Macro scenario - Mexico

April 16, 2025

Winter is here

- In the context of the trade war and elevated policy uncertainty, Mexico appears to have avoided the worst-case scenario, so far.
- Still, we revised our 2025 GDP growth forecast downward again, now predicting a contraction of 0.5% (from 0.0%). We forecast a 0.5% QoQ GDP contraction in 1Q25, following a -0.6% QoQ decline in 4Q24. For 2026, we expect a modest recovery, with GDP growth bouncing back to 0.5% (down from 1.4% in our previous scenario).
- We forecast that inflation will end this year at 3.9% and 2026 at 3.6%. While the disinflationary trend should be supported by a deceleration in economic activity, we remain cautious as volatile items have contributed to taking inflation below the ceiling of Banxico's target range. Any event that leads to a higher exchange rate, increased fuel prices, adverse climate events, among other factors, poses risks to the scenario.
- We expect Banxico to cut the monetary policy rate by 50-bp again in May, following the current forward guidance. Provided that the USDMXN remains stable, and activity data remains weak, Banxico should not face any obstacles in delivering an additional easing of the same magnitude. Our terminal rate is now projected at 7.5% in 2025 and 7.0% in 2026 (previously 8.5% in 2025 and 8.0% in 2026).

Third time's the charm

After unveiling reciprocal tariffs on April 2 on most of the world, the US paused their implementation for ninety days on April 9. Imports from Brazil and most economies in the region received a 10% tariff, while other economies were subject to higher tariffs. As of this writing, retaliatory tariffs for countries that did not reciprocate with tariffs are fixed to 10% for 90 days (China, with tariffs announced that suppress 100% is the notable exception). For now, reciprocal tariffs on imports from Mexico and Canada were not considered, but uncertainty remains and important details about trade within the region are still missing. USMCA exemptions from the announced 25% tariffs (covering approximately 90% of all Mexican exports to the US according to our estimation) remain in place.

Despite Mexico avoiding the worst-case scenario, uncertainty remains until a USMCA renegotiation is completed. We maintain our view that the U.S. administration's tariff threats are a mechanism to gain leverage in advance of the free-trade renegotiation process. We expect Mexico to comply with U.S. demands to keep the trade deal in place.

Greater, and swifter-than-expected tariffs from the US along with Mexico faring relatively better in comparison to other countries could be a driver to a better USDMXN ahead. But it's too early to call given the unprecedented uncertainty in the scenario. We maintain our forecast for the USDMXN at 21.0 this year, close to current levels. We expect 21.3 next year.

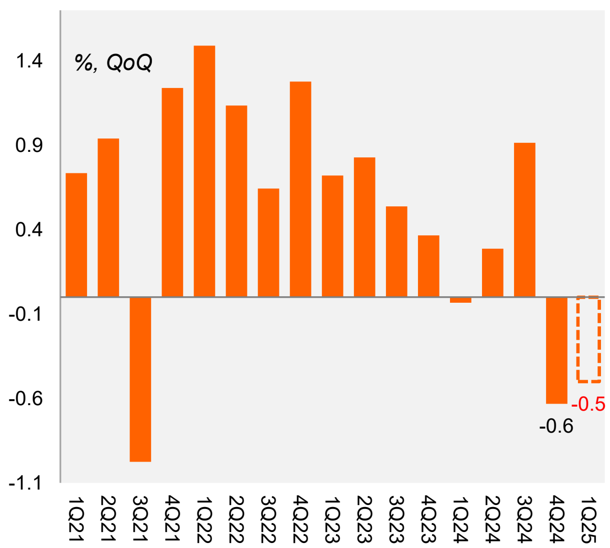
Recession fears materializing

We revised our 2025 GDP forecast downward for the third consecutive month, now predicting a full recession with a 0.5% contraction in GDP this year, compared to zero growth in our previous scenario. We anticipate a 0.5% QoQ GDP contraction in 1Q25, indicating a technical recession, following the 0.6% decline in 4Q24. This is driven by weaker-than-expected data as of February, such as industrial production, investment, and consumption. Considering our 1Q25 forecast, the carry-over for 2025 now stands at -0.3%. We expect the second half of the year to improve in terms of public investments, trade competitiveness following the April 2nd announcement targeting countries with high tariffs, and lower domestic interest rates. However, avoiding a contraction this year seems challenging given the starting point.

We continue to anticipate weaker performance from the international sources of Mexico's growth, primarily in manufacturing exports and certain services such as freight and wholesale trade. The outlook for domestically related sectors is mixed, with moderation in local services and a contraction in construction and investment. The government is focused on strengthening the domestic market, amid changes in the global outlook, which might be a modest driver for growth going forward.

For 2026, we expect a modest recovery, with GDP growth rebounding to 0.5%, down from 1.4% in our previous scenario. The context remains characterized by unusually high uncertainty, with negative repercussions from the trade policy changes in 2025.

We forecast a 0.5% drop in GDP in 1Q25

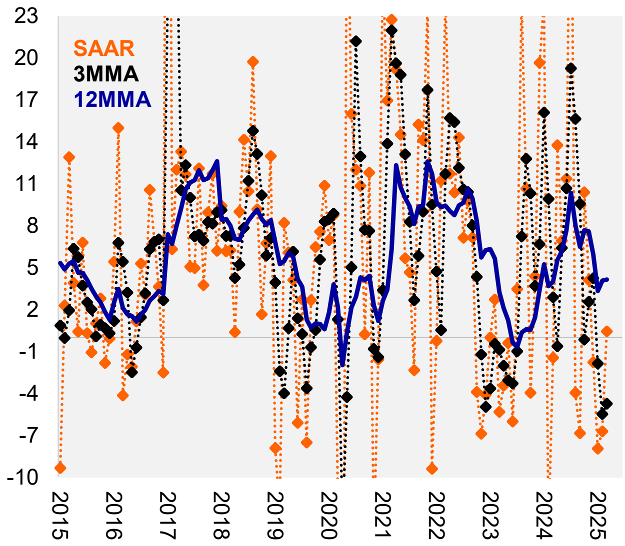


Source: INEGI, Itaú.

Inflation around 4% is conditional on volatile non-core items

Inflation is currently close to 3.8% on an annual basis and is running lower at the margin, mainly due to deflation in fresh fruits and vegetables (volatile non-core items).

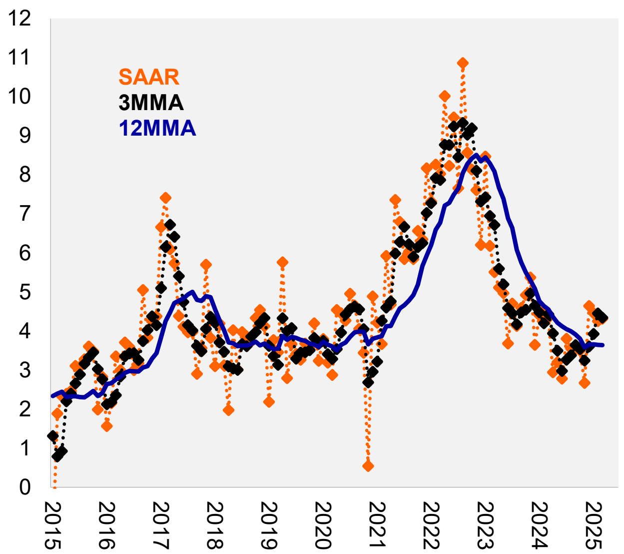
Non-core CPI negative at the margin



Source: INEGI, Itaú

On the other hand, core inflation, which is stickier, is running above 4%. Even with a muted FX pass-through, tradables inflation is likely to normalize and return to the pre-pandemic trend (~4% YoY), as a still tight labor market prevents any significant disinflation in services.

While core inflation in close to 4.5% using annualized seasonally adjusted data



Source: INEGI, Itaú

We forecast CPI for 2025 at 3.9% and CPI for 2026 at 3.6%.

While the disinflationary trend should be supported by a deceleration in economic activity, we remain cautious. Although inflation is below the ceiling of Banxico's target range, much of the current level of inflation is related to volatile items. Any event that leads to a higher exchange rate, increased fuel prices, adverse climate events, or other factors, poses risks to the scenario. It is worth noting that inflation expectations remain well-behaved, oscillating close to, but slightly lower, than Banxico's upper band for the inflation target, with the 1-year inflation expectation currently at 3.92%.

Banxico to deliver another 50-bp cut in May (YE25 7.5%, down from 8.5%)

We expect Banxico to cut the monetary policy rate by 50-bp again in May, following the current forward guidance. Provided that the USDMXN remains stable, and activity data is weak, Banxico should not face any obstacles in maintaining the easing pace at the May meeting. After May, we anticipate another 50-bp cut in June, followed by two cuts of 25-bp in August and September, with the terminal rate now reaching 7.5% (previously 8.5% in 2025 and 8.0% in 2026). Our own Taylor rule estimate for Mexico currently stands at 7.75%. If the FOMC cuts rates sooner or more this year (more than our base case scenario of 50-bp in 2H25), Banxico will have more room to ease and could take the policy rate close to or below 7%.

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Mexico | Forecast

	2020	2021	2022	2023	2024	2025F		2026F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-8.4	6.0	3.7	3.3	1.5	**-0.5**	0.0	**0.5**	1.4
Nominal GDP - USD bn	1,121	1,316	1,467	1,793	1,853	**1,918**	1,928	**2,005**	2,115
Population (millions)	127.7	129.0	130.1	131.2	132.3	**133.4**	133.4	**134.4**	134.4
Per Capita GDP - USD	8,844	10,218	11,241	13,688	14,005	**14,384**	14,457	**14,916**	15,736
Unemployment Rate - year avg	4.4	4.1	3.3	2.8	2.7	**3.0**	2.9	**2.9**	2.9
Inflation									
CPI - %	3.2	7.4	7.8	4.7	4.2	**3.9**	3.9	**3.6**	3.6
Interest Rate									
Monetary Policy Rate - eop - %	4.25	5.50	10.50	11.25	10.00	**7.50**	8.50	**7.00**	8.00
Balance of Payments									
MXN / USD - eop	19.9	20.5	19.5	17.0	20.8	**21.0**	21.0	**21.3**	21.3
Trade Balance - USD bn	34.2	-10.8	-26.9	-5.5	8.2	**-10.0**	-10.0	**-10.0**	-15.0
Current Account - % GDP	2.4	-0.3	-1.2	-0.3	-0.3	**-0.6**	-0.6	**-0.6**	-0.6
Foreign Direct Investment - % GDP	2.5	2.5	2.5	2.0	2.0	**2.0**	2.0	**2.0**	3.5
International Reserves - USD bn	195.7	202.4	199.1	212.8	229.0	**230.1**	230.1	**230.6**	230.6
Public Finances									
Nominal Balance - % GDP	-2.8	-2.8	-3.2	-3.3	-5.7	**-4.0**	-3.9	**-3.5**	-3.4
Primary Balance - % GDP	0.1	-0.3	-0.4	-0.1	-1.5	**0.6**	0.6	**0.5**	0.5
Net Public Debt - % GDP	49.9	48.9	47.6	46.8	51.4	**52.3**	51.8	**52.3**	51.4

Source: IMF, Bloomberg, INEGI, Banxico, Haver and Itaú

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