra as deputy governor.**
- **Expectations for both headline and core inflation in coming quarters remained virtually unchanged, with an anticipated convergence to target in Q3-26. The Board maintained its assessment of inflation risks remaining biased higher, though with greater uncertainty due to US policy announcements.**
- **We believe the decision was dovish, signaling the possibility of another 50bps cut at the next meeting, in late-March. We keep our forecast for an 8.50% end-2025 rate given upside inflation risks.**

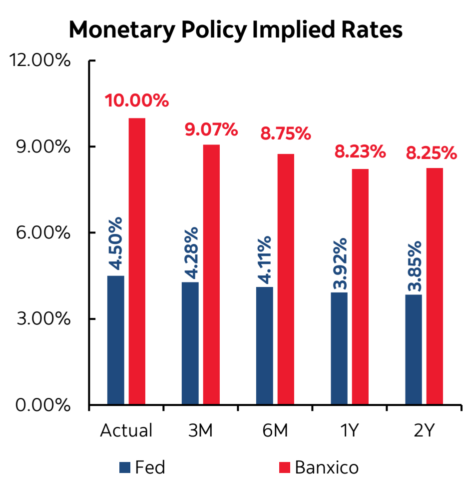
For the fifth consecutive meeting and the first of 2025, the Governing Board of Banco de México decided to cut the benchmark interest rate, to 9.50% (chart 1). This is the first time since August 2020 that Banxico has cut the target rate by 50bps, following four straight 25bps reductions. Most analysts expected a cut of this magnitude today, while some others anticipated 25 basis points.

In today's decision, the five members of the Board, including newly-appointed deputy governor Gabriel Cuadra, voted in a 4–1 split with the majority opting for the 50bps move while dissenter Jonathan Heath favoured a 25 bps cut—as was generally expected, in line with public comments made by Heath in the lead-up to the decision. The Governing Board virtually kept its expectations for headline and core inflation unchanged for 2025 and 2026, forecasting a convergence to the 3.0% target in the third quarter of 2026.

The bank's statement mentioned that the pace of global growth in the last quarter of 2024 was slightly lower than expected. However, it highlighted that global risks have increased due to the escalation of geopolitical tensions—including the implementation of policies that reverse global economic integration—drawn out inflationary pressures, and greater volatility in financial markets. Regarding the US economy, the statement highlighted the increase in government interest rates and the appreciation of the US dollar amid greater uncertainty.

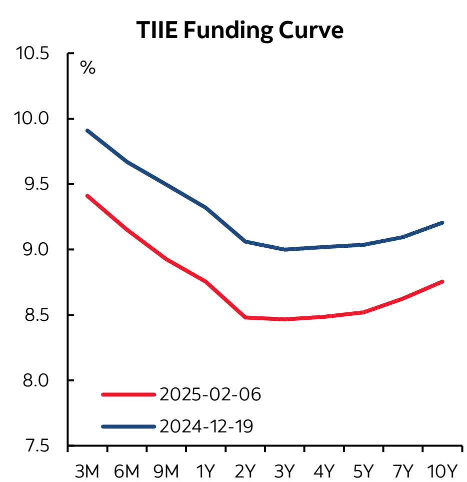
As for the domestic backdrop, the statement indicated that economic weakness worsened in the last quarter of 2024, registering a contraction, and assessed that the balance of risks is biased to the downside. The statement also noted that the USDMXN

Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

traded in a wide range, although in an orderly manner, without showing a clear trend. Notably, the announcement of US tariffs led to sharp currency weakness that was reversed once an agreement on a tariffs pause was announced.

Regarding inflation, the Governing Board highlighted that in the first two weeks of January it reached its lowest level since 2021, at 3.69%, while the core component was close to the 2003–2019 average, standing at 3.72%. The bank made marginal changes to its inflation projections for the current quarter but kept the rest of the forecast horizon unchanged, thus continuing to anticipate a convergence to the 3% target in Q3-26. Nevertheless, the statement acknowledged that medium- and long-term expectations remain stable but above target (table 1). As for the balance of inflation risks, it remains biased to the upside, although the Board notes that changes in US economic policy have increased uncertainty to the outlook, with rising risks on both sides of the inflationary balance.

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 (Feb. 25) a.o.p.	4.6%	4.8%	5.0%	4.5%	3.7%	3.5%	3.4%	3.3%	3.2%	3.1%	3.0%	3.0%
Previous (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%
Var. Current - Previous	0.0%	0.0%	0.0%	-0.1%	-0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	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 (Feb. 25) a.o.p.	4.7%	4.2%	4.0%	3.7%	3.6%	3.5%	3.4%	3.3%	3.2%	3.0%	3.0%	3.0%
Previous (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%
Var. Current - Previous	0.0%	0.0%	0.0%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Sources: Scotiabank Economics, Banxico.

Among the upside risks to inflation, the Board mentioned: the persistence of core inflation; greater currency depreciation; disruptions from geopolitical conflicts or trade policy; higher cost pressures; and weather-related effects. In downside risks, it highlights: lower-than-anticipated economic activity; a reduced pass-through of some cost pressures; and the impact of currency depreciation on inflation being smaller than anticipated.

We believe that the monetary policy statement reflects a dovish stance. On the one hand, the majority voted in favour of increasing the magnitude of the cut, and the statement highlighting a new “stage” in the fight against inflation—one which does not necessarily require such a high level of monetary restriction to achieve the inflation goal—are indicative of this. The Board also showed a clear dovish bias by leaving the door open to additional half-point cuts (while maintaining a restrictive stance). In this regard, we believe it will be important to monitor the evolution of key upside inflation risks (namely an increase in geopolitical tensions or trade price frictions), as well as the effects of local economic weakness on inflation to the downside.

We anticipate that 2025 will be a very challenging year for Banxico, as there are global and local risks that can impact price formation higher, without ignoring the role that the expected economic slowdown for this year and its implications on prices, which will define the path of monetary policy. Looking ahead, and as a result of the above, the likelihood that Banxico will cut the benchmark interest rate by 50bps at the next monetary policy meeting on March 27th has considerably risen. Nevertheless, we maintain our expectation of a year-end rate of 8.50%. It will be of great importance to evaluate the minutes of this decision that will be published on February 20th, 2025. Finally, it is worth mentioning that, in an “express” process, Dr. Gabriel Cuadra was nominated by President Sheinbaum and ratified by the Senate as deputy governor, to join and participate in today’s monetary policy decision.

The USDMXN was volatile during the session, ranging from $20.41 to $20.65, reaching levels of $20.47 after the official statement was published. Meanwhile, the TIIE Fondeo curve fell an average of 4 basis points from yesterday, while the 3-month implicit curve stands at 9.07% and the one-year implicit curve stands at 8.23%. The latest surveys expect a benchmark interest rate close to 8.50% at the end of 2025 (chart 2).