

International Commentary — August 8, 2025

One More and Done For Banxico?

Summary

Banxico's August meeting was rather uneventful as most actions taken by Mexico's central bank were largely anticipated. Local economic and market trends suggest Banxico has space for additional easing in September, policy space that is also supported by a Federal Reserve that is likely to lower interest rates next month. With that said, we believe Banxico's easing cycle will end after the September meeting. Core inflation is stubbornly elevated, while the Banxico-Fed rate spread is historically narrow and is a source of high vulnerability to sudden shifts in capital flows to emerging markets. A less dovish outlook for Banxico combined with Mexico being uniquely isolated from expected rises in regional political risk supports our view for near-term Mexican peso strength and longer-term resilience.

Economist(s)

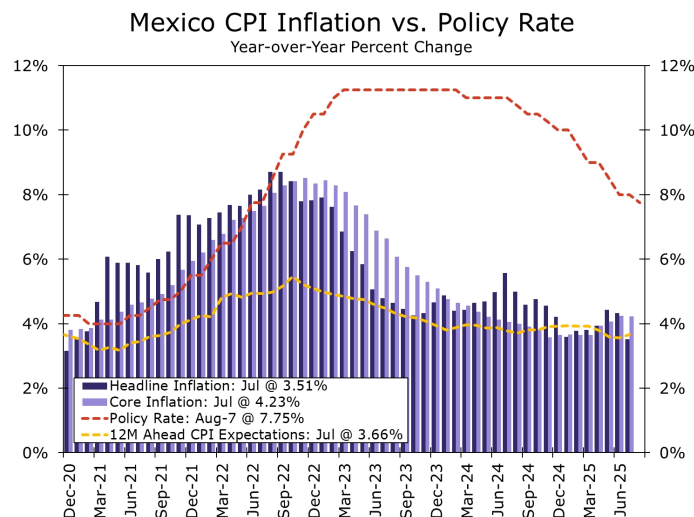
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Don't Expect Much More Banxico Easing Past September

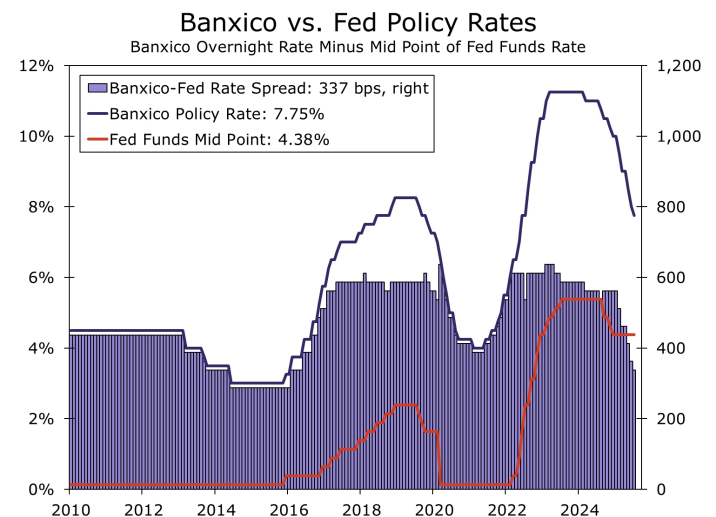
An anticipated policy rate decision in Mexico turned out to be rather uneventful. As expected, Banxico lowered its policy rate by 25 bps to 7.75% at its August meeting. Policymakers continued to demonstrate a modest divergence in views as the decision was split 4-1 with the dissenter in favor of keeping rates unchanged, also as expected. The anticipation associated with the meeting stemmed from the forward guidance that policymakers might offer. Leading into the meeting we believed policymakers would look to give themselves maximum flexibility for future monetary policy decisions. With that said, we were curious if policymakers would commit to further rate cuts or signal a possible end to easing. In line with our view, Banxico's official statement offered little in terms of forward guidance and closely resembled "data dependence" without explicitly using those words. By expressing data dependence, Banxico indeed gives itself room to assess not only the evolution of incoming domestic data, but also external developments, most importantly the Federal Reserve. On the domestic data front, core inflation remains stubbornly high and above the upper bound of Banxico's 3% +/- 1% CPI target (Figure 1). At the same time, an output gap remains in place due to subdued local economic trends, while the peso remains one of the best performing emerging market currencies this year. Externally, soft U.S. labor market data and sluggish U.S. economic trends have led financial markets to price a high likelihood of a Fed rate cut in September. Banxico, historically correlated to Fed monetary policy decisions, will have the luxury of watching what the FOMC does in September before making its own rate decision. As of now, we believe the Fed will deliver a 25 bps cut in September. Fed easing, along with still modest policy space for easing from domestic economic and markets trends, should lead to Banxico delivering another 25 bps rate cut in September.

Figure 1



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 2



Source: Bloomberg Finance L.P. and Wells Fargo Economics

Alongside the September rate cut, we believe policymakers will still communicate data dependence in the official statement. Data dependence will continue to offer policymakers flexibility on future monetary policy decisions, particularly if the Fed delivers multiple rate cuts through the end of this year. However, even if the Fed does cut rates multiple times in the coming months, we are not convinced Banxico's easing cycle extends past September. Not only is core inflation elevated which will constrain monetary policy space for additional easing, but the spread between Banxico and Fed policy rates is historically narrow (Figure 2). While the peso has performed well and capital outflows from Mexico have not materialized in a significant way, we think Banxico will still need to maintain a reasonable gap to prevent sizable capital flow shifts and FX depreciation in the event of a shock. As of now, real rate differentials relative to the U.S. are a source of vulnerability for the peso and Mexico more broadly, while at the same time, multiple potential shocks are on the horizon (Fed uncertainty, reciprocal tariffs, Mexico specific tariffs, USMCA renegotiation, etc.). Staying on hold after the September cut against a backdrop of Fed easing places the direction of travel for the rate spread in favor of the peso, reducing vulnerability to a sudden stop in capital flows to Mexico and emerging markets more broadly. Our Banxico view is less dovish relative to market pricing, supportive of our forecast for the USD/MXN exchange rate to hit MXN18.50 by the end of this year. We also believe

peso strength and overall resilience can be a product of Mexico being excluded from the upcoming Latin America election cycle. Broadly speaking, we expect political risk across Latin America to rise noticeably leading into elections; however, Mexico will be uniquely excluded from that trend. For market participants that want exposure to high carry currencies with limited political risk, Mexico and the peso offers a solid option that we believe can also support the currency through the end of this year but also over the medium-to-longer term.

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