

A REASONABLE ECONOMIC FRAMEWORK IN THE LIGHT OF A POOR BALANCE IN OCTOBER AND NOVEMBER

The financial markets stabilized last week, with a marginal recovery of the peso in the forex market and some progress in the stock market. The improvement seems to be anchored in the signals that the new government has anticipated for 2019 on what seems a reasonable economic framework. Among those signals, the following stand out:

1. A primary fiscal surplus of 1% of the Gross Domestic Product (GDP).
2. Real GDP growth of 2.0%.
3. Expected annual inflation between 3.3% and 3.5%, convergent towards Banco de Mexico inflation target.
4. Expected crude oil price between 55 and 58 dollars per barrel.
5. Average exchange rate around 20 pesos per dollar.

However, in November, the spot exchange rate closed at 20.36 pesos per dollar, which implies depreciation of 8.09% in the last two months and of 3.48% year-to-date. The fall could have been steeper, if it weren't for the rise of more than 1% in long-term interest rates -the rate of return of the 10-year government bond already exceeds 9.0 %- and for the necessary monetary policy response of Banco de Mexico, by raising the reference interest rate 25 basis points -which leaves the overnight government funding rate at 8.0%. In addition, Mexico Central Bank cautioned about having to increase the reference rate again before the end of the year.

In November, Mexbol closed at 41,733 for a fall of 15.26% considering the last two months and of 13.70% year-to-date. It should be noted that in these two months of adjustment the index fell to 39,427 points, which represents a loss of practically 20%.

It is not surprising that financial markets will charge a high price on the destruction of value that institutional investors, such as the Afores, have already reflected in their financial reports. In this context, it will be essential to analyze the implications of the two messages that the president delivers: the institutional one addressed to Congress at his investiture as president, but mainly, the one at the National Palace.

In the quarterly inflation report for July-September, Banco de México (BANXICO) reduced the upper limit of the growth range for this year from 2.0%-2.6% to 2.0%-2.4% as well as for 2019, which went from 1.8% -2.8 % to 1.7% -2.7%. This is since "elements of internal uncertainty prevail regarding various aspects of the economic policy that the new administration will have to implement", including the economic budget.

Banxico also revised its inflation estimates upwards and indicated that it would be until the first half of 2020 when inflation is around the target of 3 percent. Among the factors that pressure prices are i) the depreciation of the peso against the dollar, ii) the costs of energy and agricultural products, iii) the escalation of protectionist measures and iv) the unjustified increase in wages.

Alejandro Díaz de León, Governor of Banco de México, stressed that although the foreign exchange market has improved, the fixed income market has suffered setbacks. This is visible on interest rates hikes, especially on long-term bonds. In this sense, the commitment of Banco de México is "to reduce the uncertainty elements that weigh on financial markets in general and fixed income in particular." It is worth mentioning that the interest rates of ten-year M bonds exceed 9%, its highest level since 2008. Regarding capital inflows and outflows, the Central Bank noted that uncertainty and volatility in the last two months have affected prices and volumes, which in turn impact investment decisions.

On November 27th, the International Monetary Fund announced that Mexico meets the criteria to maintain the flexible credit line of 74 billion dollars until next year. Moreover, Banxico announced that international reserves amount to 173,907 million dollars, its highest level since July 2017. Both sources of contingent funding amount to 248 billion dollars. After the review, the IMF highlighted the following:

- Mexico has a sustainable external position, its external debt remains relatively low, as well as its current account deficit.
- It has healthy public finances, as well as a position of sustainable public debt, together with prudent fiscal policy.
- Mexico is one of the emerging countries with the highest credit ratings, successfully placing sovereign bonds in international markets.
- There is an adequate level of international reserves to deal with problems of an economic nature.
- Low and stable inflation despite being above the inflation target of Banxico, medium-term expectations are well anchored.
- It has a solid financial system without solvency problems. The capitalization and liquidity levels of the banks are kept at adequate levels according to international standards.
- 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.

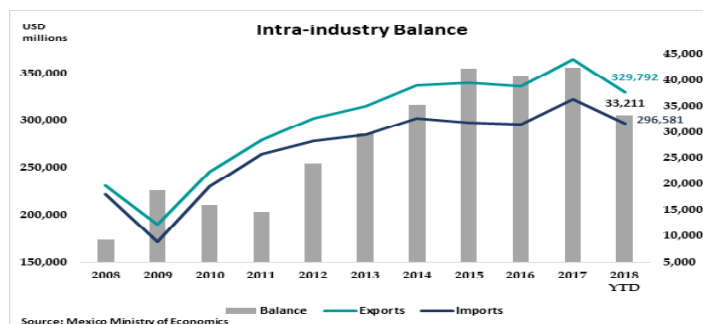
Banco de México Governor emphasized that international reserves have the key purpose of providing liquidity and a different use would imply a lending activity; which is not allowed by the law nor is consistent with respecting the autonomy of the Central Bank; since the issuance of primary money must be anchored and exempt from political cycles.

Economic indicators

Trade Balance

In October, the trade deficit balance was 2.9 billion dollars, its highest level since January. Exports were 41,352 million dollars, the highest for at least 27 years since the historic series began. 88% of exports correspond to manufacturing, which reached their best performance since the beginning of the series in 1980.

Imports reached 44.288 billion dollars, 13.7% more than in 2017, this rise was driven by an increase of almost 30% in oil imports, as well as higher demand for intermediate goods due to intra-industry trade between Mexico and the US.

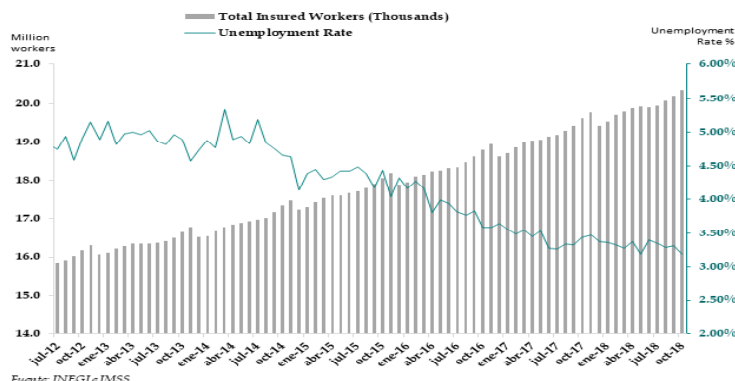


Unemployment Rate

The unemployment rate in October was 3.19%, its lowest level in 12 years (seasonally adjusted).

The employment rate stood at 96.8% considering the economically active population. This is people over 14 years old who work at least six hours per week. However, 55.3% are informal workers.

Insured Workers vs. Unemployment Rate



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Compliance

Definitions

GDP: Is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The S&P/BMV IPC: seeks to measure the performance of the largest and most liquid stocks listed on the "Bolsa Mexicana de Valores". The index is designed to provide a broad, representative, yet easily replicable index covering the Mexican equities market.

BANXICO: Mexico's central bank, monetary authority and lender of last resort. The main objective of Banco de México is to maintain a low and stable inflation.

M-bonds: Federal Government fixed-rate development bonds that are issued and placed at terms of over one year, pay interest every six months and their interest rate is determined at issue date and remains fixed all along the life of the bond.

National Palace: The National Palace (Palacio Nacional) is the headquarter of the President in Mexico. It is located on Mexico City's main square.

Intra-industry Trade: Trade among the same industry.

Congress: The General Congress of the United Mexican States is the bicameral legislature of the federal government of Mexico consisting of two chambers: the Senate of the Republic (128 senators) and the Chamber of Deputies (500 deputies).

International Monetary Fund- The International Monetary Fund (IMF) is an organization of 189 countries created in 1945 to ensure the stability of the international monetary system—the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The Fund's mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.

Afores - Private pension fund managers within the Mexican Pension Fund System responsible for managing individual accounts and investing savings.

Gross Domestic Product - Gross domestic product (GDP) at market prices is the expenditure on final goods and services minus imports: final consumption expenditures, gross capital formation, and exports less imports.

Trade Balance - the difference between the value of a country's imports and exports for a given period.

Basis Points (BPS): Refers to a common unit of measure for interest rates and other percentages in finance.

Disclosures

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