A HEALTHY MEXICAN ECONOMY AT THE BEGINNING OF A PARADIGM OF A NEW REGIME

November 30, 2018 was not only the last day of ex-President Enrique Peña Nieto, but ended an era characterized by a period of neoliberal model through privatizations, disciplined monetary policies, recording a 2.6% on average economic activity growth, which undoubtedly was not enough to compensate the vote against the PRI political party due to the exacerbating impunity and corruption levels in the previous 6 years.

The International Monetary Fund, IMF, published on November 27th that Mexico has adequate availability of statistical information, which complies with the international criteria of transparency and integrity, which allows for a more effective analysis of its policies.

- A sustainable external position, healthy public finances, as well as a position of sustainable public debt, and prudent fiscal policy.
- Mexico plots the highest credit rating, within the Emerging Markets, successfully placing sovereign bonds in international markets.
- It has an adequate level of international reserves, inflation with medium term expectations well anchored, despite being above the target inflation of Central bank.
- Solid financial system without solvency problems with solid liquidity levels according to international standards.

2018 Economic Outlook

Quarterly GDP Growth by component

The Gross Domestic Product (GDP) growth in the third quarter of 2018 was 2.5%. A relatively good performance. GDP growth was mainly driven by the tertiary sector (3.2%), especially by financial services (8.5%), retail (5.5%), and information in mass media (4.4%). The primary sector advanced 2.2% and the secondary sector —which includes manufacturing, construction, mining and power and utilities—rose 1.1%.

Despite downward revisions, growth expectations consensus for 2018 remains around 2.0% while GDP growth for 2019 faces risks related to the paradigm of a new regime.
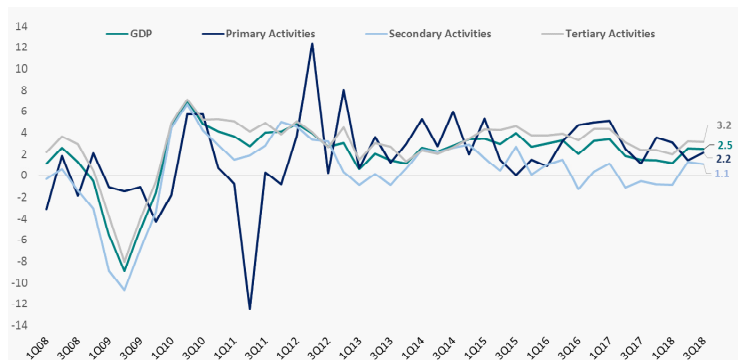
**Gross Domestic Product**
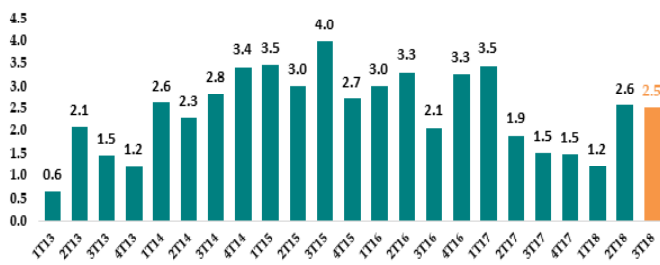
Source: INEGI

Source: INEGI.

Quarterly GDP by Component
YoY Growth

Source: INEGI.

Consumption in Mexico remains stable and represents ~70% of the country´s GDP; employment, remittances, steady credit growth, and lower inflation helps to understand the resilience of same-store sales growth.

Same Store Sales vs. Walmex Sales
*Monthly Year over Year Variation*
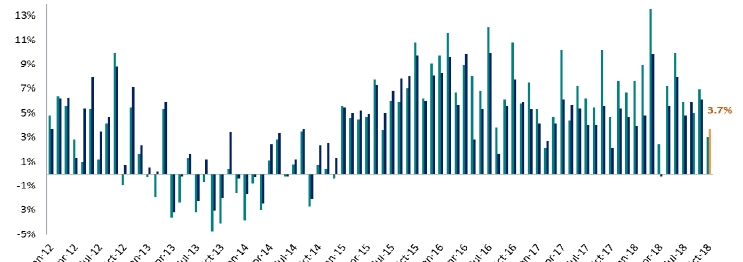
Source: ANTAD.

Consumer confidence

Consumer confidence in July reached its highest level in five years and was also strong in August, September and October. In this context, same-store sales, an indicator that measures the performance of more than 55,000 retail stores within Mexican retailers' association ANTAD, has increased more than 4% each month from July-October. Similarly, Walmart´s same-store sales indicator, used as a consumption indicator within the retail industry in Mexico, shows that monthly sales increased by 6% in the same period.
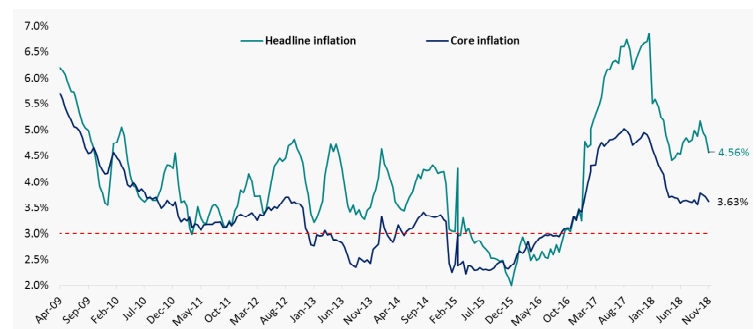
Consumer Confidence
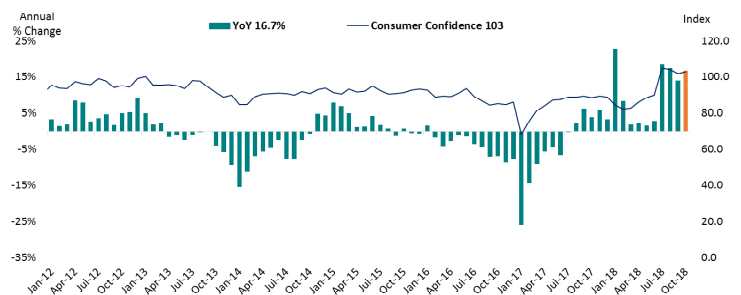
Source: INEGI; Banxico.

Inflation

Inflation has remained high, mainly as a result of the evolution of its non-core components. According to Central Bank, the balance of risks for inflation remains biased to the upside and has deteriorated in view of the evolution of the exchange rate in the current context of uncertainly and the possibility of additional shocks from energy or other components of non-core inflation.
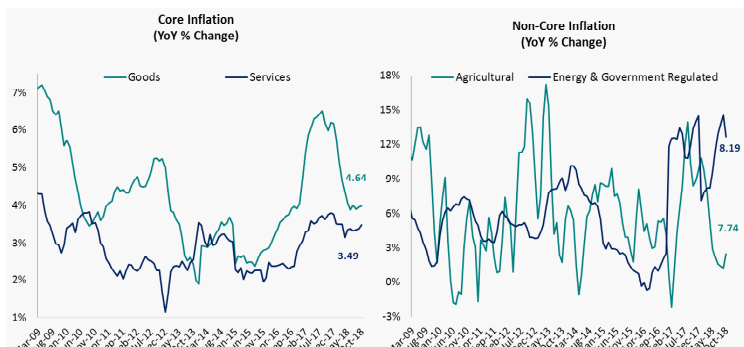

Source: INEGI.

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Core Inflation
(YoY % Change)

Non-Core Inflation
(YoY % Change)

Source: INEGI.

High employment and wage purchasing power recovery remain strong. Wage pressures that result from tighter labor conditions or increments to minimum wages.

Wages & Consumer Inflation
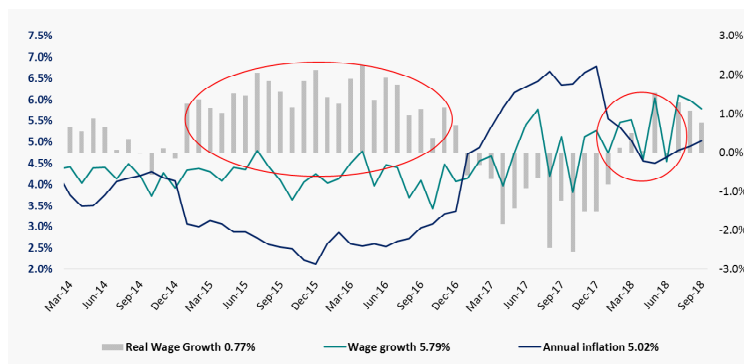
Source: INEGI; Banxico.

The Gross Fixed Investment in September, adjusted for seasonality, increased only +0.2%, its lowest growth in the year after the 2.2% fall in August. Total investment in machinery increased 2.5%. Investment in international machinery increased 6.8% and national investment decreased 3.9%. Investment in construction fell for the fifth time in the year (-1.0%) due to lower investment in residential construction (-2.1%).
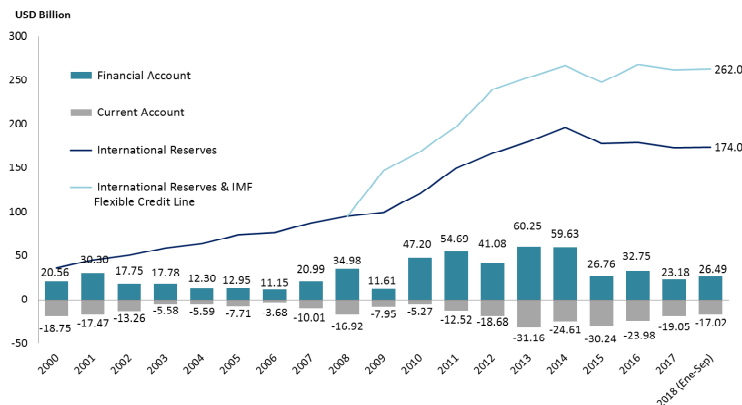
Gross Fixed Investment
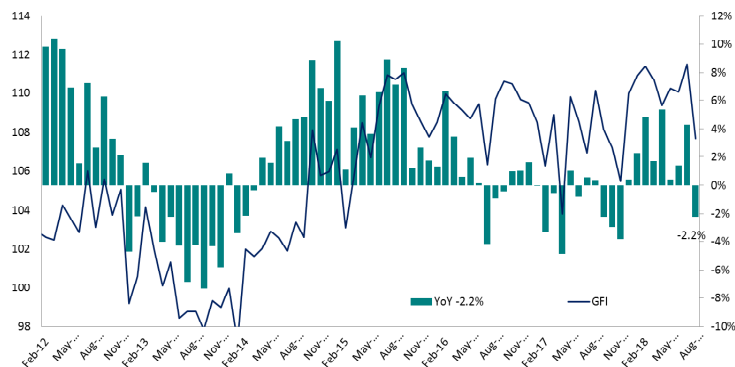
Source: INEGI.

Financial account surplus was above US $26 billion which offsets the Current Account deficit. Furthermore, International Reserves at US $174 bn and the International Monetary Fund flexible credit line amount to US $262 billion.

Balance of Payments

Source: INEGI.

Foreign Investment in Debt

Foreign investment in goverment debt securities —including Treasury Certificates (CETES), Development Bonds (BONDES), Udibonos and M bonds—went from US $ 68.54 bn in September to US $63.68 bn in October. However, this fall was mainly due to peso depreciation against the US dollar. Adjusted for peso depreciation against the US dollar, net investment in government bonds increased US $1.1 bn dollars.

Position in Goverment Bonds
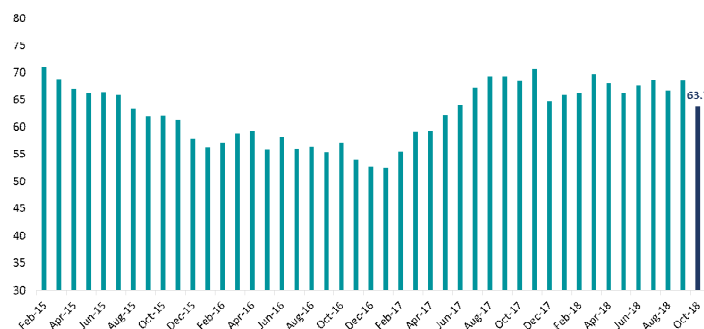
Source: Banxico.

Inflows & Outflows
Billion US Dollar
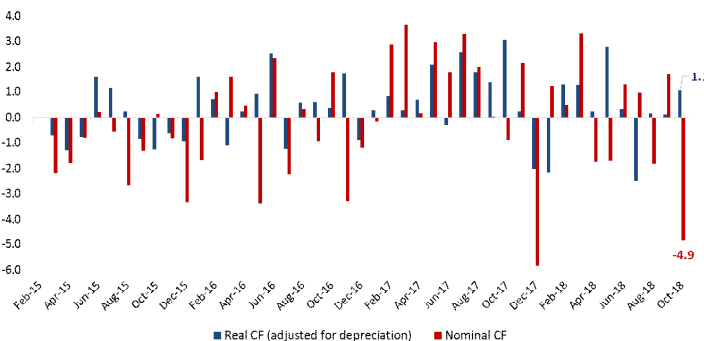
Source: Banxico.

Mexican peso depreciation for the year-to-date period to November 22, 2018 was 3.21%

MONTHLY ECONOMIC REPORT   **NOVEMBER/DECEMBER 2018**

A HEALTHY MEXICAN ECONOMY AT THE BEGINNING OF A PARADIGM OF A NEW REGIME

MXN/USD Spot Exchange Rate
(As of November 22nd, 2018)

Source: Bloomberg.

Domestic interest rates have increased sharply, and the stock exchange has declined. In the above context Banxico increased 0.25% its reference rate to 8 percent. Since late 2015 Banxico has increased the monetary policy rate more than 5% (or 500 basis points). The Board of Governors of Mexico´s Central Bank is committed to adjust monetary policy timely to achieve convergence to inflation target of 3% +/- 1%.

BANXICO & FED Reference Rate
(As of November 15th, 2018)
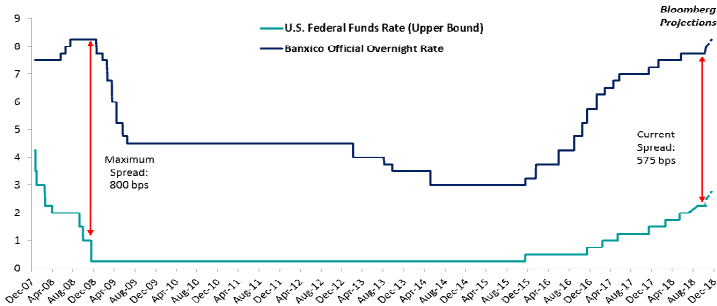
Source: Banxico; Federal Reserve of the United States; Bloomberg.

MEXBOL

The equity market has presented good opportunities during the September-December sharp correction for long-term investors. Top down supported by a well-tuning economy. Bottom-up reflects our deep knowledge of companies´ internationally competitive edge reflecting attractive valuations under good fundamentals besides uncertainty on a decelerating economy in the short term.

Our investment philosophy includes investment themes as follows: i) consumption-defensive, ii) sales and EBITDA in hard currency, iii) diversified EBITDA contribution outside Mexico.

Consumption, Financials and Materials are among our favorite sectors.

MEXBOL Index *(As of December 13th, 2018)*
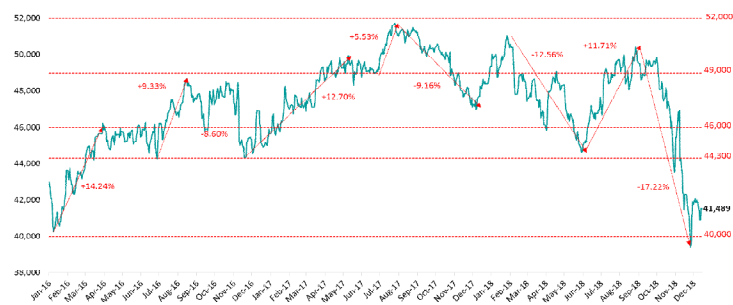
Source: Bloomberg.

Key topics at President Lopez Obrador's inaugural speech on December 1st, 2018:

1. **Legal reforms:** end corruption, and change the Education reform
2. **Fiscal and economic policy:** no tax increases, gasoline will only have inflation adjustments, Mexico will not increase its indebtedness, Banxico autonomy will continue, and there will be a free trade zone in the border.
3. **Infrastructure:** construction of Santa Lucia airport (replacing Texcoco), development of Tren Maya (recently voted on the public referendum), construction of a new refinery in Tabasco ("Dos Bocas", also voted on the public poll), and refurbishment of the six refineries Mexico currently has (running at ~40% utilization rate).
4. **Social policy:** 2m young workers presently unemployed will employed and trained by the private sector, the government will pay them a monthly salary of M$3,600 (US$180), 10m of scholarships, and 100 new state universities.
5. **Intraregional development:** AMLO announced that he would seek the unification of efforts between Canada, the United States, and Mexico so they can invest in the area to generate economic development to reverse migration.
6. **Austerity policy:** Lowering public employee´s salary, among others.
7. **Mandate period:** AMLO highlighted he's not planning to be re-elected and mentioned he will call for public consultation in 2.5 years asking whether he should be revoked from his mandate or not.

2019 Budget Bill

Mexico's government presented an austere, conservative and fiscally responsible Budget Bill for 2019, making clear its commitment to stay on the path of fiscal consolidation. The proposal included cuts to dependencies and social programs and highlighted that budget revenues are estimated 0.5% lower than those registered in 2018. The budget calculated total revenue of $5.3 tn pesos (US$287 bn), with almost 20%, coming from oil income and 62.3% from taxes. A promised reduction in taxes along the U.S. border, to 20% from 30%, was included in the bill and would cost some $40 bn pesos.

Concerning spending, $252 bn pesos were set aside for priority projects, including $100 bn pesos to double old-age pensions and $44.3 bn pesos to provide bursaries and apprenticeships for 2.6m young people who neither work nor study. Also, $15 bn pesos had been set aside in the budget to develop Santa Lucia airport, the military base where the government plans to add two runways.

Congress has until December 31 to review, suggest changes, and approve the budget.

Budget Bill	2018	2019
GDP *(annual variation)*	2.30%	2.00%
Surplus *(as % of GDP)*	0.70%	1.00%
Inflation *(annual variation)*	4.70%	3.40%
Exchange Rate *(USD/MXN)*	$19.20	$20.00
Short-term Interest Rate	7.70%	8.30%
Real Interest Rate	3.10%	5.00%
Current Account *(as % of GDP)*	-1.80%	-2.20%
Average Oil Price (dpb) *20% of total income*	$46.00	$55.00
Oil Production *(million barrels per day)*	1.9 (0.88 exported)	1.8 (1.0 exported)

PAM continues to use its in-depth fundamental analysis with a bottom up approach searching for good opportunities at the prevailing markets volatility on external shocks and a domestic equity market that likely will continue to gradually learn to operate within a political noise of a new regime.

Yours sincerely,

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Definitions

PRI: *Institutional Revolutionary Party; Mexico.*
IMF: *The International Monetary Fund is an international organization that aims to promote global economic growth and financial stability, to encourage international trade, and to reduce poverty.*
GDP: *Gross Domestic Product is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.*
INEGI: *The National Institute of Statistics and Geography.*
BANXICO: *Banco de Mexico is the central bank of Mexico.*
SHCP: *Secretaria de Hacienda y Credito Publico, is the Ministry of Finance.*
FED: *The Federal Reserve System (also known as the Federal Reserve or simply the Fed) is the central banking system of the United States of America.*
MEXBOL: *The S&P/BMV IPC Index measures the performance of the largest and most liquid stocks listed on the "Bolsa Mexicana de Valores". The index is designed to provide a broad and representative index covering the Mexican equities market. It is not possible to invest directly in an index.*
PRI: *Institutional Revolutionary Party; Mexico.*
ANTAD: *stands for Asociación Nacional de Tiendas de Autoservicio y Departamentales (National Retailers Association of Mexico)*
Same-store Sales: *Same-store sales measures the sales of a company's existing stores that have operated for more than one year, excluding sales of new stores.*
Consumer Confidence Index: *indicator that provides a proxy for future developments of households' consumption and saving, based upon answers regarding household expected financial situation, their sentiment about the general economic situation, unemployment and capability of savings. It is not possible to invest in the Consumer Confidence Index.*
Gross Fixed Investment: *is a term used to describe the net capital accumulation during an accounting period for a particular country. The term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity.*
Balance of Payments: *The balance of payments is a statement of all transactions made between entities in one country and the rest of the world over a defined period of time, such as a quarter or a year.*
EBITDA: *EBITA is an acronym for earnings before interest, taxes and amortization.*
CETES: *Federal Treasury Certificates (Certificados de la Tesorería de la Federación) are the oldest debt instruments issued by the Federal Government of Mexico.*
BONDES: *Federal Government Development Bonds (Bonos de Desarrollo del Gobierno Federal) are floating-rate government securities, i.e., they pay interest and their rate is revised periodically (the terms at which the rate is periodically revised have changed along their history).*
UDIBONOS: *Federal Government Development Bonds denominated in Investment Units (Bonos de Desarrollo del Gobierno Federal denominados en Unidades de Inversión) were created in 1996 and are inflation-hedged instruments.*
M-BONOS: *Fixed-rate Federal Government Development Bonds (Bonos de Desarrollo del Gobierno Federal con Tasa de Interés Fija) were first issued in January 2000. Today, they are issued and placed at 3, 5, 10, 20 and 30 years.*
AMLO: *Andrés Manuel López Obrador; (born 13 November 1953), commonly referred to by his initials AMLO, is a Mexican politician currently serving as the 58th President of Mexico since 2018.*

Disclosures