ECONOMIC OUTLOOK

MEXICO

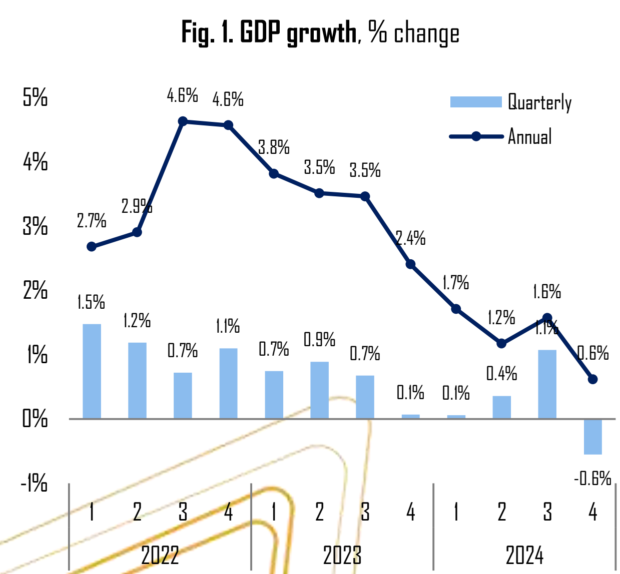
JANUARY 2025

GDP GROWTH IN 2024

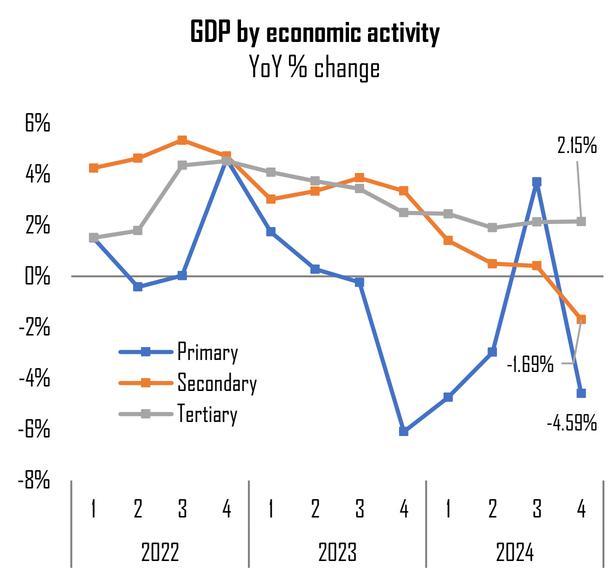
The timely estimate of Gross Domestic Product (GDP) growth published by INEGI shows that Mexico's economy grew 1.3% in 2024, with respect to the previous year. This shows a sharp deceleration from the 3.2% growth observed in 2023. The fourth quarter data show that GDP contracted 0.55% from the previous quarter, a larger than expected decline (-0.3%). This is the first quarterly contraction in GDP since the third quarter of 2021, and before that since the second quarter of 2020, when it plunged due to the pandemic. With the 0.55% quarter-over-quarter decline, the annual growth rate in the fourth quarter is 0.62%. With growth of 1.3% in 2024, Grupo Financiero BASE estimates that GDP per capita had growth of 0.52% and is still 0.52% below 2018 levels.

Breaking down the timely estimate figures by major groups of economic activity, we observe that the quarterly contraction of 0.55% was concentrated in primary activities (-8.89%, its largest drop since the second quarter of 1999) and secondary activities (-1.21%, its largest drop since the second quarter of 2020). On the other hand, tertiary activities, also known as the service sector, registered a quarterly growth of 0.22%. Likewise, tertiary activities were the only ones to register annual growth in the fourth quarter, growing 2.15%. In contrast, primary activities showed an annual contraction of 4.59% in the fourth quarter, while secondary activities fell 1.69%. This is the largest annual decline for the secondary sector since the third quarter of 2020, and looking beyond pandemic quarters, annual contractions greater than this are only observed in quarters of recessions: 2019, 2009, 2001-2002, 1995, 1986, and 1983.

In all of 2024, growth of 1.3% was driven by the tertiary sector, with growth of 2.2%. Secondary activities barely managed to remain at the same levels as in 2023, with an annual growth of 0.1%. Finally, primary activities fell 2.2% in the year.



Source: Grupo Financiero BASE with information from INEGI.



Source: Grupo Financiero BASE with data from INEGI.

For 2025, Grupo Financiero BASE estimates that in a central scenario, Mexico's GDP will grow 0.8%, maintaining a deceleration trend but without entering into contraction. By 2026, a rebound in economic activity is expected, with growth close to 2%. However, the outlook continues to be marked by high uncertainty, since, in addition to the internal challenges facing Mexico, significant external risks have emerged, particularly from the United States.

CONTEXT OF THE MEXICAN ECONOMY

The Mexican economy faces a complex scenario at the beginning of 2025, marked by important changes both internally and externally. Following the federal elections of June 2024, Dr. Claudia Sheinbaum, candidate of the MORENA-led coalition, assumed the presidency in a context characterized by high political and economic uncertainty. MORENA's triumph in both houses of Congress ensured the continuity of the political ideology implemented by Andrés Manuel López Obrador, including a strong role of the State in key sectors of the economy and an increasing participation of the armed forces in civilian tasks.

However, Sheinbaum's administration also inherits considerable challenges, such as a historic level of indebtedness and the need for fiscal consolidation in 2025. Public spending during 2024 was exceptionally high, driven by the last year of López Obrador's administration, which prioritized social programs and the completion of flagship infrastructure projects. This spending, largely financed with debt, brought the Historical Balance of Public Sector Borrowing Requirements (RFSP) to 50.2% of GDP, well above the 43.6% at the close of 2018. By 2025, the Ministry of Finance and Public Credit (SHCP) has proposed a reduction in indebtedness to 3.9% of GDP, which implies a significant cut in spending, mainly in public investment, while mandatory spending, such as pensions and debt service, continues to grow.

Added to this is the approval of the judicial reform, which allows for the popular election of judges, magistrates and ministers. This change has generated concern among investors due to the potential weakening of the rule of law, affecting the protection of property rights and confidence in institutions.

On the external front, Donald Trump's return to the U.S. presidency on January 20, 2025 introduces significant risks for Mexico. Trump's "America First" agenda includes protectionist trade measures, renegotiation of trade agreements and increased restrictions on migration, which could negatively impact Mexican exports, remittances and foreign investment. Additionally, in his inaugural speech he designated Mexican cartels as terrorist organizations, which could strain diplomatic relations and generate additional uncertainty.

The Mexican economy also faces the risk of the revision to the Mexico-U.S.-Canada Agreement (T-MEC) scheduled for 2026, which could become another pressure factor, and one that will undoubtedly be used by the Trump administration as a negotiating technique for issues related to migration and drug trafficking at the border.

Inflation moderated during 2024, closing the year at 4.21% annually, compared to 4.66% in December 2023. Although headline inflation did not register a significant decrease, core inflation fell from 5.09% to 3.65% in the same period, which is undoubtedly an improvement, as the core rate is the best measure to assess the trend in the price level. For 2025, headline inflation is expected to continue its downward trend, closing at approximately 3.9%, due to lower inflationary pressures in part because of the economic slowdown in Mexico. However, it is important to remember that there are still risk factors that could lead inflation to rebound, particularly in the non-core component (agricultural products and energy).

In its fight against high inflation, Banco de México ended 2024 with a target interest rate of 10.00% after having made several cuts totaling 125 basis points. Given that the ex-ante real interest rate remains elevated at 6%, above the estimated level of the neutral real interest rate (between 1.8% and 3.6%), Banco de México's Board of Governors considers that there is sufficient room to continue easing its monetary stance. Rate cuts are expected to continue during 2025 and could end 2025 at 8.50%.

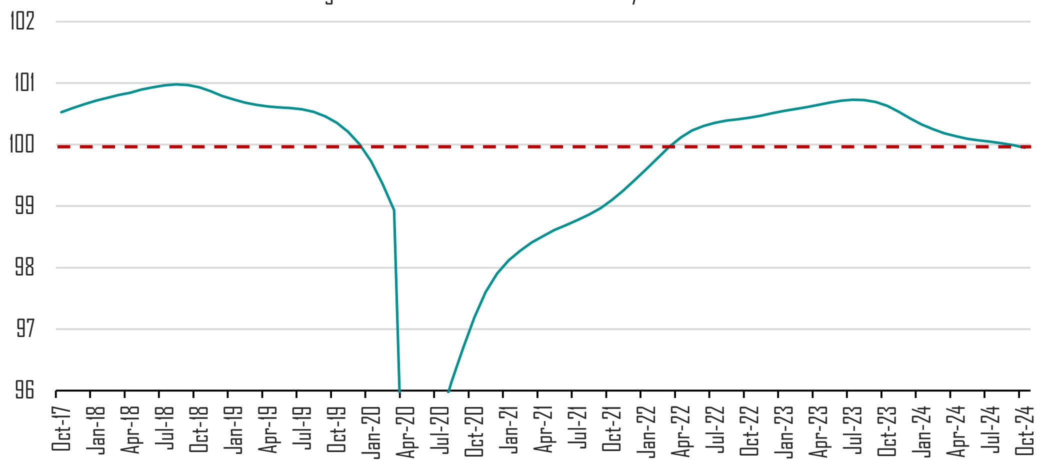
The economic outlook for 2025 is marked by a combination of internal uncertainty and external pressures. The need for fiscal adjustment will undoubtedly be a drag on consumption and investment, while risks associated with the relationship with the United States, the weakening of the rule of law in Mexico, and geopolitical tensions introduce further obstacles to the country's economic growth.

Although there are positive factors that could boost consumption and investment, such as moderating inflation and a possible easing of monetary policy, Mexico faces an environment of many challenges, in which it will be crucial for the government to play a good role as a promoter of Mexico, seeking to strengthen confidence in the economy, encourage investment and promote macroeconomic stability.

It is worth noting that the system of cyclical indicators (SIC) published by INEGI shows that, under the methodology used by the Organization for Economic Cooperation and Development (OECD), Mexico's economy is already in a recessionary phase of the business cycle[1] . This does not imply that Mexico is in recession, since the other SIC methodology shows that Mexico's economy is still expanding. Moreover, there is no data yet to suggest a significant and widespread decline in economic activity.

[1] In October 2024 (most recent data), the coincident indicator decreased for the fifteenth consecutive month, something that had not occurred since the period from September 2018 to May 2020, when it fell for twenty consecutive months. With this, the indicator has been below the long-term trend (100 points) for two months, so that the economy is considered to be in a recessionary phase. Furthermore, the clear downward trend of the leading indicator suggests that the recessionary phase of the economic cycle could continue in the following months.

Fig. 3. Cyclical Indicator System: Coincident Indicator
100 = Long-term trend of the Mexican economy



Source: Grupo Financiero BASE with information from INEGI.

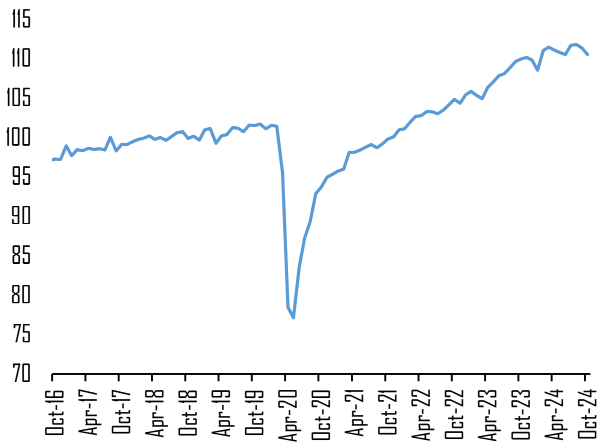
COMPONENTS AND DETERMINANTS OF AGGREGATE DEMAND

PRIVATE CONSUMPTION

Private consumption (by households and companies) constitutes the largest part of aggregate demand, accounting for approximately 71% of Mexico's GDP. Consumption is a key indicator for assessing the economic well-being of the population, as it reflects the ability of families to acquire the goods and services that satisfy their needs and improve their quality of life. A high level of consumption is in turn a reflection of the various economic variables that determine it. The main variable that determines consumption is income; however, consumption decisions are also influenced by factors such as consumer confidence in the economy, the level of interest rates and changes in expectations about the future. In a context of uncertainty, such as the one we are currently experiencing, consumers are likely to adopt a more cautious stance, which could affect the level of consumption and, therefore, economic growth.

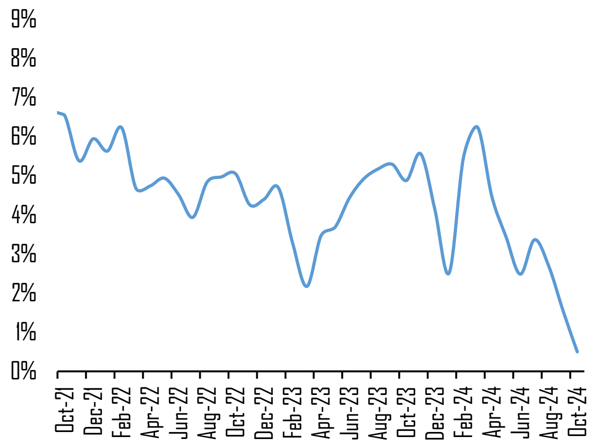
The monthly indicator of private consumption in the domestic market published by INEGI shows an annual growth of only 0.50% as of October 2024 (Fig. 5), the lowest rate since February 2021, when an annual contraction of 5.36% was recorded in February 2021, when contractions were still observed due to the COVID-19 pandemic. In the first ten months of 2024, cumulative growth over the same period of 2023 is 3.25%, the lowest for a same period since 2020, when due to the pandemic a contraction of 10.67% was recorded. However, it is important to analyze these consumption growth figures taking into account the history before the pandemic. After the twelve months following the collapse in consumption in the early 2020s, the baseline for calculating annual growth rates was quite low, so the indicator began to show high growth rates. In the years following the crisis of COVID-19 such high growth rates were observed in many economic indicators, that the observed growth of 3.25% per annum in the first ten months of 2024 is considered low. However, between the drops in consumption in 2009 and 2020, the indicator only registered growth rates higher than 3.25% in 2010 and 2011 (which likewise corresponded to high growth on a low comparison basis). The average annual growth rate of consumption from 2012 to 2019 was 1.93% (in the first ten months of each year); in this context, growth of 3.25% in the first ten months of 2024 should not be considered low and indicates that private consumption remains resilient in the face of an uncertain outlook for the Mexican economy.

Fig. 4. Private consumption indicator
2013 = 100



Source: Grupo Financiero BASE with information from INEGI.

Fig. 5. Private consumption indicator
YoY % change



Source: Grupo Financiero BASE with data from INEGI.

Now, it is important to analyze the performance of consumption from a breakdown by type of consumption. Consumption of domestic goods and services registered a contraction of 0.16% in October 2024, while consumption of imported goods grew by 4.14%. Likewise, the consumption of domestic goods and services shows an annual growth of 1.21% in the first ten months of 2024, while the consumption of imported goods grew 16.17% in the same period. This is important because it means that the resilience of private consumption in Mexico is largely due to the fact that the consumption of imported goods has remained strong, and this type of consumption may have different determinants than the consumption of domestic goods, the most important being the exchange rate. Between March 2022 and September 2024, the exchange rate remained below 20 pesos per dollar, after having exceeded levels of 22 pesos per dollar in previous years. This appreciation of the peso against the dollar made imported goods more attractive to consumers in Mexico. Now that the exchange rate is back above 20 pesos to the dollar, it is very likely that we will begin to see a drop in the consumption of imported goods. If this materializes, the likelihood of Mexico falling into recession will increase significantly.

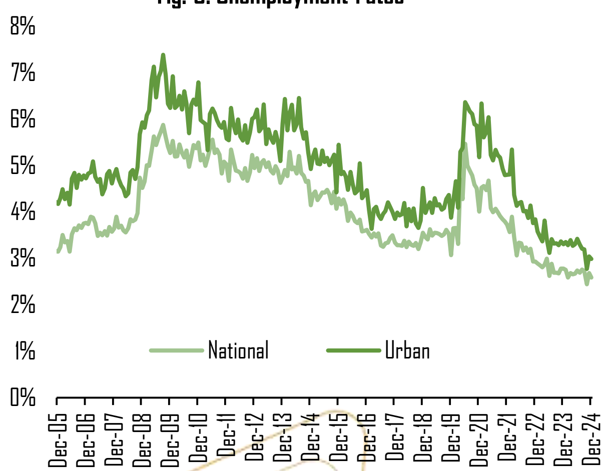
LABOR MARKET

The National Occupation and Employment Survey (ENOE) published by INEGI shows that at the end of 2024, the Economically Active Population (EAP) was at a level of 60.80 million people, which means that during the year it increased by 66 thousand people, equivalent to a growth of 0.11%. This growth in the EAP occurred with an increase in the employed population of 175 thousand people and a decrease in the unemployed population of 109 thousand people. In percentage terms, this means that employment grew 0.30%, and the unemployed population fell 6.84%.

The 0.30% increase in the employed population in 2024 is the lowest since 2020, as employment plummeted in that year due to the pandemic. Prior to that, the lowest rate of growth in the employed population is 2014. Formal employment figures according to the Mexican Social Security Institute (IMSS) show something similar. The variation in formal employment in December 2024 was 1.79%, which excluding the contractions registered during the pandemic, is the largest monthly drop since December 2018. That is, it exceeds the drop observed in December 2019, when there was a recession. These figures are worrisome and suggest that the economy could be close to entering a stagnation or recession. Likewise, the trend in the annual growth rate also seems to show that negative rates could soon be recorded. However, it is important to consider that the slowdown also comes at a time when the unemployment rate is near historic lows.

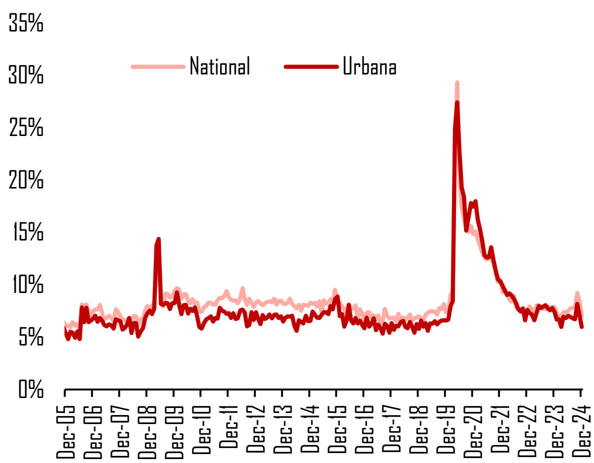
At the end of 2024, the national unemployment rate stood at 2.59%, an improvement over the 2.78% rate recorded at the end of 2023. Since the series began in 2005, unemployment rates have only twice been lower than 2.59% in December 2024, and both were in the same year: February 2024 (2.59%) and October 2024 (2.44%, the historic low). The urban unemployment rate, which is a more accurate indicator than the national unemployment rate because it better reflects the dynamics of the labor market in cities, where most formal economic activity is concentrated, closed 2024 at 2.99%. This is the lowest rate since October 2024 (when the historical minimum was recorded) and prior to that there is no record of a lower rate. In addition, the underemployment rate also showed an improvement over the year, going from 7.90% in December 2023 to 7.10% in December 2024, the lowest rate since March 2024. This is important, as in addition to job creation, the jobs that are created are, on average, getting better, as fewer people require additional work to meet their needs.

Fig. 6. Unemployment rates



Source: Grupo Financiero BASE with information from INEGI.

Fig. 7. Under-employment rates

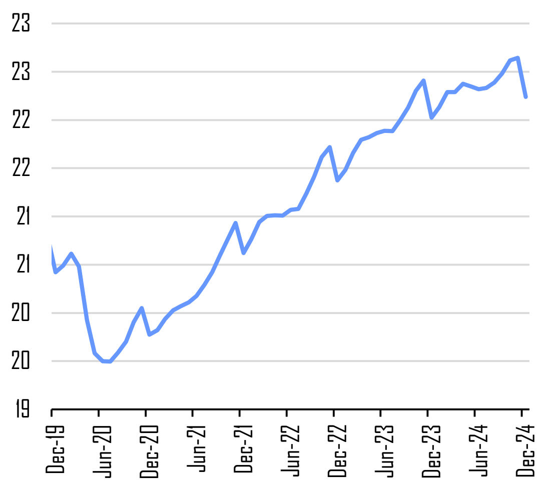


Source: Grupo Financiero BASE with data from INEGI.

When unemployment rates are very low, it is common to see a slowdown in the creation of new jobs. This is because most people are already employed, which limits the number of workers available to fill new vacancies. This phenomenon is often interpreted as a sign that the economy is operating close to its full employment level. This can also be evidenced by higher wage pressures, as companies compete for a reduced pool of workers. IMSS figures show that the average base contribution wage continues to grow at high rates, registering an annual growth of 9.20% in December.

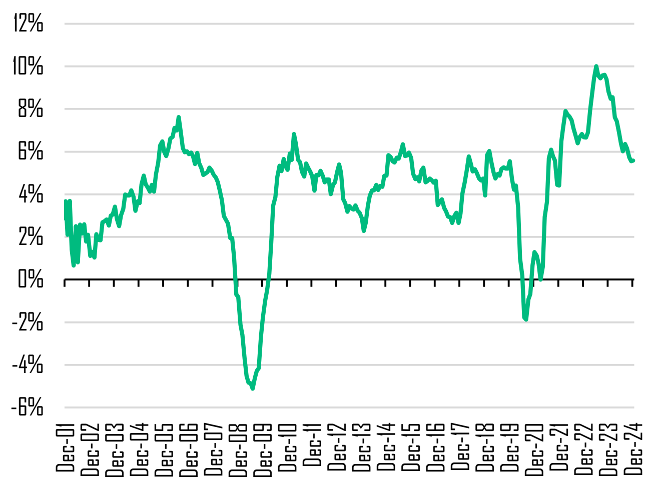
Using IMSS wage and employment data, an estimate of the behavior of the real wage bill can be obtained by multiplying the average contribution base wage by the total number of jobs insured with the institute. In 2024, formal employment grew 0.97% and the real base salary (adjusted for inflation) increased 4.56%, resulting in an increase in the real wage bill of 5.58%. In 2024, the average growth rate of the real wage bill stood at 6.74%. While this growth rate falls short of the 8.84% average in 2023, real wage bill growth is still high compared to pre-pandemic levels. In 2019, a year of recession in Mexico, the real wage bill showed an average increase of 5.29%, while in 2018 it registered one of 4.85%. In fact, subsequent to the contractions observed during the Great Recession and before the pandemic crisis in 2020, the highest annual growth rate was 6.82% in March 2011. In this context, the average growth of 6.74% in 2024, or even the point annual growth rate of 5.58% in December 2024, is considered high.

Fig. 8. IMSS-affiliated jobs. Millions of people



Source: Grupo Financiero BASE with information from INEGI

Fig. 9. Real wage mass according to IMSS figures. YoY % change



Source: Grupo Financiero BASE with data from INEGI.

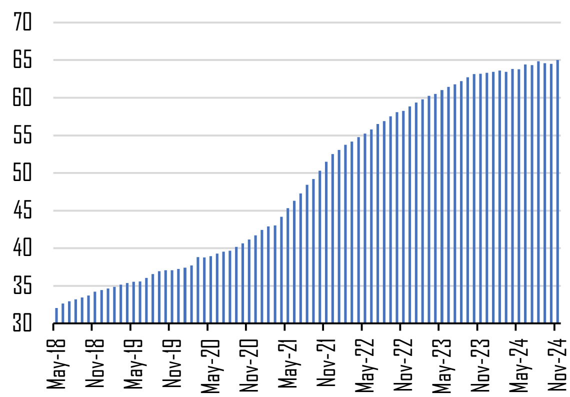
REMITTANCES

Another important determinant for the growth of private consumption in Mexico is remittances, which are the resources that people abroad, mainly in the United States, send to their families in Mexico. In November 2024, remittances grew 10.63% annually, reaching a cumulative flow for the last 12 months (December 2023 to November 2024) of 65,014.71 million dollars, a new historical maximum and an increase of 0.81% with respect to the cumulative flow for the previous 12 months.

Remittance inflow data is published by Banco de México in U.S. dollars, but what is relevant for Mexico's economy and households is the growth in the purchasing power of these remittances.

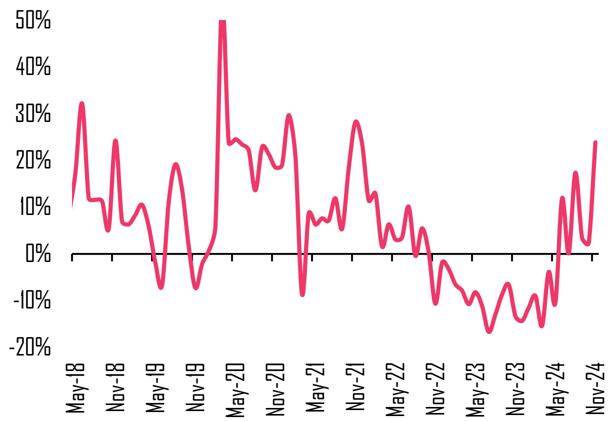
When the peso depreciates against the dollar, remittance recipients are getting more pesos for the same amount of dollars. In this sense, due to an annual peso depreciation of 17.08% in November 2024, remittances measured in Mexican pesos grew 29.53% annually. Adjusting for inflation, the purchasing power of remittances grew 23.89% annually in the same month (Fig. 11). This increase reflects a substantial improvement in household disposable income, which tends to boost private consumption. However, this positive effect will depend on the continuation of these favorable conditions in the exchange market and inflation.

Fig. 10. Cumulative remittance flows over the last 12 months, billions of dollars



Source: Grupo Financiero BASE with information from Banxico

Fig. 11. YoY % real growth in purchasing power of remittances monthly inflows



INEGI Source: Grupo Financiero BASE with data from Banxico

Grupo Financiero BASE estimates that remittances in dollars will have grown 3.8% in 2024, and that their purchasing power will have grown 2.9%. By 2025, remittances in dollars are estimated to grow 3.3%, with an average exchange rate of 19.50 pesos per dollar and inflation of 4.1% per year, which would give a growth in the purchasing power of remittances of 5.1% per year. However, the risks of a weakening U.S. labor market and possible restrictions on remittances under the new Trump administration persist. Given that remittances accounted for about 2.6% of GDP in 2024, any significant decline would negatively impact Mexico's economic growth.

According to figures from the report "New Americans in the United States" prepared by the American Immigration Council, there are a total of 46.12 million migrants living in the United States. Of these, it is estimated that 23.1% are Mexicans, that is, approximately 10.65 million Mexicans living in the United States. Of these, it is estimated that close to 4 million Mexicans are in the United States illegally and are at risk of being deported due to President Trump's immigration policies. However, it is important to make a distinction between Trump's speech and his actions. Trump's first administration may be popularly known for being tough on migrants, but figures from the U.S. Department of Homeland Security's Office of Homeland Security Statistics show that during his first administration (2017-2021) there were fewer deportations than in each of the two Obama administrations (2009-2012 and 2013-2016).

Although remittances may not be affected as much, slight decreases in flows could have important consequences for many households in Mexico, particularly in entities highly dependent on remittances. Taking GDP figures by state, available for 2023, and the remittances each received in that year converted to pesos, we can get a measure of how dependent their economies are on remittances. The 2023 figures show that the five most vulnerable entities, according to the percentage that remittances represent of their GDP, are Chiapas (15.57%), Guerrero (13.76%), Michoacán (10.90%), Zacatecas (10.57%) and Oaxaca (9.83%). Furthermore, these percentages are very high compared to the percentage that total remittances represent of Mexico's GDP, which in 2023 was 3.53%.

Table 1. Remittances as a percentage of GDP, figures for 2023.

	State	Remittances as % of GDP		State	Remittances as % of GDP
1	Chiapas	15.57%	17	Veracruz	3.37%
2	Guerrero	13.76%	18	Querétaro	2.90%
3	Michoacán	10.90%	19	Sinaloa	2.86%
4	Zacatecas	10.57%	20	Estado de México	2.68%
5	Oaxaca	9.83%	21	Chihuahua	2.29%
6	Nayarit	7.09%	22	Tamaulipas	2.07%
7	Guanajuato	6.83%	23	Baja California	2.05%
8	Morelos	6.04%	24	Coahuila	1.58%
9	Durango	5.99%	25	Yucatan	1.52%
10	Hidalgo	5.71%	26	Sonora	1.52%
11	Puebla	5.08%	27	Ciudad de México	1.45%
12	San Luis Potosi	4.91%	28	Quintana Roo	1.38%
13	Colima	4.14%	29	Baja California Sur	1.34%
14	Jalisco	3.98%	30	Nuevo León	1.04%
15	Aguascalientes	3.93%	31	Tabasco	0.97%
16	Tlaxcala	3.89%	32	Campeche	0.52%

Source: Grupo Financiero BASE with information from Banxico, INEGI.

FIXED INVESTMENT

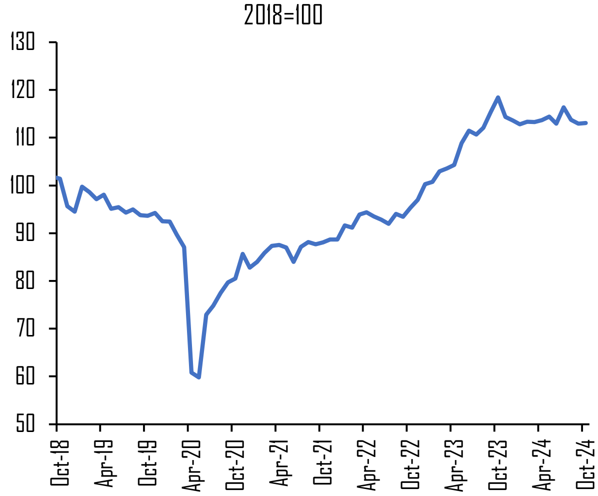
Fixed investment plays a key role in the development of an economy, since it involves the acquisition of durable goods such as machinery and equipment, and the construction of infrastructure, which increase the country's productive capacity and increase the economy's future growth potential. In addition, this type of investment generates direct benefits for the population, since it promotes job creation, improves income and generally raises the level of well-being.

The most recent gross fixed investment data is from October 2024, where an annual contraction of 4.52% was registered. This is the second consecutive contraction, after the first fall of the indicator since February 2021, when the contractions because of the pandemic were still being observed.

The greatest deterioration in investment has been in the construction components, particularly non-residential. Total investment in construction registered an annual drop of 11.64% in October, which is the largest contraction suffered by this type of investment since December 2020. Broken down by type of construction, residential construction showed an annual drop of 3.52% in October (the largest since April 2023), while non-residential construction suffered an annual contraction of 16.34% (the largest since September 2020).

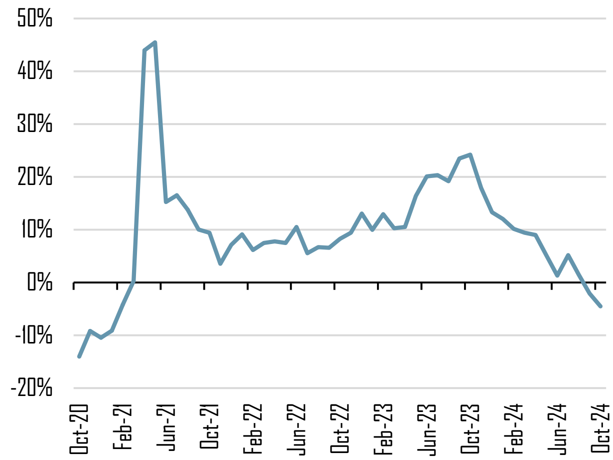
It is important to note that the drop in investment, especially in construction, is largely due to a base effect following strong growth in previous periods. Between May 2023 and April 2024, construction recorded an average annual growth of 21.23%, reaching an all-time high in October 2023. In this context, it is not surprising that twelve months after this historical maximum, an annual contraction is observed. In fact, the indicator is relatively stable (Fig. 12), averaging a level of 113.72 points in the last twelve months, and in October it stood at 113.06 points, but although the level of investment remains at relatively high levels, the comparison with previous periods of high growth generates negative rates in the annual indicators. This can distort the perception of overall economic performance and, consequently, affect investor and consumer confidence. Therefore, although the base effect is a mathematical phenomenon, its implications can have an impact on growth data, economic dynamics and future growth expectations.

Fig. 12. Gross Fixed Investment
2018=100



Source: Grupo Financiero BASE with information from INEGI

Fig. 13. Annual Growth Rate of Gross Fixed Investment



Source: Grupo Financiero BASE with data from INEGI.

In the first ten months of 2024, the gross fixed investment indicator accumulated an annual growth of 4.44%, but this will decrease once the data for November and December are recorded. Thus, it is possible that in 2024 the gross fixed investment indicator will have grown around 3.5%, after growths of 8.16 in 2022 and 16.54% in 2023. By 2025, investment could follow low growth due to caution among investors, both local and foreign, given that internally, uncertainty persists about the judicial reform and externally, Trump's tariff threats could slow down investment projects and reinvestment of profits in Mexico. With this, gross fixed investment growth could be around 1% per year.

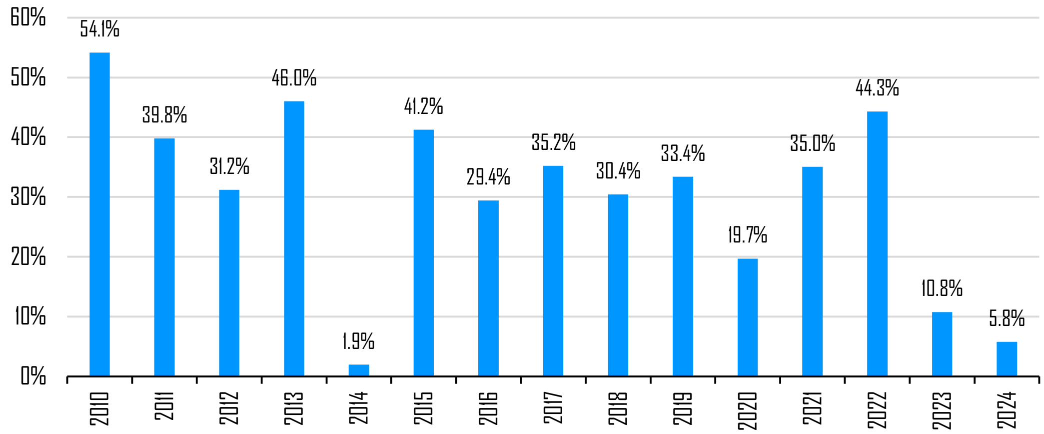
FOREIGN DIRECT INVESTMENT

Foreign direct investment (FDI) is a key factor for Mexico's economic development, as it drives growth, generates employment and modernizes sectors such as the automotive, manufacturing and technology sectors, in which Mexico seeks to become more competitive in international trade. Likewise, the arrival of foreign capital also reflects confidence in the country's macroeconomic stability, which is why factors such as security and legal certainty are fundamental for attracting foreign investment.

According to figures from the Ministry of Economy, in the first three quarters of 2024, Mexico received 35.738 billion dollars in foreign direct investment (FDI), an all-time high for this period and a growth of 8.54% over 2023. However, when compared to revised figures, the increase was only 1.45%, the lowest since 2020.

86.03% of FDI came from reinvestment of profits, with a growth of 14.02%, while new investment accounted for only 5.77%, its lowest level since 2014 (Fig. 14), with a drop of 45.61%. This is most likely a reflection of the obstacles presented by the factors of political uncertainty, the lack of adequate infrastructure in basic services such as electricity and water, and the loss of institutional quality and confidence about the Mexican economy.

Fig. 14. New investments as a percentage of total FDI. Cumulative figures for the first three quarters.



Source: Grupo Financiero BASE with information from Banxico

The low growth of new investment in Mexico is worrying, as it reflects a failure to take advantage of *nearshoring*, something that has benefited other emerging economies. The fact that only 5.77% of FDI comes from new investments-its lowest level since 2014-indicates that the flow of foreign capital is concentrating on reinvesting profits from already established companies, rather than attracting new companies that can generate employment and strengthen the country's competitiveness. In light of this, it is essential that the Mexican government generates the necessary conditions to attract investment, since otherwise it is losing ground to other economies that are attracting the interest of investors in the nearshoring context-even the United States, with a much more expensive labor force, but sufficient infrastructure and stability, is positioning itself as a more attractive destination for the relocation of companies.

FOREIGN TRADE

In Mexico, total exports account for 37.97% of GDP according to 2024 data as of the third quarter and its growth is supported by trade with its North American partners. Through November 2024, Mexico's non-oil exports accounted for 95.4% of the total, with a cumulative annual growth of

5.07%. This was since non-oil exports sent to the United States accumulated growth of 6.0%, while those sent to the rest of the world only grew 0.3% in the same period. Cumulative automobile exports to the United States between January and November alone grew 6.3%, while those to the rest of the world contracted 10.1%.

Mexico is the Latin American economy with the highest degree of economic complexity according to the Harvard Atlas of Economic Complexity, occupying 21st place, followed by Costa Rica, which ranks 50th. The only three emerging economies that surpass Mexico according to the complexity index are Hungary in position 13, China in position 18 and Romania in position 20. This implies that Mexico's exports are of higher complexity than most emerging economies (except those already mentioned) and show a similar structure to those of advanced economies such as Finland in position 19, France in position 22 and Israel in position 23.

Mexico's high economic complexity is due to the specialization and close relationship in supply chains with the United States, in sectors such as vehicle manufacturing, industrial machinery, and electrical equipment and machinery, in which Mexico's exports compete directly with advanced economies such as Germany and Japan. This gives Mexico an advantage, as the United States could not easily substitute what it imports from Mexico. However, this does not eliminate the risk of tariffs, as the United States has near-monopsony power over Mexico, which Trump can use to achieve other objectives such as stopping the migration of undocumented people and the flow of illicit substances. In addition, Trump could use the tariffs to increase tax revenue and decrease the US fiscal deficit, which is at record highs.

Trump threatened to impose a 25% across-the-board tariff on imports from Mexico from the first day of his term. He did not do so and instead said he could impose it as of February 1. It is worth noting that Trump asked his team for a detailed report by April 1 on the benefits that the T-MEC has given to the United States. The fact that he has postponed the decision on the tariff is a positive thing, as it shows that Trump could be using it as leverage for other objectives, but that he does not really intend to impose it or at least not to that extent and on all products. It would not be an unusual thing for Trump to not follow through on his threat. In the campaign for his first term, he threatened a 30% tariff on all imports from Mexico. This tariff never materialized. In his first term, Trump focused on starting a trade war (which is still going on) with China. Because of this trade war and the effects of the pandemic on supply chains, Mexico is now the leading supplier of imports to the United States.

In the remote scenario of imposing a 25% general tariff on imports from Mexico, the price of Mexican products in the United States would rise and their quantity demanded would fall. It is estimated that for every 1% increase in the price of exports, exports fall 1.33%. If only half of the tariff is passed on to U.S. consumers, Mexican exports would fall 12%. This would be reflected in a 4.4% contraction in GDP, holding everything else constant. The decline would not only occur in 2025, but would deepen as the tariff lasts longer. This deepening would be due to the decoupling of the U.S. and Mexican supply chains, as well as the domino effect on the rest of the economy.

The impact on employment would be severe. As of September 2023, the export manufacturing industry (establishments with IMMEX program) employed 2,932,291 people, or 13.04% of formal employment registered with the IMSS on the same date. Most of this employment (35.27%) is in the transportation equipment manufacturing industry, followed by computer equipment manufacturing with 12.61% and the plastics and rubber industry with 7.30%. These three industries account for 55.18% of export manufacturing employment. Export manufacturing is made up of 5,195 establishments, of which 21.62% are manufacturing transportation equipment, 11.78% are in the plastics and rubber industry, and 10.13% are manufacturing metal products, with these three industries accounting for 43.52%.

The impact on the Mexican economy would not be heterogeneous on a regional scale, affecting mainly states whose exports represent a high proportion of their GDP, such as: Chihuahua where exports represent 144.6% of GDP, Coahuila with a proportion of 111.2% of exports to GDP, Baja California with 97.8%, Tamaulipas with 83.2%, Campeche with 80.1%, Aguascalientes with 61.4%, San Luis Potosi with 55.4%, Sonora with 50.3%, Guanajuato with 49.9%, Queretaro with 49.9%, Nuevo Leon with 48.3% and Puebla with 40.8%. These states account for 80.2% of Mexico's total exports.

With a high tariff, foreign companies would no longer have incentives to reinvest their profits in Mexico and install new plants. There would also be an indirect effect on manufacturing, with the suppliers of exporting companies. The same would be true for the service sector. With all this, the Mexican economy could fall into a depression. There would be a structural change and not only a circumstantial one, since a 25% tariff would imply that in practice there is no trade agreement. With the above, Mexico's sovereign debt credit rating would be downgraded. This would be a very negative scenario, from which Mexico would take years to recover. However, this is a very unlikely scenario, since the supply chains of both countries are closely linked and a 25% tariff on Mexican products would cause strong price pressures in the United States. However, there is a high probability that the U.S. will implement tariffs on specific Mexican products. For other countries, the likelihood of a general tariff is higher, as the impact on the U.S. economy would be much lower. This implies that Mexico could be subject to tariffs, but on a much smaller scale than those that the U.S. could impose on other countries. Thus, Trump's protectionist rhetoric could once again give Mexico the opportunity for economic growth, as happened during his first term in office when he initiated the trade war with China.

INFLATION AND MONETARY POLICY

Inflation in Mexico began the year with mixed signals, as some components point to a deceleration, such as services (particularly housing and other services) within the core component and agriculture (especially fruits and vegetables) within the non-core component. However, in other items, such as merchandise (both food and non-food) within the core component, it is observed that the deceleration trend registered during 2024 may have reached its limit.

Fig. 15. Inflation rates. Year-on-year change

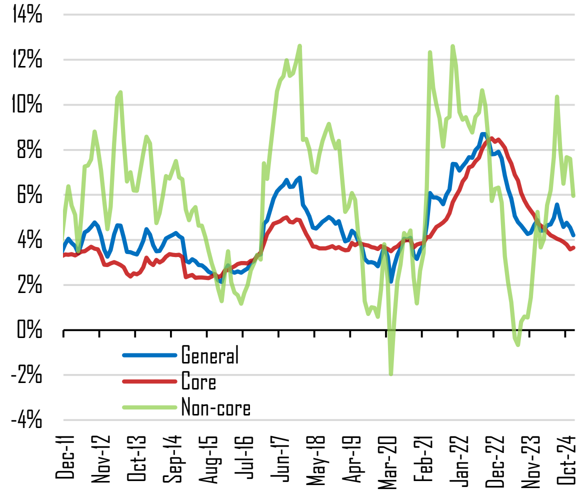
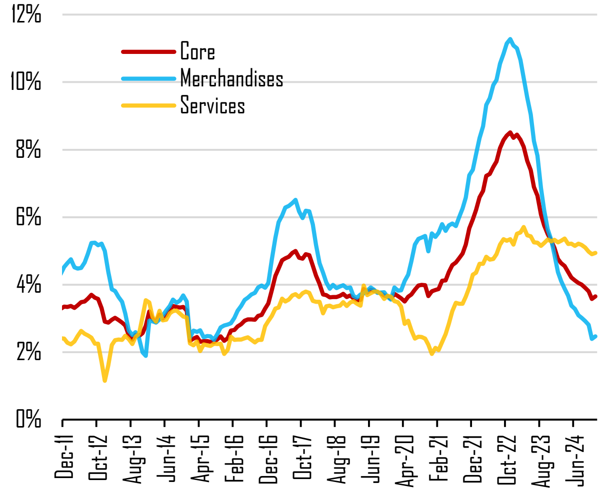


Fig. 16. Core inflation and its components. Year-on-year variation



Source: Grupo Financiero BASE with information from INEGI.

Source: Grupo Financiero BASE with data from INEGI.

It should be recalled that the core component is considered core inflation, since it determines the path of headline inflation in the medium and long term, as it excludes products with more volatile prices. The non-core component, on the other hand, includes goods with more volatile prices and on which monetary policy has little effect.

In the first fortnight of January, according to the National Consumer Price Index (NCPI), headline inflation decelerated to 3.69% annualized, its lowest level since the second fortnight of February 2021. Non-core inflation also decelerated sharply to 3.60% annualized, its lowest level since the second half of February 2024. This deceleration was mainly due to lower agricultural pressures, particularly due to the drop in fruit and vegetable prices. Nevertheless, the energy sector showed greater pressures, due to: 1) upward pressures on international oil prices due to the expectation of a lower global supply, in a period where demand remains strong due to colder than expected weather conditions in the northern hemisphere and to the latest U.S. sanctions against Russia's energy sector, 2) the upward adjustment in electricity tariffs at the beginning of the year, and 3) the increase in the Special Tax on Production and Services (STPS) at the beginning of 2025.

In contrast, the core component registered annual inflation of 3.72%, the highest rate since the second fortnight of October 2024, making it three fortnights of acceleration. This performance is worrisome because it indicates an exhaustion of the deceleration achieved last year. Both food and non-food commodities are under upward pressure from increased exchange rate volatility. The greatest pressures are related to the depreciation of the peso and the possibility that the exchange rate will continue to rise. This tends to affect both food and non-food goods due to the increase in import costs, as many food goods depend on inputs or products brought in from abroad, while non-food goods (particularly durable and semi-durable goods) are also sensitive to changes in the exchange rate. It should be recalled that the exchange rate showed notable volatility at the close of 2024 and early 2025, reaching a high of 20.9072 pesos per dollar on December 31. This occurred after the results of the U.S. elections, which gave Donald Trump the win. Uncertainty increased due to Trump's threats to impose a 25% tariff on imports from Mexico after his inauguration on January 20. However, these pressures may be limited if services continue with a gradual slowdown, particularly in housing and other services.

At a biweekly rate, headline inflation stood at 0.20%, showing a rebound after 0.04% in the second half of December. It is important to mention that this behavior is usually observed at the beginning of the year, since December frequently presents a moderation in inflation rates, particularly in its second fortnight. However, although the data for the first fortnight of January followed this pattern by surpassing the level of the previous fortnight, it is relevant to note that this is the lowest inflation recorded for an equal fortnight since 2019. Moreover, the figure was well below market expectations, which anticipated higher inflationary pressures at the beginning of the year (0.27% fortnightly).

In summary, the result of the first fortnight of January suggests that inflation is showing a better performance and could close at 3.9% annualized in December 2025, getting closer and closer to the Bank of Mexico's 3% target. With this, the Bank of Mexico could continue to cut the interest rate, including by 50 basis points on February 6, and close the year at 8.5%.

RISKS FOR ECONOMIC GROWTH

The outlook for Mexico's economic growth is marked by high uncertainty, derived from both internal and external factors. Domestically, the implementation of public policies and structural reforms poses risks to economic stability and the investment environment, while externally, global market conditions, U.S. monetary policy and the high probability of strong trade tensions generate additional challenges. The most important risk factors are discussed in more detail below:

Internal risks

1. **Reforms and Sheinbaum's economic policy**. President Claudia Sheinbaum's administration has implemented and promoted economic policies and reforms that have generated controversy for their potential negative effects on Mexico's economic growth and development. Since before taking office, Sheinbaum was a key figure in supporting the political and economic agenda of her predecessor, Andres Manuel Lopez Obrador, and the MORENA party. AMLO and Sheinbaum's public policy upholds a supposedly redistributive approach, with increases in social programs and subsidies, but lacks a strategy to create a business-friendly environment for entrepreneurs and encourage productive investment and economic growth.

2. **Cuts in public spending**. Public finances continue to be a worrying factor and a major brake on Mexico's economic development. The federal government was forced to cut public spending in 2025 after it incurred a historic level of debt in 2024. However, the government has little room to maneuver with the budget, as a large portion consists of unavoidable expenditures, so the spending cuts were mainly in physical investment. In addition, the revenue and expenditure plan that was proposed and approved for 2025 is based on very optimistic assumptions and depends on having a historically high level of revenue collection. If these assumptions are not met, the government would have to incur more debt or further reduce spending.

3. **Slowdown in investment and job creation**. The slowdown in job creation (formal and informal) and the contraction in gross fixed investment represent serious challenges for the Mexican economy, as both factors are essential to sustain economic growth. Lower job creation reduces household income, limits consumption and affects the well-being of the population, while the contraction in gross fixed investment affects productive capacity, slows future growth and weakens Mexico's competitiveness.

External risks

1. **Trump Administration**. Donald Trump's return to the U.S. presidency represents a significant challenge for Mexico's economy, especially because of his aggressive stance and his strategy of pressuring the country to address issues in which he believes Mexico does not play a favorable role for his agenda. Trump has demonstrated in the past his willingness to use threats to impose tariffs as a negotiating tool, seeking to get Mexico to adopt stricter measures in immigration management and the fight against drug trafficking, particularly because of the fentanyl crisis that the U.S. population is going through. This type of discourse and strategy generates uncertainty in trade relations and in the Mexican economy in general.

   President Trump commented that beginning February 1, he will impose tariffs of 25% on Mexican imports and spoke about beginning negotiations for the revision of the TMEC, although this revision is planned for 2026. In addition to the damage that the imposition of tariffs would cause to both countries, the mere threat of tariffs weakens business confidence and discourages foreign investment in Mexico, affecting job creation and economic growth.

   He also highlighted the executive order signed by Trump on his first day as president, in which he initiated the process for the State Department to designate drug cartels as foreign terrorist organizations. This gives the US government a basis to use measures such as sanctions, financial controls and immigration restrictions. Although it is not yet known what measures the Trump administration will take and how far-reaching they may be, the president did acknowledge that this measure would not be to Mexico's liking.

   Ultimately, the Trump administration reportedly seeks to have Mexico assume greater responsibility for ensuring security on its side of the border by collaborating to prevent both illegal migrant crossings into the United States and drug trafficking.

2. **Economic situation in the United States**. A slowdown in U.S. economic growth is expected by 2025. Fears of a recession appear to have dissipated, and U.S. inflation has moderated, declining from 3.4% in December 2023 to 2.9% in December 2024. However, there is much uncertainty ahead of Trump's policies, particularly on trade. With inflation converging to 2% and the labor market resilient, the Fed stands to continue to make interest rate cuts, but the imposition of tariffs on goods imported from Mexico, Canada and China would put upward pressure on prices. On the other hand, Trump is likely to attempt tax cuts, which could provide a boost to economic activity, although this would not be until 2026 and entails a fairly high level of indebtedness for the United States.

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