

Mexico

Gradual improvement of economic growth

Economic growth strengthened in 2026 and is expected to gain further momentum in 2027. Although the economy has shown notable resilience in a challenging environment, Mexico continues to face medium-term challenges arising from lower potential growth and structural pressures on public finances.

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Despite quarter-to-quarter volatility, economic activity in Mexico improved in 2026. Average gross domestic product (GDP) growth is projected at 1.8%, up from 0.7% in 2025 and above our 1.0% forecast in the previous edition of The Year Ahead. This acceleration was underpinned by resilient consumption, a partial recovery in investment during the second half of the year and modest spillovers from strong exports of technology-related goods.

For 2027 we expect these trends to continue. Together with a more stable global environment and diminishing headwinds from fiscal and monetary policy, they should result in a similar pace of growth. We project average GDP growth of 1.7%. While this is below the 2.0% forecast we made last year, it suggests that the economy will gradually move towards that figure, albeit more slowly than anticipated. Evidence suggests that potential growth has declined relative to the decade before the pandemic. Nevertheless, the economy has shown considerable resilience despite a challenging global environment and persistent uncertainty across North America.

Unemployment has remained near historical lows against a backdrop of reduced labour force participation, as well as a rising share of informal employment. Formal job creation should pick up gradually throughout 2027, in line with economic activity, while unemployment should move closer to its long-run average.

Annual headline inflation ranged from 3.1% to 4.6% in 2026, driven by agricultural supply shocks. Core inflation declined from 4.5% at the beginning of the year to levels slightly below Banco de México's upper tolerance threshold of 4.0%, as currency appreciation and moderating wage pressures offset the effects of new taxes. We expect headline inflation to reach 3.9% by year-end 2026, converging to 4.0% by the end of 2027. On monetary policy, we believe that the policy rate has reached its terminal level in this cycle and will therefore remain at 6.5%.

The medium-term adjustment of public finances continued, albeit more slowly than announced. The fiscal deficit has narrowed by slightly more than 1.5% of GDP over the last two years despite weaker economic activity, while the public debt-to-GDP ratio

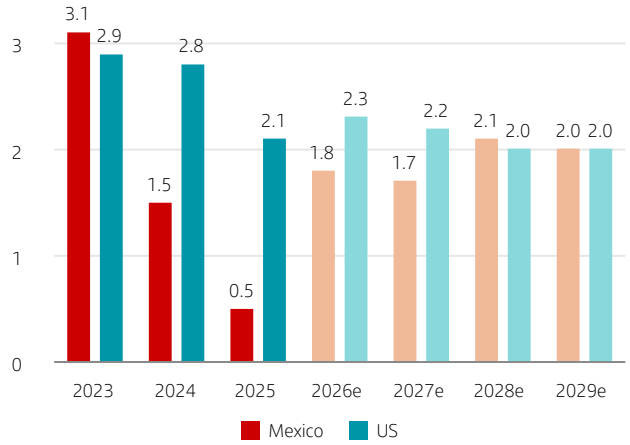
Mexico

continued to rise. Several major rating agencies have downgraded or revised their outlook for Mexico's sovereign debt, although Mexico has retained investment grade status, supported by a public debt of 54% of GDP and a debt structure heavily tilted towards peso-denominated, fixed-rate instruments.

In 2027, the fiscal deficit is set to decline by 0.2% of GDP to 3.9%, while public debt will rise by an additional 1.0% of GDP to 55.0%. We expect further gradual fiscal adjustments over the coming years, supported by measures to enhance revenues, which should be sufficient to fend off short-term market concerns. However, structural challenges will persist, given reduced flexibility in public expenditure and the narrowness of the revenue base.

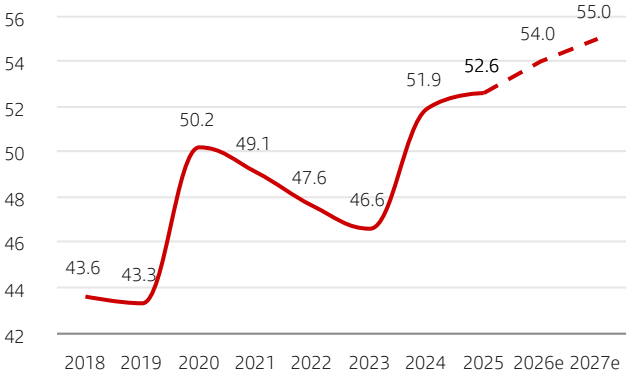
External imbalances have diminished from already low levels, driven by surging technology-related exports, weak imports of capital goods and stronger remittance inflows. We project the current account deficit at less than 0.5% of GDP in 2026, widening modestly to below 1.0% in 2027. As the deficit amounts to less than one-third of expected net foreign direct investment inflows in both years, Mexico will be relatively insulated from capital market volatility, and the peso's expected depreciation should be gradual and orderly.

Mexico: Growth will continue to strengthen
(%, y/y)



Sources: INEGI, BEA and Santander Research.

Mexico: Public debt will continue to increase through 2027
(% of GDP)



Source: SHCP (Historical Balance of the Public Sector Borrowing Requirements).

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.8	1.7	2.1
Unemployment rate	2.8	3.2	3.4
CPI inflation	3.8	3.9	4.0

Source: Santander Research. Annual average.

Mexico's export resilience amid trade uncertainty

Mexico's trade engine remains strong, and preferential access to the US market continues to support export growth and external stability. However, shifts in US trade policy have diminished gains for domestic activity.

An export-oriented manufacturing base and the USMCA agreement

International trade has been a cornerstone of Mexico's development strategy ever since the North American Free Trade Agreement (NAFTA) was signed in 1993. In the following years, NAFTA was complemented by a network of 13 free trade agreements spanning 52 countries that account for roughly 60% of global gross domestic product (GDP).

The strategy to open up the Mexican economy to trade fostered the development of a large and sophisticated export-oriented manufacturing base: Mexican goods exports in 2025 were worth 665 billion US dollars, or 36% of Mexican GDP, with manufacturing goods accounting for more than 90%. Mexican exports are heavily focused on the US, which is the destination of around 80%.

Given the heavy reliance of Mexican exports on the US market, the renegotiation of NAFTA during the first Trump administration was a critical moment. The resulting agreement, the US-Mexico-Canada Agreement (USMCA), entered into force in 2020 and introduced several changes, particularly regarding the automotive sector. Regional content for vehicle exports increased from 62.5% to 75.0%, new wage requirements were introduced for vehicle production, and a 16-year sunset provision was established, with periodic six-year joint reviews to determine whether the agreement should be extended. Failure to reach an agreement in the joint reviews triggers annual reviews until an agreement is reached or the original 16-year term expires.

Although the overhaul of the regional trade framework increased uncertainty, thereby contributing to a decline in private investment in Mexico during that period, the USMCA also helped preserve Mexico's preferential access to the US market at a time of profound changes in global trade patterns. In the years that followed, Mexico overtook China as the top exporter to the US. Between 2020, when the USMCA entered into force, and 2025, the value of Mexican exports to the US increased by 38% in US dollar terms, while total automotive exports grew by 26%.

Changes under the second Trump administration

The shift in US trade policy that began with the second Trump administration, which raised the average effective tariff on US imports to its highest level in nearly a century,



Mexico

In focus

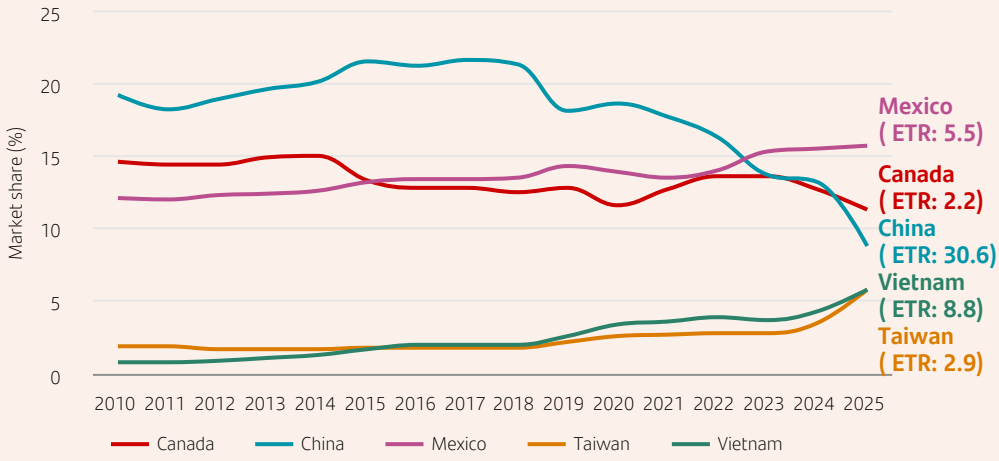
has posed a new challenge for the Mexican economy. While it has once again contributed to a material weakening of private investment, it has also enabled Mexico to consolidate its position as the top exporter to the US.

Mexican exports have benefited from a comparatively favourable tariff treatment, as most USMCA-compliant trade continues to enter the US duty-free. However, elevated sector-specific tariffs, combined with limited exemptions for USMCA-compliant goods, have weighed heavily on the automotive sector. This, together with higher trade barriers on Chinese exports and the booming demand for technology-related goods by US firms, has led to strong growth of Mexican exports and a marked shift in their composition. Auto exports have contracted, while computer and electronics exports have surged. This compositional shift has been unfavourable for economic growth, as the domestic spillovers generated by auto exports are significantly larger than those of the computer and electronics sector, reflecting the former's more extensive domestic supply chains and the latter's lower labour intensity.

The US government's decision not to renew the USMCA under its current terms for an additional 16 years, despite proposals by the Mexican and Canadian governments to do so, means that the agreement will be subject to annual reviews. Therefore, the environment surrounding the trade relationship in the coming two years will closely resemble the current one, with low average tariffs, full exemptions for the bulk of USMCA-compliant trade, some elevated sector-specific tariffs, including on vehicles and auto-parts, and limited clarity regarding the medium-term outlook. In that setting, Mexican exports should continue to expand at a solid pace, although their contribution to growth will be lower than in the past.

In short, Mexico's preferential access to the US market should continue to underpin external stability, but persistent policy uncertainty and less domestically integrated export growth will likely keep the broader growth impulse contained.

Composition of US imports by country of origin
(% of Total US Imports)



Source: US International Trade Commission. ETR: average Effective Tariff Rate for 2025.