Macro scenario - Mexico

June 13, 2025

Hope with a hedge

- Not all signs point South: the economy is slowing but showing some resilience. Few sectors have experienced consecutive monthly contractions, unlike in other periods of economic weakness, while some indicators have delivered better-than-expected results. Additionally, our upward revision to the 2025 US GDP will provide additional support to the economy, leading us to adjust our 2025 Mexico growth forecast to 0.2% from -0.5%, while maintaining our current 1.0% projection for 2026 due to still-high uncertainty.
- We updated our 2025 FX forecast to MXN 20.0/USD from MXN 21.0/USD and our 2026 FX projection to MXN 20.5/USD from MXN 21.3/USD, supported by a weaker USD. Lingering uncertainty and Banxico's easing cycle could exert some pressure on the exchange market at the end of this year.
- We expect Banxico to cut rates by 50-bps in June, followed by a more cautious approach with two 25-bp cuts in August and September, leading to a terminal rate of 7.5% in 2025.

Stabilized uncertainty, unsettled future

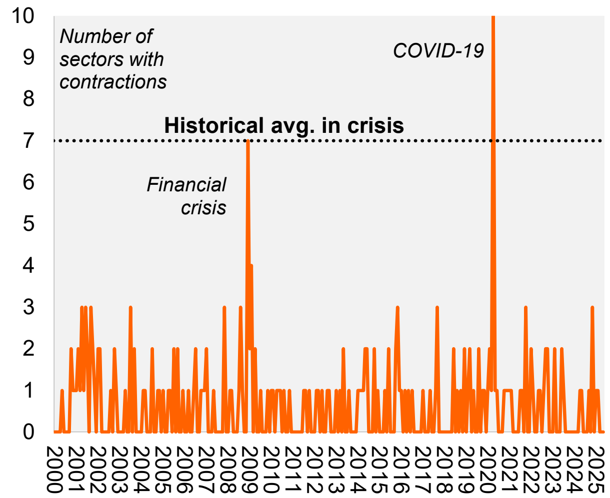
Although the judicial election brought no major surprises, medium-term risks to Mexico's institutional environment persist. The majority elected to the Supreme Court and other judicial positions are aligned with the ruling party and other interest groups. However, since the result was essentially priced in, volatility in Mexican financial assets remained contained, with the domestic risk premium and the USDMXN stable, at least for now.

Not all signs point South

The National Institute of Statistics confirmed that 1Q25 GDP grew by 0.2% QoQ, with a statistical carry-over for 2025 positive at 0.2%. Additionally, historical data was revised, showing a slightly better result for 2023 (from 3.3% to 3.4% YoY) and a decrease for 2024 (from 1.5% to 1.4% YoY). This results in a slightly lower base effect for this year.

When examining the monthly GDP as of March, few sectors have contracted sequentially, unlike in previous periods of economic weakness. The absence of a widespread decline in economic activity allows us to have a somewhat more positive outlook for growth this year. Additionally, some indicators, such as retail sales, exports, and the unemployment rate, have shown better-than-expected results at the margin. Moreover, the upward revision of our 2025 GDP forecast for the US, from 1.2% to 1.7%, should provide additional support to the Mexican economy. We revised **our Mexico 2025 GDP growth forecast to 0.2% from -0.5%, while maintaining our current 1.0% projection for 2026 due to still-high uncertainty.**

There is no widespread decline in economic activity



More than 3 consecutive months of MoM SA contractions.

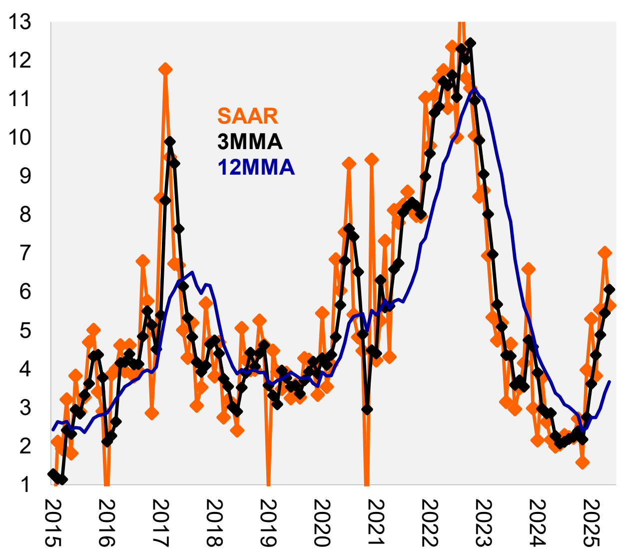
Source: INEGI, Itaú

Disinflation: a completed chapter?

We maintained our year-end inflation forecast at 3.9% and at 3.6% in 2026. In our view, the disinflation phase has largely occurred due to the non-core component, and recent upside surprises indicate increased volatility, mainly in food inflation. Core goods inflation is still showing marginal upward pressure due to a low base effect, while services inflation remains persistent amid a tight labor market.

Although Banxico estimates that the exchange rate pass-through to inflation is limited, especially when the output gap is negative, a stronger-than-expected appreciation of the peso could have a greater impact on core inflation.

Goods inflation is above 5% at the margin



Source: INEGI, Itaú

We maintain a cautious stance. While a slowdown in economic activity could contribute to further disinflation, several factors continue to pose risks to the outlook, such as a potential depreciation of the exchange rate, adverse weather events, and other external shocks. Inflation expectations are floating near the upper bound of Banxico's 3% target range (+/-1%), with one-year survey-based expectations currently at 3.59%.

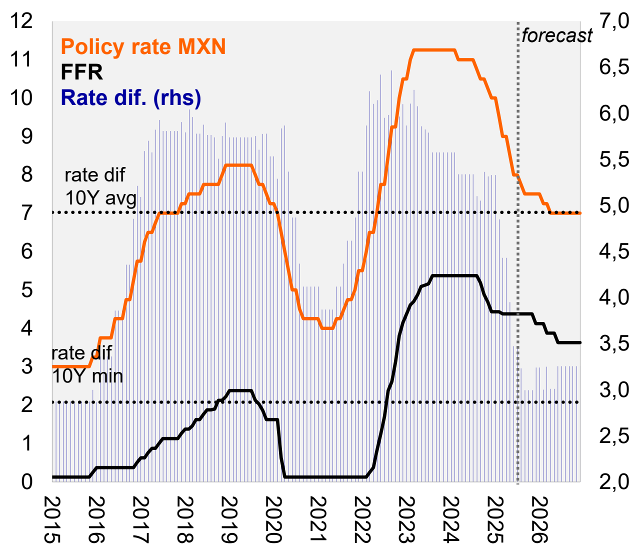
Banxico still on the dovish side

In the minutes of the May 15 meeting, where Banxico unanimously cut rates by 50-bps to 8.5%, the guidance suggested another rate cut of similar magnitude in June. One of the most relevant topics discussed in the meeting, according to the text, was economic weakness, as indicated in the 1Q25 quarterly report, with a downward GDP revision (from 0.6% to 0.1% in 2025 and from 1.8% to 0.9% in 2026). Most board members believe that the economic slowdown will lessen inflationary pressures.

Additionally, the minutes revealed some divisions within the board, with two members discussing the rate differential with the U.S. and one member advocating for a more cautious monetary policy pace going forward. In our view, the next meeting will be crucial to confirm the current forward guidance or introduce a new one that could pave the way for a step down to 25-bp rate cuts.

As of now, we anticipate a more cautious approach after June, with two 25-bp cuts in August and September, leading to a terminal rate of 7.5% in 2025.

A restrictive monetary policy approach will prevail



Source: Banxico, Fred, Itaú

MXN has shown resilience

We updated our FX forecast to MXN 20.0/USD for year-end (from MXN 21.0/USD) and MXN 20.5/USD for next year (from MXN 21.3/USD). We now expect the USD to remain weaker at the margin, which will continue to support the peso throughout the year. However, lingering uncertainty ahead of the USMCA review -set to begin as early as 2026- combined with questions around Banxico's policy direction following aggressive rate cuts and a consistently dovish tone despite recent inflation surprises, could exert some pressure on the exchange market toward the end of this year.

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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	3.4	1.4	**0.2**	-0.5	**1.0**	1.0
Nominal GDP - USD bn	1,121	1,316	1,467	1,798	1,857	**1,935**	1,918	**2,023**	2,005
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	14,033	**14,514**	14,384	**15,050**	14,915
Unemployment Rate - year avg	4.4	4.1	3.3	2.8	2.7	**2.9**	3.0	**2.8**	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	**20.0**	21.0	**20.5**	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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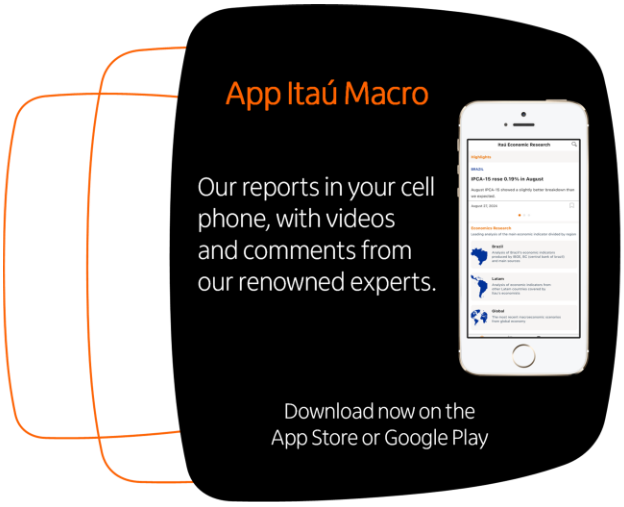

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