

USMCA deal favors a possible end of year rally

The week was characterized by a notable change of sentiment in the Mexican market and a reduction of uncertainty in other markets. The significant drivers were:

- i. Mexican authorities and the Democrats reached an agreement so that the lawmakers in the United States can ratify and promptly implement the United States-Mexico-Canada Agreement (USMCA).
- ii. China and the United States reached a phase one partial commercial agreement. China has pledged to i) intensify its purchases of agricultural products from the United States by US\$32 billion, ii) take measures against intellectual property theft, iii) not manipulate its currency and, iv) open the financial sector to more foreign companies. The United States will not continue with the tariff's rollover scheduled for December 15th and seems ready to reduce existing taxes placed to US\$360 billion in imports from China.
- iii. In the United Kingdom, Boris Johnson's conservative party won the general election with a significant advantage, which allowed him to obtain a qualified majority in parliament. The preceding enables the United Kingdom to ratify the agreement it had previously reached with the European Council and leave the European Union before the January 31st deadline in a consensual manner.

Mexican Stock Exchange

The certainty that the USMCA generates for the Mexican economy motivated the index to gain 6.95% in the week, which leaves the year to date (YTD) return at 12.72%; recovering the losses that Mexbol had accumulated as a result of the fears that the United States' Congress would not ratify the USMCA before the electoral campaigns. Although this news does not reverse the low performance of the index in the year, it opens the possibility of a year-end rally and improves the outlook for 2020. Noteworthy, fears of returning to levels observed after the cancellation of the New Airport Mexico City International (NAICM) are fading away.

Spot Exchange Rate

In line with the performance of Mexbol and motivated by the new USMCA agreement, the peso-dollar spot exchange rate closed at MX\$19.04 per USD, which implies a considerable weekly appreciation of 1.37% and a 3.2% YTD gain of the Mexican currency. The greater certainty that comes with the ratification of the trade agreement and Mexico's solid external accounts lead to less volatility for the exchange rate.

Interest Rates

Banxico will have its next monetary policy decision on December 19th. In the past meeting, two of the five members of the Board voted for a 50-bps reduction; this allows inferring that there could be a 25-bps reduction that would leave the rate at 7.25%. Also, both headline inflation (2.97%) and core inflation (3.65%) are within the central bank's target range (3.0% ± 1.0%). In that sense, the 10-year M-bond rate closed at 6.85% (-6 bps).

New USMCA Agreement

Negotiators from Mexico, the United States, and Canada signed the renewed USMCA. The above means that organizations as the Democrats of the United States Congress, the American Federation of Labor, and the Congress of Industrial Organizations (AFL-CIO), which previously opposed the treaty, now endorse it.

The main modifications were:

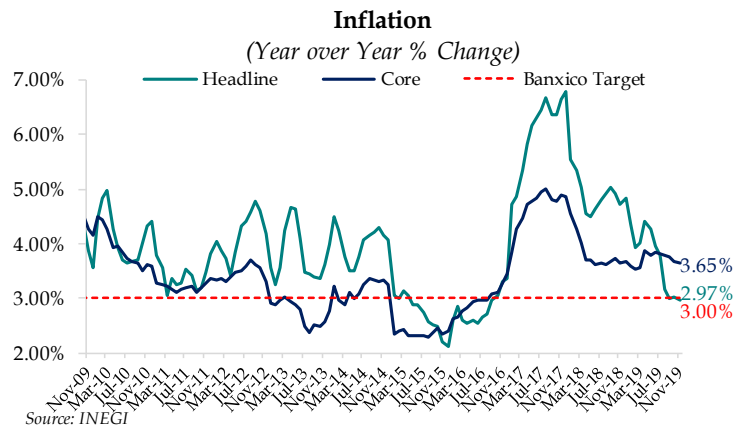
- i. A panel of experts will solve labor disputes amongst countries. Countries involved in the conflict will elect panel members proportionally, besides Mexico may also present disagreements regarding companies either in the United States or in Canada.
- ii. There was a demand that 70% of the melted steel and aluminum of automotive companies came from the North American region; the resolution was to discuss the steel process in seven years, while there will be no new implementations regarding aluminum.

- iii. In the subject of biological medicines, the first version of USMCA required members to grant producers patents for up to 10 years. To protect consumers, Democrats requested the elimination of this clause, a fact that both Canada and Mexico agreed to.

Economic Indicators

Inflation

Annual headline inflation in November was 2.97%, slightly below Banxico's 3.0% specific target. However, the annual core inflation accumulated six consecutive months with reductions and amounted to 3.65%. Annual non-headline inflation also had a setback and closed at 0.98%. The products with the highest declines were avocado, lemon, and orange, whose prices fell by -11.87%, -14.30%, and -8.72%, respectively. Headline inflation is already below the specific target of Banxico, and the trajectory of the core inflation, which is a good predictor of the general one, is within the range and heading to the objective regarding the Board's next meeting on December 19th.



Labor Productivity

The Economy's Global Index of Labor Productivity (IGPLE) registered a slight 0.2% QoQ increase in 3Q19. The primary sector had the highest growth in productivity with an increase of 2.2%, followed by the secondary with a 0.8% rise, while the tertiary sector recorded a -0.2% decline. The IGPLE exhibits a reduction of -1.8% YoY that seems inconsistent with the increase in the real wages of the workers.



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Definitions

American Federation of Labor and Congress of Industrial Organizations (AFL-CIO): Is the largest federation of unions in the United States which represents more than 12 million active and retired workers. The institution engages in substantial political spending and activism, typically in support of Democrats and liberal or progressive policies.

Banco de México (Banxico): Is the central bank of Mexico. 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.

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

European Council: Institution that defines the EU's overall political direction and priorities. It is not one of the EU's legislating institutions, so does not negotiate or adopt EU laws.

European Union (EU): Is a political and economic union of 28 member states that are located primarily in Europe.

Mexbol: The S&P/BMV IPyC seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. It is not possible to invest in an index.

Mexican Stock Exchange: The Mexican Stock Exchange headquartered in Mexico City, is the full service securities exchange of the country, dealing in cash equities, derivatives and fixed income products.

New Mexico City International Airport (NAICM): Name of the construction of a civil airport, which was suspended on Thursday, January 3, 2019 in favor of building a new international airport at an air base; Felipe Angeles International Airport.

Quarter over Quarter (QoQ): Refers to the mathematical process of comparing one quarter of data to last years' same period.

The National Institute of Statistics and Geography (INEGI): Is an autonomous agency of the Mexican Government dedicated to coordinate the National System of Statistical and Geographical Information of the country.

United States-Mexico-Canada Agreement (USMCA): Is a signed but not ratified free trade agreement between Canada, Mexico, and the United States.

Year to Date (YTD): Refers to the period of time beginning the first day of the current calendar year or fiscal year up to the current date.

Year over Year (YoY): Indicates the change from the comparable amount reported in the same period one year earlier.

M-Bond: Mexico 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.

Spot Exchange Rate: Is the current price level in the market to directly exchange one currency for another, for delivery on the earliest possible value date.

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