Markets affected by United States Rates

During the first week of October, financial and exchange markets presented significant adjustments for the fear of a greater and faster hardening in the monetary policy of the Federal Reserve of the United States (FED).

This is, the possibility that reference rate of the Fed will rise more rapidly and reach a magnitude higher than 2.50% in December 2018 and 3.0% in July 2019, which were the anticipated rates by the financial markets consensus at the end of September. The factors that unleashed a strong concern among investors were the following:

1. The warning from Jerome Powell, Fed chairman, that the Fed would continue its upward trajectory of rates if the US economy continues to grow as it has until now. He even highlights that "there is still a long way to go" to reach a neutral position in which the rate increase is no longer necessary.

2. In the context of this important statement, the US labor report for September released at the end of the week, showed an unemployment rate of 3.7%, the lowest since 1969, which was also accompanied with higher wage pressures in the labor market. With a full employment economy, Jerome Powell's warning had a strong resonance in the financial markets.

3. Motivated by what is described in the two previous points, the rate of the Treasury bond recorded a strong weekly increase of 15-basis-point to reach levels not seen since 2011; due to its term and being practically exempt of credit risk that represents the cost of capital opportunity, especially for investments in capital markets.

In this context, the impact on the markets that are of our interest was the following:

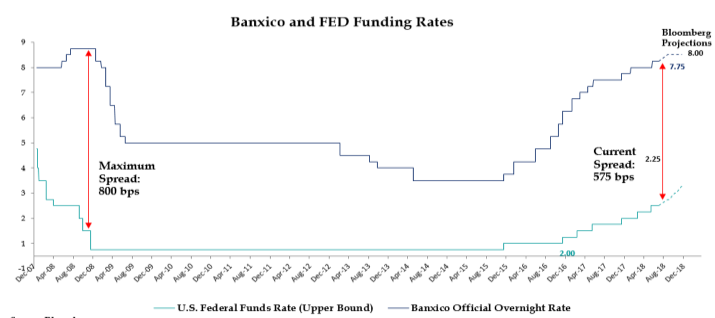
- At the operations close on October 5, the spot-interbank exchange rate for 48 hour delivery, was at 18.82 per dollar, still within the band of 18.50 and 19.50 pesos per dollar since the announcement of the commercial understanding between Mexico and the US at the end of August, that we established as the range in which we would see the exchange rate fluctuate until the end of the year.
- With the last increase of 25 basis points of the FED reference rate, the yield rate of the 10-year Treasury bond was 3.2% for the first time since 2011 and the rate for the 30 years bonds at 3.3%, it's the highest level since 2014. This reaction has negative implications for the international capital markets, both shareholders and government and corporate debt.
- In Mexico, the rate increase of US treasury bonds -emblematically within 10 years- were combined with the decision of the Central Bank to leave unchanged the one-day bank funding rate to correct to some extent the "flattening" of the local yield curve. Thus, the 10-year M bond rate closed at 8.135% on October 5, with a weekly increase of 20 bps.
- In the United States, stock markets significantly resented the increase in the 10-year Treasury bond rate. The S&P 500 and NASDAQ indices had weekly retracements of 0.95% and 3.18% during the first week of October, while the Dow Jones did not show any change. However, they still have attractive accumulated yields of 9.52%, 13.75% and 8.83% in the year, respectively.
- The Mexbol Index of the Mexican Stock Exchange (BMV) was no exception regarding the generalized adjustment of the international capital markets. At the end of October 5, the index was 48,053 points for a weekly decline of 2.93% and a cumulative yield of -1.13% for the year-to-date period. Despite this adjustment, Mexbol has respected the fluctuation range between 48,000 and 50,000 points that we established at the beginning of September as a possibility for the next months.

Relevant Economic Information

The labor statistics office of the United States reported that the unemployment rate for September (3.7%) reached a minimum not seen since 1969, besides this is the third consecutive month where the unemployment rate is below 4 percent, due to the record number of new jobs, consumer confidence and the dynamic growth of the economy.

On Thursday, October 4, the governors' board of the Central Bank of Mexico was held, where for the second consecutive time the reference rate remained unchanged at 7.75, a decision that contrasts with the recent increase of the FED reference rate. Among the arguments of the Governing Board to keep its interest rate unchanged, they highlighted: (i) the nature of the inflationary shocks is transitory, (ii) The trend of core inflation continues to be descendant (sic), (iii) The unemployment rate has remained stable at an average 3.4%, for the last quarter reported by INEGI (June, July and August), (iv) Less uncertainty after the trilateral agreement between Mexico, the United States and Canada, (v) The spread between FED reference rate and Banxico is 550 basis points, which gives freedom to not reflect changes in the rate immediately.

Banxico Reference Rate

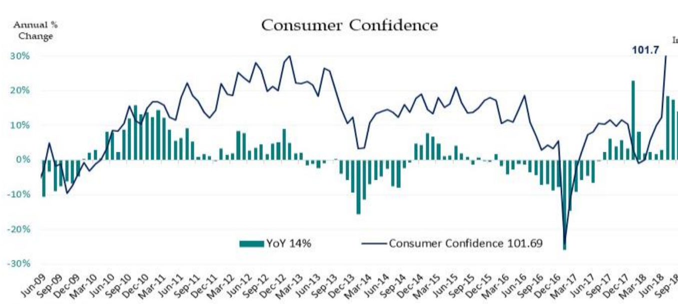


Source: Bloomberg.

The Board of Governors of the Central Bank of Mexico decided to leave its reference rate unchanged at 7.75% for the meeting held on October 4. (Source: Banxico)

Consumer Confidence Index

In line with the observed behavior since last July; the consumer confidence index showed a strong annual increase of 14%; this result adds 3 consecutive months of high growth that have taken the index to a remarkable historical maximum not seen since the end of 2012. The strengthening of consumer confidence is undoubtedly an important factor of support for consumption, the main engine of growth in the economy for recent years.



Source: INEGI y Banxico

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Definitions

GDP: *Gross Domestic Product proxy. 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*

BANXICO: *Banco de México is the central bank of Mexico. By constitutional mandate, it is autonomous in both its operations and management. Its main function is to provide domestic currency to the Mexican economy and its main priority is to ensure the stability of the domestic currency's purchasing power. Its other functions are to promote both the sound development of the financial system and the optimal functioning of the payment systems.*

FED – The Federal Reserve System is the central bank of the United States and arguably the most powerful financial institution in the world.

S&P 500*: The Standard & Poor's 500 Index - S&P 500 is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value. The S&P 500 is a market value or market-capitalization-weighted index and one of the most common benchmarks for the broader U.S. equity markets.*

NASDAQ: *The Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests.*

Dow Jones: *The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. The DJIA was invented by Charles Dow in 1896.*

INEGI: *The National Institute of Statistics and Geography.*

Mexbol Index: *The Mexbol Index 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.*