Notes from our August Mexico trip

- We recently met with authorities and local experts to discuss Mexico's economic performance and outlook amid domestic and trade-related uncertainties. Overall sentiment continues to improve at the margin. Mexico is now seen as better positioned in terms of economic activity and relative competitiveness in global trade than we heard in our previous trip (in May). The bar for Banxico to continue cutting rates beyond the September meeting is high. Besides the FOMC easing – which is a necessary but not sufficient condition – core inflation should hover around, preferably below, the 4% threshold. This is a moment to be cautious, and the board's forward guidance should change for the next meeting, adhering to a step-by-step approach, possibly with a tweak: "will assess further *adjustment* to the reference rate" in lieu of "will assess further *adjustments* to the reference rate". The USMCA renegotiation is expected to occur at the end of next year, with overall conditions remaining the same, although there should be a tougher stance on local content rules. The electoral reform is expected to take place at the beginning of 2026, and market participants believe it is already priced in.

Main takeaways

We recently met with the Central Bank, senior officials from the Ministry of Finance, and local experts.

The overall sentiment continues to improve at the margin[1]. Economic activity has been better than expected, especially in 2Q25, driven by external demand/net exports amid weak domestic demand, reflected by gradual revisions to the 2025 GDP growth outlook by market participants. Separately, the economy seems better positioned with respect to trade competitiveness, especially with its main trading partner. Agents remain particularly optimistic about the medium-term (beyond 2027) perspective. Given its geographic location and labor market characteristics, Mexico will always have a significant comparative advantage in North America.

Meetings with the Central Bank suggest that the end (or a pause) of the current easing cycle is approaching. The bar for Banxico to continue cutting rates beyond the September meeting is high, consistent with our view. Besides FOMC easing – which is a necessary but not sufficient condition for Banxico cuts beyond September– core inflation should hover around, preferably below, the 4% threshold. This is a moment to be cautious, and the board's forward guidance should change for the next meeting, adhering to a step-by-step approach, possibly with a singular version of the current one: "assess an additional *adjustment*" in lieu of "will assess further *adjustments* to the reference rate". Inflation dynamics are tricky, as core inflation remains sticky and above 4%, while non-core inflation is running unusually low. Given the volatile nature of the non-core group, it should at least return to its historical average, posing risks to headline inflation as well. Discussions did not refer to the cycle's terminal rate, as the short-term scenario remains uncertain. However, if inflation dynamics improve next year, a continuation of the current cycle is expected (any discussion that the next movement might be a rate hike is off the table for now).

Regarding economic activity, **Banxico's staff acknowledged a stronger performance of the Mexican economy,** driven by the industrial sector. Private construction and manufacturing have shown resilience. Although no new projects have been launched, the private sector has maintained existing ones, supporting construction activity. Non-automotive manufacturing has expanded despite tariffs, as some Mexican products cannot be substituted, and the administrative burden has caused delays in tariff collections. Currently, Banxico forecasts a 0.1% GDP expansion

[1] For comparison, our last trip notes from May25 is available at: https://macroattachment.cloud.itau.com.br/attachments/b09c86a5-f65e-4438-aca1-93436fbf4e9c/20250526_MACRO_VISION_Notes_From_Mexico_Trip.pdf

for 2025 and 0.9% for 2026. We expect an upward revision in growth (and a narrower negative output gap) in the next Quarterly Report on August 29, which also contributes to a hawkish twist at the margin.

Our note: *our current scenario anticipates another 25-bp cut in September, with all options on the table beyond that, including pausing or continuing the easing cycle. Our global scenario considers only one 25-bp cut by the Fed in December, which we believe aligns with our 7.5% endpoint. If the FOMC restarts easing in September, Banxico may bring forward some of the cuts we were expecting only in 2026, ending the year at 7.0%, with two additional 25-bp cuts at the beginning of the next year, also consistent with our current FOMC scenario. Our most recent monthly report is available here.*

With fiscal consolidation underway, a revenue-enhancing tax reform seems unlikely in the near term. Revenues this year exceed expectations, mainly due to measures like taxing foreign marketplaces and improving tax collection efficiency. A tax reform seems unlikely in the near future, given the political challenges it presents, as well as the still-relevant low-hanging-fruit gains in terms of increasing revenues through efficiency and tax evasion measures. The administration will present the 2026 budget in early September. While they have not disclosed details of what will be included, it is expected to include support for Pemex. Regarding the macroeconomic framework, they expect downward adjustments to their current GDP estimates for 2025 and 2026[2], which could also imply revising the fiscal deficit forecast upward from a range of 3.2-3.5% of GDP in 2026. Lower expenditure on public infrastructure projects could be reversed in 2026.

The USMCA renegotiation is expected to occur at the end of next year, with overall conditions remaining the same, although there should be a tougher stance on local content rules. Local experts acknowledge that even in a scenario with a bilateral agreement between Mexico and the US, or with several changes in the USMCA, Mexico will remain more competitive relative to other economies. The medium-term outlook for Mexico seems better than anticipated at the beginning of the year, despite the deterioration of domestic institutions due to judicial and electoral reforms.

The electoral reform is expected to take place at the beginning of 2026, and market participants believe it is already priced in[3].

Julia Passabom
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[2] Currently at 1.5-2.3% in 2025 and 1.5-2.5% in 2026.
[3] For more details on the electoral reform please see our Macro Vision available at: https://macroattachment.cloud.itau.com.br/attachments/421864bb-da4b-4ae6-ae39-663a0b15c767/20250812_MACRO_VISION_MEXICO_Electoral_reform.pdf

Mexico | Forecast

	2020	2021	2022	2023	2024	2025F	2026F
Economic Activity							
Real GDP growth - %	-8.4	6.0	3.7	3.4	1.4	**0.6**	**1.2**
Nominal GDP - USD bn	1,121	1,316	1,467	1,798	1,857	**1,943**	**2,035**
Population (millions)	127.7	129.0	130.1	131.2	132.3	**133.4**	**134.4**
Per Capita GDP - USD	8,844	10,218	11,241	13,688	14,033	**14,572**	**15,140**
Unemployment Rate - year avg	4.4	4.1	3.3	2.8	2.7	**2.7**	**2.7**
Inflation							
CPI - %	3.2	7.4	7.8	4.7	4.2	**4.1**	**3.7**
Interest Rate							
Monetary Policy Rate - eop - %	4.25	5.50	10.50	11.25	10.00	**7.50**	**7.00**
Balance of Payments							
MXN / USD - eop	19.9	20.5	19.5	17.0	20.8	**19.0**	**19.5**
Trade Balance - USD bn	34.2	-10.8	-28.1	-12.3	-18.5	**-10.0**	**-10.0**
Current Account - % GDP	2.4	-0.3	-1.2	-0.3	-0.3	**-0.6**	**-0.6**
Foreign Direct Investment - % GDP	2.5	2.5	2.5	2.0	2.0	**2.0**	**2.0**
International Reserves - USD bn	195.7	202.4	199.1	212.8	229.0	**230.1**	**230.6**
Public Finances							
Nominal Balance - % GDP	-2.8	-2.8	-3.2	-3.3	-5.7	**-4.0**	**-3.5**
Primary Balance - % GDP	0.1	-0.3	-0.4	-0.1	-1.5	**0.6**	**0.5**
Net Public Debt - % GDP	49.9	48.9	47.6	46.8	51.4	**52.3**	**52.3**

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

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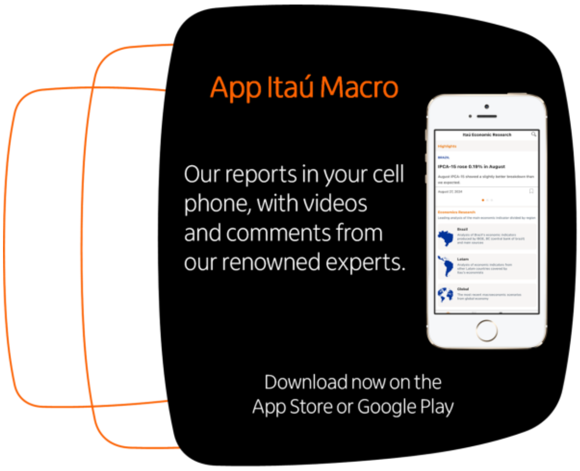

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