

## Banxico Watch

# With inflation in check, slowing growth, and a very restrictive policy rate, Banxico will deliver a second 50bp cut

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March 25, 2025

## Banxico's confidence in further big cuts is contingent upon the peso's orderly trading and the absence of a marked depreciation

- Last week, the Fed kept rates unchanged at 4.25-4.50% and continued to signal two 25bp rate cuts later this year, but a rate cut in the near term is unlikely.** The policy statement's assessment of the economy remained unchanged, but it added that "uncertainty around the economic outlook has increased." The median FOMC participant sees slower growth and higher inflation: the GDP growth projection was lowered to 1.7% for 4Q25 (from 2.1%) and to 1.8% for 4Q26 and 4Q27. The median core PCE inflation projection for the end of 2025 was revised up to 2.8% (from 2.5%), while 2026 and 2027 forecasts were left unchanged at 2.2%. The dot plot still shows two 25bp rate cuts in 2025, but despite an unchanged 3.9% and 3.4% policy rate median projection for the end of this year and next, respectively ([Figure 1](#)), the few movements on the dots suggest that more participants are in no hurry to support a change in the monetary policy stance. During the Q&A session, Powell cited two complementary factors behind unchanged interest rate projections: i) weaker growth but higher inflation which "[...] kind of balance each other out"; and ii) uncertainty. The Fed also announced a further step in the process of reducing the size of its balance sheet: from April, it will "slow the pace of decline of its securities holdings by reducing the monthly redemption cap on Treasury securities from \$25 billion to \$5 billion." Powell carefully clarified that this action "isn't sending a signal in any hidden way" regarding the Fed's policy stance. We continue to think that the door to resume the rate cut cycle could open in late 2025 and, thus, we continue to expect two rate cuts this year, though uncertainty is high (see [here](#) and [here](#) for additional details on last week's FOMC meeting). In any case, despite the Fed's pause responding to continued economic robustness and still-uncertain tariff-related inflationary effects, **Mexico's improving inflation outlook amid a clear economic deceleration and a relatively stable exchange rate presents Banxico with ample margin to continue normalizing its monetary policy stance, independent of the Fed's decisions.** Indeed, the fact that the exchange rate pass-through is estimated to be very low, especially in lower parts of the economic cycle, and that Mexican capital markets are deeper than in the past, with a lower dependency on foreign portfolio inflows, results in a higher degree of freedom for Banxico to conduct monetary policy in a more independent way (relative to the Fed) compared to the previous decade.
- Inflation readings released between policy meetings continued to support the Board's majority strategy to keep removing the still excessively tight monetary policy stance at a fast pace.** Yesterday's bi-weekly CPI release showed Mexico's headline inflation edging down by 0.1 pp to 3.7% YoY in the first half of March. This marks the sixth consecutive bi-weekly period that headline inflation has remained within Banxico's target range, below the 4.0% upper limit ([Figure 2](#)), aided by continued declines in fruit and vegetable prices (at -3.7% in the first half of March) and a slowdown in energy inflation (at 2.8%, down from 3.3% in the previous

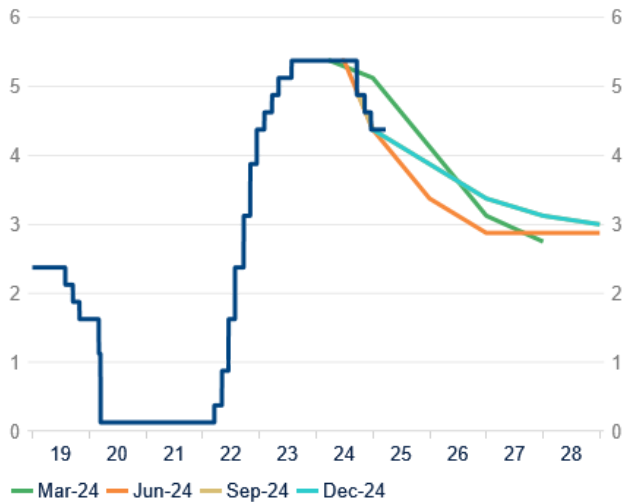
fortnight). Following a slight rise to 3.7% in February, core inflation inched down to 3.6% in the first half of March, in line with its 2003-19 average and just a tad above its 2010-19 3.4% average. Core inflation has moved in a narrow 3.6-3.7% range since November (i.e., for the past nine fortnights) in spite of the (expected) uptick in core goods inflation that bottomed out in late 2024. This has been possible through lower core services inflation which is set to continue decelerating amid weaker economic activity. Core inflation's slight decline in the first half of March was primarily driven by a significant easing in core services inflation, which fell from 4.65% to 4.2%, a level not seen since January 2022. This improvement was driven by a slowdown in the broad "other services" subindex, from 5.5% to 4.7%, as well as by the moderation of housing services inflation, to 3.6%, with the latter potentially signaling an inflection point of an uncomfortable upward trend observed since May 2021 ([Figure 3](#)). The progress on core inflation occurred despite a marginal increase in goods inflation, which rose from 2.8% to a still target-consistent 2.9%. **We continue to think that a further rebalancing between (lower) services inflation and (somewhat higher) core goods inflation (the "last mile" in the disinflation process) will allow core inflation to edge a bit further down to 3.5% by the end of the year.**

- **Board members' comments in both February's meeting minutes and the intermeeting quarterly report press conference from last month make a second consecutive 50bp rate cut a done deal.** Despite acknowledging "the risk of a greater foreign exchange depreciation," the minutes showed most members' determination to capitalize on the current period of subdued volatility in order to continue removing the still excessive policy restriction, in what they've termed a new monetary policy "phase." Two members were explicitly vocal in considering that a 50bp rate cut "could be considered at the next monetary policy meeting," and while the two other members' opinion was more nuanced (e.g., "monetary restriction can be calibrated more rapidly in some decisions"), they would probably also be in favor of a reduction of that magnitude at the next meeting. During last month's Quarterly Inflation Report press briefing, Governor Rodríguez continued to stress that Trump's-related uncertainty "must not lead us [...] to disregard the relevance of the concrete and significant advances we are seeing in our country's disinflationary process." With the knowledge at that time that real GDP contracted by 0.6% QoQ in 4Q24, which drove Banxico to bring down its 2025 GDP growth forecast to 0.6% from 1.2%, she emphasized that "going forward [they] could continue with the calibration of the monetary stance and continue adjusting it in a similar magnitude." Even Deputy Governor Heath, who voted against February's 50bp cut, might join the majority this week as he commented that "if core inflation keeps declining [and] if services prices decrease at a faster rate than the increase in goods prices" (which was the case in the most recent CPI report) "then there is plenty of room to continue lowering the rate." A 50bp cut is now expected by all analysts in the latest Citi survey. **The main question is whether Banxico will maintain a dovish tone, leaving the door open for a potential third consecutive 50bp rate cut in May.**
- **Banxico's confidence in delivering further big rate cuts is contingent upon the peso's orderly trading conditions and the absence of a marked depreciation that could prompt inflationary risks.** The (second) most recent agreement between Presidents Trump and Sheinbaum to postpone the imposition of broad-based tariffs on US imports of Mexican goods, coupled with the Mexican government's decision to forgo retaliatory measures against tariffs on steel, aluminum, and other products outside USMCA rules, has likely led market participants to assign a higher probability to a scenario where Mexico navigates Trump's April 2nd global tariff announcement relatively unscathed. The Mexican peso appreciated by slightly more than 5% to 19.9 ppd within days of the agreement, after hitting intraday levels above 21 ppd when the first grace period ended in early March ([Figure 4](#)). And, apparently more important for Banxico's reaction function, volatility in the FX market has been kept within bounds, at levels just above its historical average, but substantially lower than those observed following November's election results. On the other hand, the increasing evidence of the country's economic slowdown and labor market's deceleration, which we argue is partly explained by the excessively restrictive monetary policy that has remained in place thus far, suggests Banxico is unlikely to be

concerned about demand-driven inflationary risks in the near term. The ex-ante real policy rate will decrease from 5.6 to 5.1% following this week's rate cut, still well above Banxico's own 3.6% estimation for the upper bound of the neutral rate range. This significant leeway suggests **Banxico could keep the door open to a third 50bp cut in May before slowing down to more cautious 25bp adjustments. This would strengthen our expectation that Banxico will bring down the policy rate to a below-consensus 7.5% by the end of this year (consensus: 8.0%, market: 8.0%).**

**The median FOMC participant still expects two 25bp rate cuts in 2025**

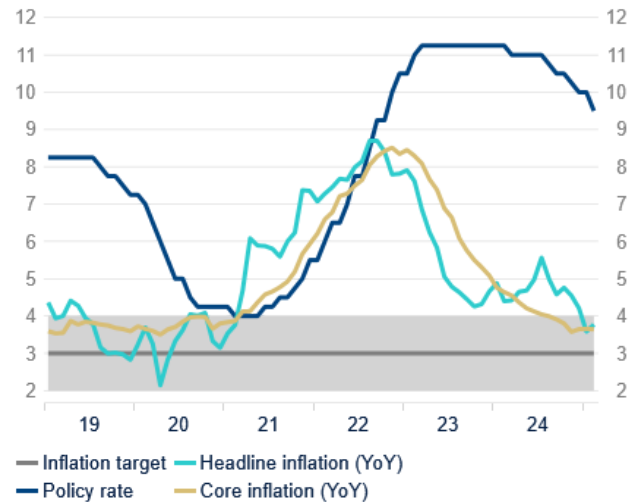
Figure 1. **FOMC PROJECTED FED FUNDS RATE (%)**



Source: BBVA Research / Fed

**Following a slight rise in February, core inflation inched down to 3.6% in the first half of March**

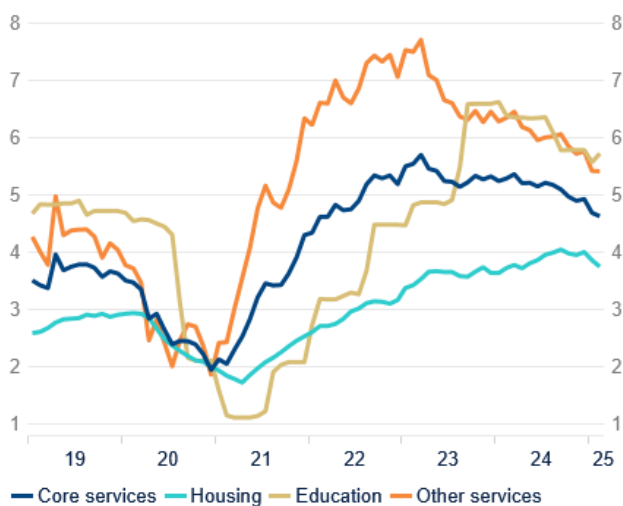
Figure 2. **INFLATION AND BANXICO POLICY RATE (%)**



The shaded area indicates the inflation target range  
Source: BBVA Research / INEGI / Banxico

**This improvement was driven by a slowdown in the “other services” subindex, from 5.5% to 4.7%**

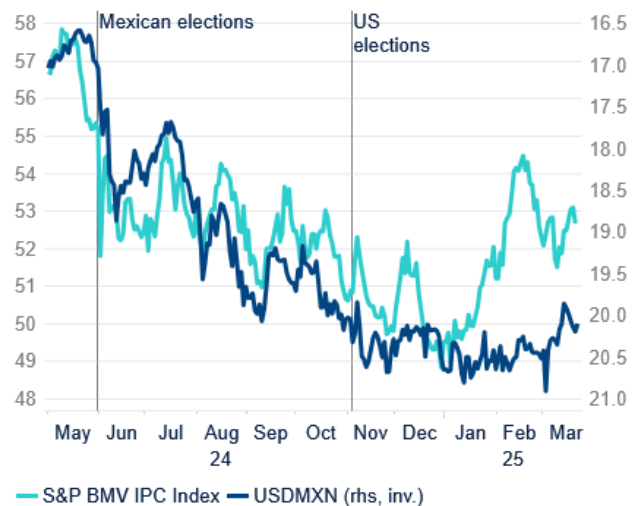
Figure 3. **CORE SERVICES INFLATION (%)**



Source: BBVA Research / INEGI

**The Mexican peso appreciated by slightly more than 5% after hitting intraday levels above 21 ppp**

Figure 4. **S&P BMV IPC INDEX AND USDMXN (THOUSANDS AND PPD)**



Source: BBVA Research / BMV / Macrobond

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