

COMMUNICATION

## Experts split over wisdom of Mexico's 25bp rates cut

Economist says policy committee's sole dissenter was right to vote to hold

By Riley Steward

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The Bank of Mexico (Banxico) cut rates by 25 basis points on August 7, as analysts had been expecting.

The monetary policy committee approved the decision by four votes to one. Jonathan Heath, a former Banxico deputy governor, was the sole dissenter, arguing that the rate should be held. Heath had dissented in the same way at the bank's previous meeting in June, arguing that core inflation was too high and policy should remain restricted.

Headline inflation in Mexico was 3.51% year on year in July, compared with 4.24% in June. However, core inflation was 4.23% in July, down only slightly on the 4.24% recorded in June.

Jose Balmori-de-la-Miyar, professor of development economics at Anahuac University in Mexico City, believes Heath's judgement was correct. He says Banxico's inability to get core inflation under control is threatening its credibility, and that further cuts could damage its reputation.

"Inflation has continued to slow during the second half of July," he says. "However, this slowdown is entirely driven by the non-core component, which is precisely the most volatile."

However, Lucinda Vargas, professor of economics at New Mexico State University, believes the cut maintains a balance between incentivising growth and price stability. Growth, she says, is expected to be barely positive, while inflation is close to Banxico's 3% target.

Vargas says internal factors, such as weak domestic consumption and investment, and external ones, such as US tariffs and lower remittances, are contributing to increased uncertainty for the economy and the central bank.

She says Banxico also needs to consider Mexico's continued law and order crisis. "Rampant violence and crime, much of it spurred by organised crime syndicates, combined with a weak rule of law thwart business activity and investment," she says. "Such conditions represent a structural drag on long-term economic growth – a key concern for any central bank." Vargas believes the threat to the economy from violent crime is far greater than "any immediate tariff threat."

Belinda Román, professor of economics at St Mary's University in San Antonio, says the current discussions over US tariffs place additional pressure on the central bank to maintain price stability.

"Banxico has as its mandate to preserve the value of the peso, which places it squarely in the world of international trade and finance," she says. "Since the country's largest trading partner is the US, the value of the peso *vis-à-vis* the US dollar is important."

Román says growth, employment and inflation are difficult terrain to navigate because they form "a triangle of impossible trade-offs". Banxico's mandate is clear, she says, but achieving it is more complex.

She believes the present media environment and the speed at which information travels make it difficult for the bank to communicate its strategy and maintain credibility. "Whatever their press release might say, it will be scrutinised and parsed for keywords that can be interpreted in a variety of ways," she says. The professor says although she finds the bank's messaging clear, others may not and will infer a variety of different things from what is being reported.

## Financial stability

Balmori-de-la-Miyar says Banxico, in co-ordination with other authorities, will need to monitor the broader stability of Mexico's financial system.

The US Treasury in June accused two small Mexican banks and a brokerage firm of financing a drugs cartel. It issued an order prohibiting US financial institutions from transacting with the firms. The order has been suspended, until September, after the Mexican government took over the firms on June 26.

Balmori-de-la-Miyar says that although the firms may represent a small percentage of total bank assets in Mexico, "future investigations into banks in Mexico could undermine confidence in the financial system".