Macro scenario - Mexico

May 16, 2025

The long and winding road

- This is a challenging year for growth in Mexico. The country appears to have narrowly avoided a technical recession, with the 1Q25 GDP flash estimate rising by 0.2% compared to 4Q24 (up from -0.6% in the previous quarter). Given the uncertainties, we maintain our GDP forecast of a 0.5% contraction for 2025. However, we're improving our forecast for 2026 from +0.5% to +1.0%, given a better expected performance from the US economy following significant relief on US-China tariffs.
- We forecast that inflation will end this year at 3.9% and reach 3.6% in 2026. In our view, the disinflation process has already occurred, and headline inflation is projected to oscillate close to the ceiling of Banxico's inflation target tolerance range, down from nearly 9% at its peak in 2022. A note of caution: most of the disinflation resulted from non-core items, while core goods continue to accelerate at the margin, and core services remain sticky in a still-tight labor market scenario.
- In this context, Banxico delivered another 50-bp cut in May, and we expect an adjustment of the same magnitude in June, following the current forward guidance. Beyond that, we anticipate a more cautious approach, with two 25-bp cuts in August and September, leading to a terminal rate of 7.5% in 2025.

Uncertainty (inevitably) remains

Non-USMCA-compliant Mexican producers are collaborating with the government to adhere to the local content trade agreement's rules. Although volatility will persist in the foreseeable future, the domestic risk premium and the USDMXN remain stable, suggesting a somewhat limited impact on financial assets. However, uncertainty inevitably affects economic activity and business decisions.

Recession in disguise

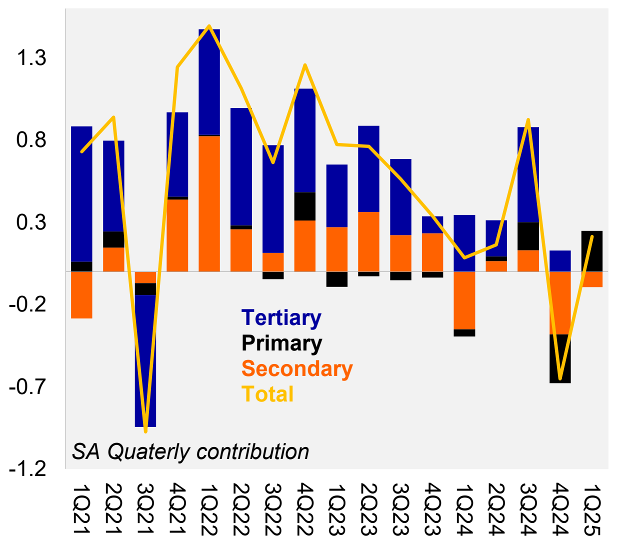
Mexico appears to have narrowly avoided a technical recession: the 1Q25 GDP flash estimate indicated a 0.2% quarterly growth, up from a -0.6% contraction in the previous quarter. However, the only source of growth during this quarter was the agricultural sector, which rebounded from a drop in 4Q24. Without growth in the agricultural sector, the economy would have contracted by 0.1% QoQ, indicating a technical recession after all. The statistical carry-over for 2025 by the end of 1Q25 stands at +0.2%.

Looking ahead, we continue to anticipate weaker performance from the international sources of Mexico's growth, primarily in manufacturing exports, due to the effects of some tariff frontloading 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 domestic demand amid changes in the global outlook, which might modestly drive growth going forward.

Given all these uncertainties, we have maintained our GDP forecast of a 0.5% contraction for 2025. This is a challenging period for growth in Mexico, as economic weakness persists, with volatility and heterogeneity across sectors.

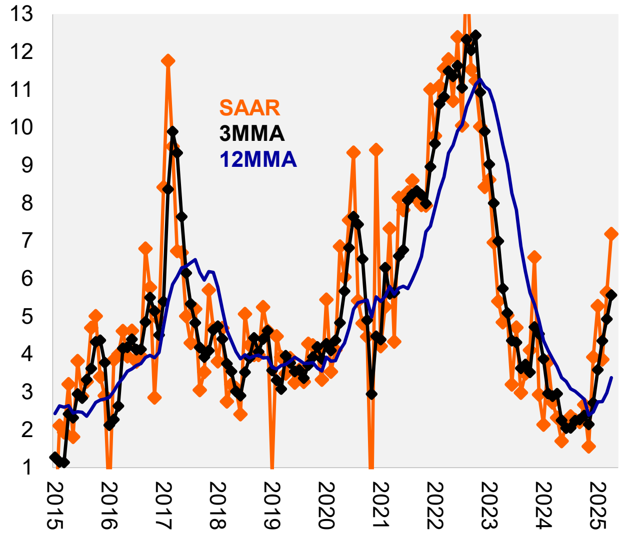
However, we're improving our forecast for 2026 from +0.5% to +1.0%, given a better expected performance from the US economy following significant relief on US-China tariffs.

1Q25 +0.2% QoQ (with +8.1% QoQ from the primary sector)



Source: INEGI, Itaú.

Goods inflation is above 5% at the margin



Source: INEGI, Itaú

Disinflation in the rearview mirror

We forecast headline CPI to end the year at 3.9% and at 3.6% in 2026. In our view, the disinflation process has already occurred, and headline inflation is projected to oscillate close to the ceiling of Banxico's inflation target tolerance range, down from nearly 9% at its peak in 2022. Note, however, that most of the disinflation came from non-core items, while core goods inflation continues to accelerate at the margin, and core services remain sticky in a still tight-labor market scenario.

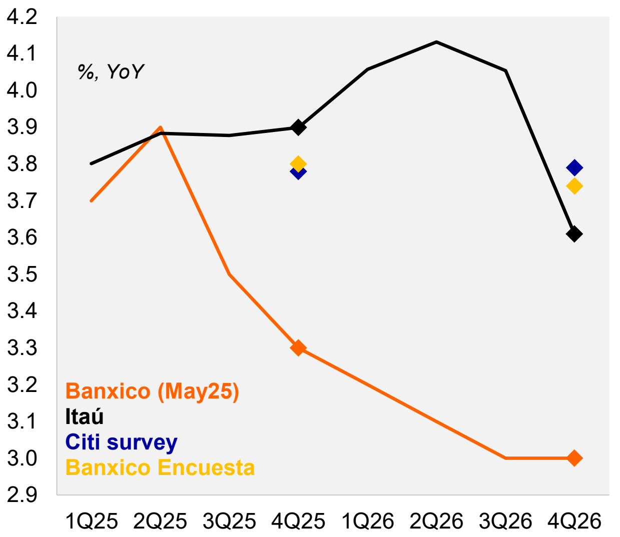
While further disinflation could be supported by the deceleration in economic activity, we remain cautious. Any event that leads to a depreciation of the exchange rate, increased fuel prices, adverse climate events, or other factors poses risks to the scenario. It is worth noting that inflation expectations remain well-behaved, oscillating close to the ceiling of Banxico's 3% inflation target tolerance range (±1%), with survey-based one-year inflation expectations at 3.79%.

Banxico: sticking to the plan

Banxico delivered another 50-bp cut in May, and we expect an adjustment of the same magnitude in June, 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 current easing pace for one more meeting. Beyond that, we anticipate a more cautious approach, with two 25-bp cuts in August and September, leading to a terminal rate of 7.5% in 2025.

Banxico will likely update its inflation convergence forecast. Currently, the Central Bank projects inflation reaching the 3% target by 3Q26, which is faster than our forecast and those of other economists surveyed by Banxico. Given this anticipated revision and the late stage of the current easing cycle, we believe Banxico will choose to decelerate the current easing pace during the second half of this year.

Banxico will update its inflation convergence forecast (probably in June)



Source: Banxico, Citibank, Itaú

Our Taylor rule estimate for Mexico currently stands at 7.75%. If the FOMC cuts rates sooner or by more than our now base scenario of only a 25-bp reduction in 2H25, Banxico will have more room to ease and could bring 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**	-0.5	**1.0**	0.5
Nominal GDP - USD bn	1,121	1,316	1,467	1,793	1,853	**1,918**	1,918	**2,005**	1,995
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**	14,384	**14,915**	14,842
Unemployment Rate - year avg	4.4	4.1	3.3	2.8	2.7	**3.0**	3.0	**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**	7.50	**7.00**	7.00
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**	-10.0
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**	2.0
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**	-4.0	**-3.5**	-3.5
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**	52.3	**52.3**	52.3

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

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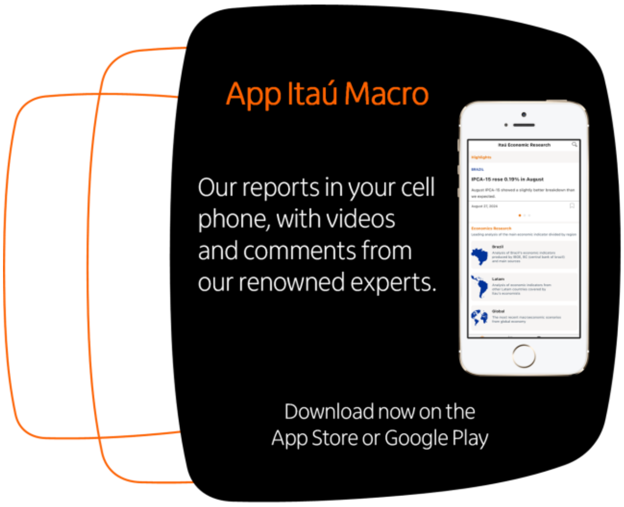

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