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Mexico—Banxico Leaves the Door Open to More Cuts, Despite Inflationary Risk

- Banco de México’s Governing Board decided to cut the benchmark interest rate by 25 basis points to 6.75%, in a split vote with three out of five members supporting the adjustment.
- The statement highlighted downside risks to economic activity stemming from the Middle East conflict amid an environment of uncertainty.
- Headline and core inflation forecasts were revised upward for the remainder of the year, with inflation still expected to converge to the target in 2Q27.
- The tone of the statement suggests that Banxico will keep the door open for rate cuts in upcoming meetings.
- We maintain our outlook for the policy rate to end the year at 6.50%, subject to the inflation trajectory, the exchange rate level, and the interest rate differential between Mexico and the United States.

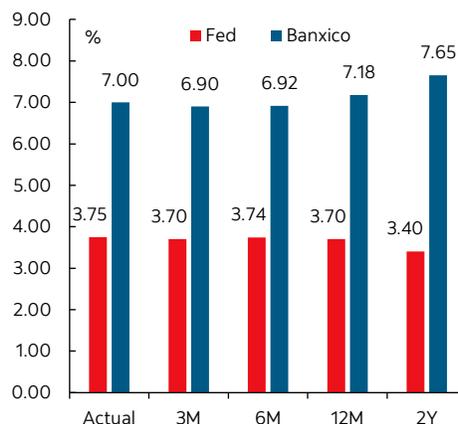
Banco de México’s Governing Board decided, by majority vote (three out of five members), to cut the benchmark interest rate by 25 basis points, bringing it to 6.75%. This decision surprised the market, which had anticipated a continuation of the pause following eleven consecutive rate cuts. Notably, two members—Galia Borja and Jonathan Heath—voted to keep the rate unchanged. In addition, the Board once again revised upward its headline and core inflation projections for the first three quarters of the year, while leaving unchanged its estimate for convergence toward the 3.0% target in the second quarter of 2027.

The statement reiterated that global economic activity is expected to expand at a faster pace during the first quarter of 2026 than in the fourth quarter, following a decline in headline and core inflation across advanced economies. It noted that the Federal Reserve kept its benchmark rate unchanged in March, and that financial markets experienced volatile performance and lower risk appetite due to the Middle East conflict, accompanied by an appreciation of the U.S. dollar and upward movements in U.S. Treasury yields. It was noted that the impact of the Middle East conflict will depend on its duration and intensity.

On the domestic front, the Governing Board noted that since the last monetary policy decision, interest rates on Mexican government securities increased across medium- and

Chart 1

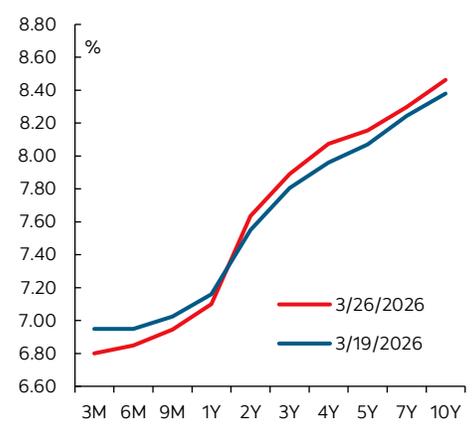
Monetary Policy Implied Rates



Sources: Scotiabank Economics, Bloomberg.

Chart 2

TIIE Funding Curve



Sources: Scotiabank Economics, Bloomberg.

long-term maturities, while the peso depreciated moderately. At the beginning of 2026, economic activity showed pronounced weakness, with the uncertain environment and potential spillovers from the Middle East conflict continuing to pose downside risks to growth.

Regarding inflation, the statement highlighted the increase in headline inflation during the first half of March to 4.63%, resulting from a rebound in the non-core component. It also mentioned that there is no evidence of second-round effects—that is, price spillovers—from the tax and tariff increases implemented at the beginning of the year. However, the statement acknowledged an increase in year-end inflation expectations: according to the latest Private Sector Analysts’ Expectations Survey, consensus now stands at 4.0% for headline inflation and 4.17% for core inflation, while longer-term expectations remain stable (3.75% headline inflation by the end of 2027). In this context, Banxico’s forecasts for both headline and core inflation were revised upward for 2026, with a smaller adjustment to core inflation for the same period, still anticipating that inflation will converge to the target in the second quarter of 2027. These estimates are subject to upside risks from external disruptions related to trade policies and geopolitical conflicts, inflation persistence, cost pressures, peso depreciation, and climate shocks; as well as downside risks stemming from weaker economic activity, lower cost pass-through, or a stronger peso. Nevertheless, the balance of risks remains tilted to the upside, while uncertainty arising from changes in U.S. economic policy continues to weigh on the outlook.

We believe that the monetary policy decision reflects a more accommodative stance compared to the previous meeting due to the unexpected rate cut, although this is partially mitigated by the split vote. It is particularly striking that two of the five Board members voted against the adjustment, along with the upward revision to inflation expectations for the first three quarters of the year and the upside bias of the risk balance—elements that contrast with the easing of the monetary stance. The statement also leaves open the possibility of continuing the rate-cutting cycle. In this context, it will be crucial to monitor developments in the Middle East conflict, the impact of higher energy prices and potential second-round effects on goods and services, as well as domestic economic weakness, exchange rate behaviour, and the relative stance vis-à-vis the Federal Reserve.

These factors could significantly influence Banxico’s next decision. Under this scenario, we estimate that the probability of the central bank continuing with rate cuts in May has declined markedly, and we therefore expect the policy rate to remain at 6.75%. We maintain our projection of a 6.50% rate by the end of 2026, provided that second-round effects from increases in taxes, tariffs, the minimum wage, and energy prices do not materialize. Finally, to gain deeper insight into each member’s position, it will be relevant to analyze the minutes to be released on April 9th, 2026.

Regarding market reaction, the exchange rate responded to the decision by increasing from MXN 17.83 to MXN 17.92 per U.S. dollar. Meanwhile, the TIE funding curve showed mixed movements. The short end (up to 1 year) declined by between 17.5 and 3.5 basis points, while the rest of the curve out to 30 years increased by between 6.5 and 15.5 basis points. The three-month implied rate stood at 6.90%, while the one-year rate reached 7.18%.

Table 1: Banxico's Headline and Core Inflation Forecasts (%)

Headline Inflation	25-Q3	25-Q4	26-Q1	26-Q2	26-Q3	26-Q4	27-Q1	27-Q2	27-Q3	27-Q4
Current (March. 26) e.o.p.	3.6	3.7	4.1	4.0	3.7	3.5	3.2	3.0	3.0	3.0
Previous (Feb. 26) e.o.p.	3.6	3.7	4.0	3.8	3.6	3.5	3.2	3.0	3.0	3.0
Var. Current - Previous	0.0	0.0	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Core Inflation	25-Q3	25-Q4	26-Q1	26-Q2	26-Q3	26-Q4	27-Q1	27-Q2	27-Q3	27-Q4
Current (March. 26) e.o.p.	4.2	4.3	4.5	4.1	3.7	3.4	3.1	3.0	3.0	3.0
Previous (Feb. 26) e.o.p.	4.2	4.3	4.4	4.0	3.6	3.4	3.1	3.0	3.0	3.0
Var. Current - Previous	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0

Source: Banxico

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