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GLOBAL ECONOMICS

LATAM FLASH

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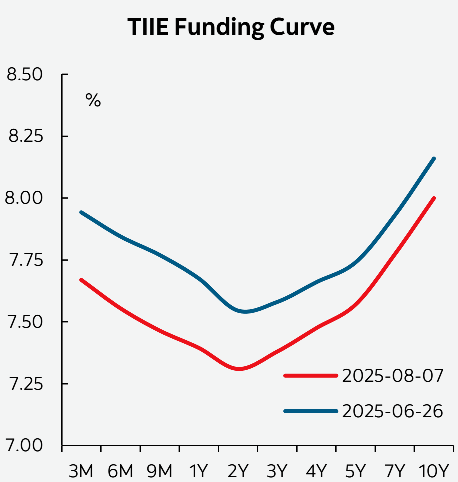
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Mexico—Banxico Cuts Rate as Expected, Signaling Openness to Further Easing

- **Banco de México's Governing Board cut the benchmark interest rate by 25 basis points to 7.75% in a split vote, as broadly expected.**
- **Headline inflation forecasts were revised downward, while core inflation projections were adjusted upward again in the short term due to a rebound in goods and services prices.**
- **The statement highlighted the increase in analysts' inflation expectations for year-end 2025, which now stand at 4.04% according to Banxico's survey.**
- **We maintain our year-end policy rate forecast at 7.50%, contingent on the inflation trajectory and the interest rate differential between Mexico and the United States.**

The Governing Board of Banco de México decided to cut the benchmark interest rate by 25 basis points to 7.75%, marking the second consecutive meeting with a split vote. Once again, Deputy Governor Jonathan Heath dissented, voting to keep the rate at 8.00%. This marks the ninth consecutive rate cut: four 25 bp cuts last year, four 50 bp cuts earlier in 2025, and this latest 25 bp reduction.

Notably, the Board revised upward its core inflation expectations from Q3 2025 to Q1 2026, while the headline inflation outlook was revised downward for Q3 2025 from 4.1% to 3.8%, but left unchanged across the remainder of the forecast horizon. The Board maintained its projection that inflation will converge to the 3.0% target by Q3 2026 (table 1).

The statement reiterated expectations of a global and U.S. economic slowdown for the balance of the year, despite slightly stronger growth in Q2. This outlook unfolds amid heightened uncertainty, driven by trade tensions and geopolitical conflicts. The dollar appreciated, while government bond yields declined. Inflation trends were described as heterogeneous across countries. The Federal Reserve held its policy rate unchanged. The statement also emphasized rising global risks due to escalating trade tensions and worsening geopolitical conflicts.

On the domestic outlook, the Board noted a quarterly pickup in economic activity in Q2, but also highlighted slack conditions due to underlying weakness. The balance of risks remains tilted to the downside. The exchange rate showed no clear trend, and government bond yields declined across all maturities.

Regarding inflation, the Board revised its short-term forecasts. Headline inflation was adjusted downward due to the slowdown in non-core components and recent declines in fruit and vegetable prices. However, core inflation forecasts were revised upward. Banxico now estimates an average annual headline inflation at 3.8% y/y for Q3, down from 4.1%, while core inflation is expected to rise to 4.1% from 3.8%, showing opposite movements for the same period.

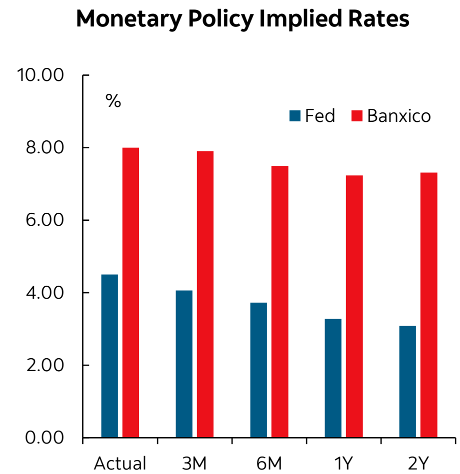
The statement acknowledged that year-end inflation expectations have risen again. The latest Banxico Expectations Survey shows consensus forecasts of 4.04% for headline inflation and 4.12% for core inflation. Nonetheless, the Board still anticipates convergence to the 3.0% target by Q3 2026. The balance of inflation risks remains tilted to the upside, though less pronounced than between 2021 and 2024. The Board reiterated increased uncertainty due to changes in U.S. economic policy, which could exert both upward and downward inflationary pressures.

Upside risks to inflation include exchange rate depreciation, disruptions from geopolitical conflicts or trade policies, persistent core inflation, cost pressures, and climate-related effects. Downside risks include weaker-than-expected economic activity, lower pass-through of cost increases, and reduced pressures from peso appreciation.

We consider this monetary policy decision reflects a less restrictive stance compared to previous meetings, following the latest rate cut. However, monetary conditions remain in restrictive territory. The dissenting vote by Deputy Governor Heath, for the second consecutive meeting, stands out. It is also worth noting the removal of detailed references to the inflation outlook, despite persistent core inflation and upward revisions to its projections.

The statement keeps the door open for further rate cuts: “Going forward, the Governing Board will assess additional reductions to the reference rate.” In this context, it will be crucial to monitor not only upside inflation risks and the impact of domestic economic weakness on price dynamics, but also labour market developments and U.S. inflation. These factors could significantly influence the Federal Reserve’s next rate decision, potentially creating more room for Banxico to continue or pause its easing cycle.

Chart 2



Sources: Scotiabank Economics, Bloomberg,

Looking ahead, we anticipate Banxico may pause its rate-cutting cycle. However, the probability of another 25 bp cut at the September 25th meeting has increased. This decision is also likely to be split, given ongoing differences among Board members regarding inflation risks and the monetary policy stance, both in absolute and relative terms.

We maintain our forecast for a year-end policy rate of 7.50%, contingent on clear signs of inflation convergence and the interest rate differential with the U.S. remaining above 325 basis points. Finally, to better understand each Board member’s stance, the minutes of this decision—scheduled for release on August 21st, 2025—will be particularly relevant.

Market Reaction: The exchange rate registered a slight depreciation during the day, fluctuating between MXN 18.60–18.67, with a limited response to the monetary policy decision. The TIIE funding curve moved lower (chart 1), with an average decline of 6 basis points compared to the previous day. The 3-month implied curve settled at 7.67%, while the 1-year curve stood at 7.42% (chart 2). According to recent surveys, analysts expect the policy rate to end 2025 in a range between 7.00% and 7.75%.

Table 1: Banxico's Headline and Core Inflation Forecasts

Headline Inflation (%)	**25-Q1**	**25-Q2**	**25-Q3**	**25-Q4**	**26-Q1**	**26-Q2**	**26-Q3**	**26-Q4**	**27-Q1**	**27-Q2**
Current (Aug. 25) e.o.p.	3.7	4.2	3.8	3.7	3.4	3.1	3.0	3.0	3.0	3.0
Previous (Jun. 25) e.o.p.	3.7	4.3	4.1	3.7	3.4	3.1	3.0	3.0	3.0	3.0
Var. Current - Previous	0.0	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Core Inflation (%)	**25-Q1**	**25-Q2**	**25-Q3**	**25-Q4**	**26-Q1**	**26-Q2**	**26-Q3**	**26-Q4**	**27-Q1**	**27-Q2**
Current (Aug. 25) e.o.p.	3.6	4.1	4.1	3.7	3.5	3.1	3.0	3.0	3.0	3.0
Previous (Jun. 25) e.o.p.	3.6	4.1	3.8	3.6	3.4	3.1	3.0	3.0	3.0	3.0
Var. Current - Previous	0.0	0.0	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0

Sources: Scotiabank Economics, Banxico.