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Mexico—Banxico Cuts Rate as Expected, Reaching End of the Easing Cycle & Will Remain on Hold

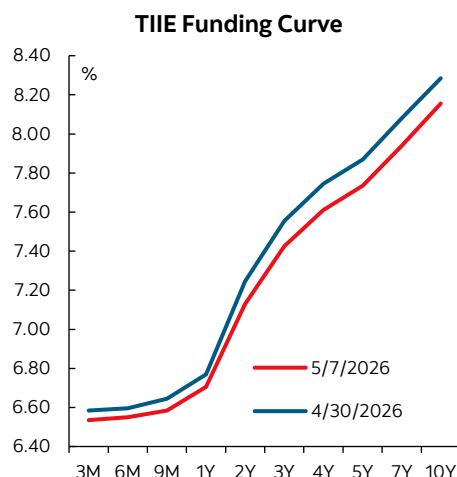
- The Bank of Mexico’s Governing Board decided to cut the policy rate by 25bps to 6.50%, in a split vote with three out of five members supporting the move.
- The statement explicitly signals the end of the easing cycle that began in March 2024.
- The Board highlighted that economic activity contracted in 1Q-2026, implying a greater degree of slack in the economy.
- Headline inflation forecasts were revised slightly upward for the remainder of the year, with convergence to target expected in 2Q-2027.
- We maintain our year-end policy rate forecast at 6.50%, contingent on the inflation path, exchange rate dynamics, and the interest rate differential with the United States.

The Bank of Mexico’s Governing Board decided, by majority (three out of five members), to cut the policy rate by 25 basis points, bringing it to 6.50%. This decision was in line with market expectations following the Governor’s remarks in the Senate last week. Notably, for the second consecutive meeting, Galia Borja and Jonathan Heath voted to keep the rate unchanged. Additionally, the Board signaled the end of the easing cycle that began in March 2024, which accumulated a total of 475 basis points in cuts. The Board also revised its headline inflation projections slightly upward, while keeping core inflation forecasts unchanged, as well as its expectation for convergence to the 3.0% target by the second quarter of 2027.

The statement reiterated that global economic activity expanded at a faster pace in 1Q-2026 compared to the previous quarter. This occurred despite an increase in headline inflation—driven by higher energy prices—and persistent core inflation in some advanced economies. It also highlighted that the Federal Reserve held its policy rate unchanged in April, and that despite a moderation in uncertainty related to the Middle East conflict, financial markets exhibited volatility and mixed performance, with a weaker dollar and limited movements in U.S. Treasury yields. The statement noted that the impact of the Middle East conflict remains uncertain and will depend on its duration and intensity.

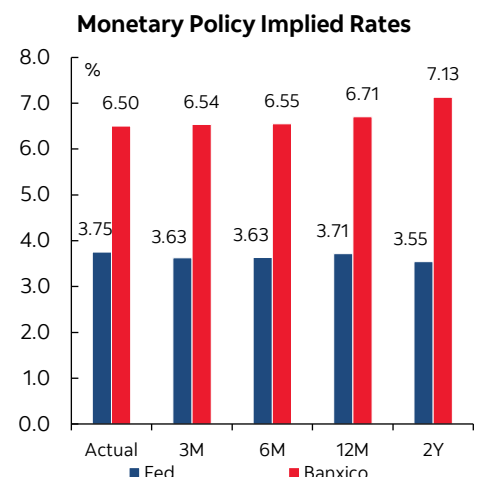
On the domestic front, the Board noted that since the last monetary policy decision, government bond yields in Mexico declined across short- and medium-term maturities,

Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

May 7, 2026

while increasing at the long end, and the peso appreciated. Economic activity contracted in 1Q-2026, implying greater slack than previously anticipated, with downside risks persisting going forward.

Regarding inflation, in April headline inflation declined from 4.63% to 4.45%, driven by a slowdown in the core component, which fell from 4.46% to 4.26%. The statement noted no evidence of second-round effects stemming from tax and tariff increases implemented earlier in the year. Year-end inflation expectations were revised upward, while long-term expectations remained stable. The Board emphasized upward revisions to inflation expectations for upcoming quarters in 2026, particularly due to the non-core component, while core inflation projections remained unchanged. It reiterated that headline inflation is still expected to converge to target in 2Q-2027, although forecasts remain subject to upside risks, including trade policy disruptions, inflationary impacts from geopolitical conflicts, persistent core inflation, cost pressures, and a depreciation bias in the peso. Downside risks include weaker-than-expected economic activity, lower cost pass-through, and reduced pressures due to peso appreciation observed since last year.

Thus, the risk balance remains tilted to the upside, driven by uncertainty related to factors such as changes in U.S. economic policy and escalating geopolitical tensions.

We believe the monetary policy decision reflects a more accommodative stance relative to the previous meeting, due to the expected rate cut, although the announcement of the end of the easing cycle and the split vote temper this bias. It is also important to highlight that the Board appears comfortable with the current level of the policy rate and considers it appropriate to hold it steady. Based on the ex-ante real rate, policy is already in neutral territory despite both headline and core inflation remaining above Banxico's tolerance range and with inflation risks still tilted to the upside—largely driven by supply shocks, which are beyond the reach of monetary policy.

In this context, it will be crucial to monitor the evolution of inflation and developments in the Middle East conflict, including the impact of rising energy prices and potential second-round effects on goods and services, as well as domestic economic weakness, exchange rate dynamics, and the relative stance versus the Federal Reserve.

We maintain our forecast for the policy rate at 6.50% by year-end 2026, provided that second-round effects from tax increases, tariffs, minimum wage hikes, and energy prices do not materialize. Finally, to better understand each Board member's stance, it will be important to analyze the minutes to be published on May 21st, 2026.

In terms of market reaction, the exchange rate showed a limited response to the decision, moving from MXN 17.24 to MXN 17.26 per dollar. Meanwhile, the TIE funding curve posted modest movements: the short end (up to one year) declined between 1 and 4 bps, while the rest of the curve (up to 30 years) increased between 2 and 4 bps. The implied curve stood at 6.54% at three months and 6.71% at one year, suggesting market expectations of rate hikes towards the end of the horizon.

Banxico's Headline and Core Inflation Forecasts									
Headline Inflation	26-Q1	26-Q2	26-Q3	26-Q4	27-Q1	27-Q2	27-Q3	27-Q4	28-Q1
Current (May 2026) e.o.p.	4.1	4.1	3.8	3.5	3.2	3.0	3.0	3.0	3.0
Previous (March 2026) e.o.p.	4.1	4.0	3.7	3.5	3.2	3.0	3.0	3.0	3.0
Var. Current - Previous	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Core Inflation	26-Q1	26-Q2	26-Q3	26-Q4	27-Q1	27-Q2	27-Q3	27-Q4	28-Q1
Current (May 2026) e.o.p.	4.5	4.1	3.7	3.4	3.1	3.0	3.0	3.0	3.0
Previous (March 2026) e.o.p.	4.5	4.1	3.7	3.4	3.1	3.0	3.0	3.0	3.0
Var. Current - Previous	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Banxico.

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