May 26, 2025

Notes from our Mexico trip

- Last week, we met with authorities, political consultants, and sectoral experts to discuss Mexico's recent economic performance and outlook amid domestic uncertainties and trade tensions with the US. The overall sentiment seems negative, but with a twist: Mexico's outlook appears worse in absolute terms, although better compared to its own worst-case scenario and without reciprocal tariffs. Banxico should continue easing while inflation remains close to 4%. The judicial elections on June 1 seem to be already priced in, so locals don't expect any further deterioration. Nearshoring and investment decisions are on hold, but the USMCA should prevail. Given its geographic location and labor market characteristics, Mexico will always have a significant comparative advantage.

Main takeaways

Last week, we met with the Central Bank, political consultants, former policymakers, and local experts from key economic sectors like manufacturing and construction.

The overall sentiment seems negative, but with a twist: Mexico's outlook appears worse in absolute terms, although better compared to its own worst-case scenario and without reciprocal tariffs. Despite the challenging and uncertain external environment, domestic policy uncertainty triggered last year seems to be the main driver of business decisions and asset prices. The economy is experiencing significant deceleration, particularly in investment. Market participants expect GDP to grow close to zero this year, with a slightly higher probability of contraction. Additionally, agents will have to contend with a higher domestic risk premium for an extended period. In this context, greater participation of the private sector in infrastructure development and public-private partnerships could present an upside risk to the activity outlook over time.

Meetings with the Central Bank suggest that the easing cycle will continue. Banxico is closely monitoring recent developments, but they are expected to proceed with rate cuts this year, as long as inflation remains close to 4% and the exchange rate is stable. The main transmission mechanism of monetary policy is the exchange rate, which may pose some risks during 2H25, especially given shifting expectations regarding the Fed's policy rate path. The credit channel plays a limited role due to low levels of credit penetration in Mexico. The forward guidance remains in place, making it very likely that Banxico will deliver another 50-bp cut in June. It is important to note that the official communication is in Spanish, so the indication of another adjustment, singular, is correct.

Inflation is nearing pre-pandemic levels, so the policy rate should also come back down. The expected economic deceleration should provide some additional disinflation, while the stable USDMXN is not perceived to pose any significant risk. There seems to be a consensus about the disinflationary net impact of global tariffs, with the growth slowdown and negative impact on commodity prices outweighing the direct upward effect on prices. **Our note:** *discussions align with our scenario; therefore, we maintain our forecast of another 50bps cut in June, followed by two consecutive cuts of 25bps, bringing the policy rate to 7.5% by year-end.*

Sheinbaum remains committed to fiscal consolidation, even if it comes at the expense of public services. The President understands the importance of well-managed fiscal accounts and is dedicated to maintaining the budget. It is difficult to foresee a revenue-enhancing tax reform in the near future, given the political challenges it presents. Market participants suggest that the government is likely to continue implementing measures to boost revenue collection, primarily by further reducing tax evasion and elusion. Maintaining the country's credit rating is important for the administration. Many discussions focused on the medium-term fiscal challenges related to PEMEX, in the context of persistent output declines and rising costs.

President Sheinbaum has successfully conducted all negotiations with the US, which has strengthened her popularity. Looking ahead, she is expected to make concessions to preserve the USMCA framework, such as those related to the rules of origin in the auto industry and China's trade relationship with Mexico. However, uncertainty around the USMCA could persist, as the US is likely to use the upcoming trade revision as leverage in broader negotiations across multiple fronts. The administration has strengthened its focus on domestic security and public safety.

The judicial reform has been relatively priced in, so low volatility in Mexican assets is expected, and a wait-and-see approach will prevail. Potential implications include slower case resolutions, shifts in firms' market power, and greater influence over the judiciary, among other effects.

Nearshoring and investment decisions are on hold due to uncertainty and external political noise, but previously announced projects remain on track. We noticed a more positive outlook from players in the real economy. All agents expect a resolution regarding the USMCA renegotiation, with the free-trade deal ultimately prevailing, albeit with some additional conditions, particularly concerning local content and limiting Chinese imports. While the industry is monitoring domestic uncertainty, it seems to play a limited role in shaping investment decisions, at least in the short term. Given its geographic location and labor market characteristics, Mexico will always have a significant comparative advantage.

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Mexico | Forecast

	2020	2021	2022	2023	2024	2025F	2026F
Economic Activity							
Real GDP growth - %	-8.4	6.0	3.7	3.3	1.5	**-0.5**	**1.0**
Nominal GDP - USD bn	1,121	1,316	1,467	1,793	1,853	**1,918**	**2,005**
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	14,005	**14,384**	**14,915**
Unemployment Rate - year avg	4.4	4.1	3.3	2.8	2.7	**3.0**	**2.9**
Inflation							
CPI - %	3.2	7.4	7.8	4.7	4.2	**3.9**	**3.6**
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	**21.0**	**21.3**
Trade Balance - USD bn	34.2	-10.8	-26.9	-5.5	8.2	**-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: FMI, Bloomberg, INEGI, Banxico, Haver, and Itaú

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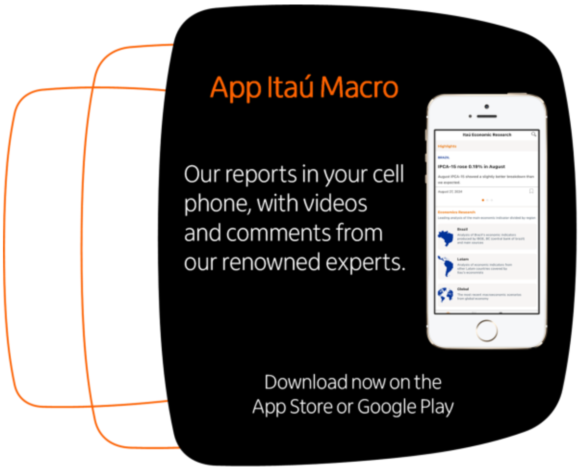

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