

MEXICO

24

LIMITED ROOM FOR MANOEUVRE

Mexican economic growth held up well in the first half of 2025. The slowdown is expected to be more pronounced in the coming quarters: export momentum is likely to diminish due to the implementation of US tariffs, while domestic demand is expected to remain sluggish. Inflation is expected to decelerate moderately, and the cycle of monetary policy easing is likely to continue in 2026. Public finances represent a structural weakness in the Mexican economy. Consistent support for the oil company Pemex, fiscal spending rigidity and overly optimistic projections used by the government when setting its annual budget have resulted in the failure of the consolidation policies proposed by successive administrations. Consequently, the fiscal deficit has been widening since 2019. Against a backdrop of slowing growth, the government's room for manoeuvre to support the economy is limited.

SLUGGISH GROWTH

Economic activity held up slightly better than expected in the first half of 2025, with real GDP growing by 0.9% year-on-year (y/y). Strong exports compensated for weak domestic demand. Contributions from private consumption and investment were negative (with total private demand contributing -1.0 and -1.6 percentage points in Q1 and Q2, respectively).

The short-term outlook is not promising. The preliminary estimate of GDP in Q3 shows a contraction of 0.3% compared to Q2. On the one hand, the decline in private consumption and investment is expected to continue (see Chart 1). Investor and consumer confidence indices deteriorated during the first eight months of the year, while remittances from overseas workers (representing nearly 4% of GDP and a significant source of support for Mexican private consumption) have decreased every month since April (down 8.3% y/y in August).

This trend reflects workers' concerns about changes in US immigration policy, the slowdown in the US labour market and, to a lesser extent, the peso's appreciation against the dollar (over 11% since the beginning of the year). This trend is likely to continue over the coming months. Finally, the decline in industrial production worsened during the summer (-2.7% and -3.6% y/y in July and August respectively, after -1.3% in the first six months of the year).

Furthermore, the expected growth slowdown in the United States (85% of Mexico's total exports) and trade tensions between the two countries will impact exports in the coming months. Overall, economic growth is projected to rebound slightly in 2026, following a significant slowdown in 2025. While forecasts suggest that Mexico will avoid recession, the risks remain on the downside.

PLANS TO INCREASE TARIFFS

At the end of September, President Sheinbaum announced plans to increase customs tariffs on nearly 1,500 products from countries with which Mexico does not have a free trade agreement, targeting Asian countries in particular, including China. Should Parliament adopt this tariff increase (discussions are set to continue until the end of November), the implementation will begin in January and last for one year. This initiative is seen as a continuation of the "Mexico Plan" introduced in January 2025, which aims to bolster domestic industry, restrict low-cost imports and increase tax revenues.

It appears that the Mexican government seeks to provide the Trump administration with further assurances regarding the reduction of its trade with China, especially as negotiations for the renewal of the US-MCA agreement are expected to conclude by mid-2026.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	3.9	3.2	1.5	0.5	0.9
Inflation, CPI, year average, %	7.9	5.6	4.2	3.9	3.7
Budget balance / GDP, %	-4.3	-3.3	-5.1	-4.4	-4.6
Public debt / GDP, %	46.9	46.5	49.1	52.5	55.5
Current account balance / GDP, %	-1.2	-0.3	-0.9	-0.4	-0.6
External debt / GDP, %	41.9	33.3	31.0	32.0	33.0
Forex reserves, USD bn	194.0	207.0	214.0	219.0	226.0
Forex reserves, in months of imports	4.8	4.1	4.3	4.5	4.2

TABLE 1

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MEXICO: SLOWDOWN IN DOMESTIC DEMAND

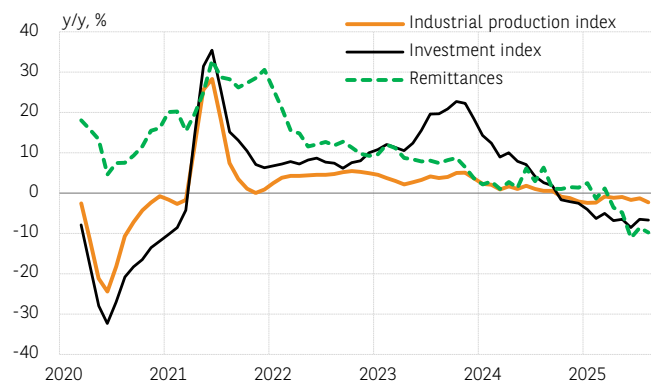


CHART 1

SOURCE: INEGI, BNP PARIBAS

The aim is to limit Mexico's role as a "connector country" (where Chinese products are imported into Mexico, processed and then re-exported to the United States, thereby evading tariffs). Mexico's bilateral trade deficit with China has almost doubled since the first wave of US tariffs in 2018, rising from USD 65 billion in 2017 to USD 119 billion in 2024. The tariff measure would affect around 10% of total imports (36% of total imports originate from countries without a free trade agreement with Mexico; China alone accounts for 21% of the total). The average tariff on Mexican imports would rise to 34%, compared with 16% currently.


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In the short term, if the new Mexican tariffs are indeed enforced, Mexican import and industrial production levels are not expected to change significantly. Developing Mexican alternatives to Chinese imports will take time. Therefore, in the coming months, substitute products will continue to be imported from other countries or regions.

On the other hand, there is a short-term risk of increased supply chain costs (imported products will generally be more expensive than Chinese products). This could result in a rise in the prices of certain consumer products.

Furthermore, if the measure is indeed temporary as announced, there will be very little incentive to invest in the development of specialised products that would lose competitiveness once tariffs are lifted.

THE CYCLE OF MONETARY EASING IS NOT YET COMPLETE

In September, inflation rose for the second month in a row (to 3.8% y/y), following a brief period of disinflation in June and July, partly due to rising consumer goods prices. Core inflation has been rising since the beginning of the year (reaching 4.3% y/y in September) and has been above the Central Bank's upper threshold (4%) since May.

Despite ongoing inflationary pressures, the Central Bank lowered its key interest rate by 25 basis points (to 7.5%, the lowest it has been in three years) at its last meeting at the end of September. Easing measures could continue in the coming months, with the Central Bank citing the appreciation of the peso, a slowdown in economic activity and significant uncertainty surrounding US trade policy in its minutes published in mid-October. The Central Bank reaffirmed its goal of bringing inflation down to 3% by Q3 2026.

PUBLIC FINANCES: CONSOLIDATION WILL TAKE TIME

Public finances are a structural weakness of the Mexican economy. The budget deficit has widened steadily in recent years and is expected to reach nearly 4.4% of GDP in 2025 (up from 1.6% in 2019).

Three main characteristics can be identified in the budgets adopted in recent years, which account for the ongoing deterioration of the deficit: 1/ The government's ability to adjust its spending has significantly diminished in recent years (see Chart 2). Several categories of social transfers, subsidies and pensions have increased since the previous government and are expected to continue rising in the coming years, especially if the constitutional reforms proposed by the current government are adopted (such as an increase in pensions). During periods of austerity, the inability to reduce this type of expenditure necessitates a reduction in public investment, which negatively impacts growth prospects. 2/ Financial support for the oil company Pemex has averaged 0.8% of GDP each year since 2019, and 3/ The macroeconomic projections used in the budget tend to be overly optimistic, particularly regarding GDP growth and oil production. This leads to inflated revenue estimates. As she promised during her campaign, President Sheinbaum does not intend to introduce a significant tax reform aimed at optimising spending and improving tax collection.

The 2026 budget unveiled last September follows this trend. Based on particularly optimistic assumptions (with GDP growth expected to reach 2.3% in 2026), the government aims to reduce the public deficit to 2.5% of GDP by 2030 (4.1% in 2026).

MEXICO: INCREASED RIGIDITY OF PUBLIC SPENDING

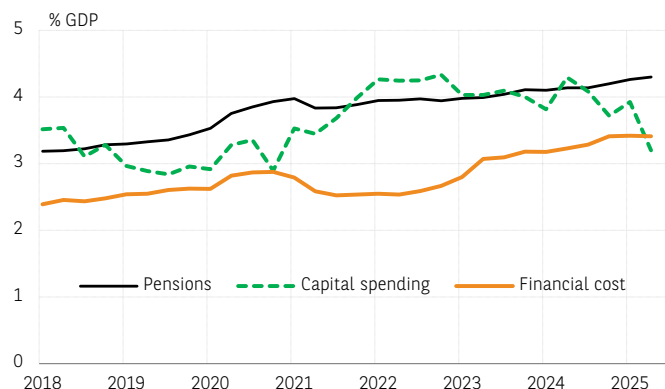


CHART 2

SOURCE: SECRETARY OF FINANCE AND PUBLIC CREDIT, BNP PARIBAS

Once again, these targets appear difficult to achieve. For 2025, the government has already revised its deficit forecast upwards to 4.3% of GDP (3.9% in the 2025 budget), mainly due to oil revenues falling short of initial projections.

In our scenario, the fiscal consolidation seen in 2025 (linked to a new tax on e-commerce) is unlikely to continue in 2026. The revenue generated by increased customs tariffs on imports will probably not be enough to compensate for the impact of the downturn in economic activity. Finally, the creation of a public-private investment fund at the end of August will allow for some continued support for Pemex outside the budget. However, the promise to end ongoing support for Pemex by 2027 seems very ambitious.

In this context, the government's room for manoeuvre to support the economy is severely constrained. A deviation in the public deficit would be worrying, given the trajectory of debt. The government is facing higher interest rates on its borrowing, and interest payments have risen in recent years. They could surpass 17% of revenue in 2025, compared with around 12% in 2019. The average interest rate on public debt is now greater than nominal growth, indicating that a larger primary surplus than previously estimated (which we project at 1.8% of GDP) is needed to stabilise the public debt ratio. However, the primary balance has generally averaged around 0.9% since 2019. In other words, the public debt ratio (projected to be 52.5% of GDP in 2025) is expected to keep increasing in the coming years.

However, sovereign risk remains limited in the short term due to a favourable public debt profile: maturities are extended, exposure to currency risk is moderate (with 23% of total debt in foreign currencies) and the Mexican government enjoys easy access to international financial markets. However, the government is vulnerable to shifts in investor sentiment, as 30% of the public debt in pesos is held by foreign investors.

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