WEEKLY ECONOMIC REPORT June 7, 2019.

June Starts off with Bad News on Trade and the Sovereign Credit Rating

In a complicated week, financial markets came out resilient; however, risks for the economy are still present from two fronts: i) the threat made by the United States of America (US) government to impose tariffs to Mexican exports, and ii) the adjustment in the ratings and perspectives of the debt of the Mexican Government and Petroleos Mexicanos (Pemex) by rating agencies Fitch Ratings and Moody's.

Tariff Imposition

If the threat made by President Trump materializes, there could be three negative effects for the Mexican economy:

1. Based on the amount of exports sent from Mexico to the US, in the period January through April 2019, the estimated cost of the tariff would be $1 billion (bn) dollars in June, $4.45 bn in August, until it reaches $7.45 bn in October. The yearly accumulated tariff would be $36.62 bd which represents 44.92% of the trade surplus that Mexico registered in 2018.

2. The tariff will raise prices of Mexican products. Because the exchange rate floats in Mexico, a depreciation of the Mexican peso would be the natural price adjustment instrument. Thus, the observed interval of the exchange rate for the first five months of the year, which range between $19.00 and $19.50 pesos per dollar, could shift to a new one between $19.50 and $20.50 pesos per dollar.

3. In the face of the stagnation registered by the Mexican economy during 1Q19, the imposition of tariffs to the Mexican exports sector could accelerate an economic recession which could last up to three quarters.

Rating Agencies Adjustments

On May 5th the rating agency Fitch Rating downgraded the Mexican government sovereign debt from BBB+ to BBB; they also revised the perspective on the grade from negative to stable. Despite this change, Mexico's sovereign debt continues cataloged as an investment grade. The adjustment is due two risks: i) the possible impact that the growth of Pemex's contingent liability can have on Mexico's public finances.

Mexico's Credit Ratings

	S&P		Moody´s		Fitch		HR Ratings	
Date	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
06/05/19			A3	Negative	BBB	Stable		
03/01/19	BBB+	Negative						
10/31/18					BBB+	Negative		
10/30/18							A-	Negative
04/11/17			A3	Stable				
08/03/17					BBB+	Stable		
07/18/17	BBB+	Stable						
12/09/16					BBB+	Negative		
08/23/16	BBB+	Negative						
03/31/16			A3	Negative				
02/05/14			A3	Stable				

Source: Rating agencies

Likewise, Moody's changed the outlook for the rating of the Mexican federal government debt from stable to negative. They also reassert the previous A3 grade; which is the lowest in the rank of good credit rating. Noteworthy that with this grade (A3), Moody's keeps Mexico with a better rating than the rest of the agencies. Moody's considers that the political and economic framework in Mexico weakens due to two variables: i) the unpredictable policy formulation from the government diminishes investors' confidence and negatively interferes in medium-term economic indicators and, ii) lower economic growth, changes in energy policies and Pemex are affecting the financial perspective of the government on a medium term.

In addition to adjustments to the Mexican sovereign rate, on May 6th Fitch Ratings downgraded Pemex's debt rating; it fell from BBB- to BB+. Therefore, Pemex lost the investment grade, and their bonds are now considered as speculative. With this downgrade, Pemex can no longer access to financing of institutional funds in international capital markets, as by definition they cannot invest in assets with lower than investment grade rate. Unlike what they did with the Mexican government, the perspective of the rating agency regarding Pemex is still negative. The downgrade reflects the continuous deterioration of Pemex's credit profile, which is the result of a persistent generation of negative cash flows and underinvestment in exploration and production.

PEMEX Credit Ratings

	S&P		Moody´s		Fitch		HR Ratings	
Date	Grade	Perspective	Grade	Perspective	Grade	Perspective	Grade	Perspective
06/06/2019			BAA3	Negative	BB+	Negative		
04/03/2019	BBB+	Negative						
29/01/2019					BBB-	Negative		
06/11/2018							HR A-(G)	Negative
19/10/2018						Negative		
31/08/2018	BBB+	Stable						
12/04/2018			BAA3	Stable				
03/08/2017						Stable		
09/12/2016					BBB	Negative		
01/07/2016					BBB+	Stable		

Source: Rating agencies

The negative effect that the tariff threats had on the spot exchange rate was amplified by the adjustments that Fitch and Moody's made to the credit ratings of the Mexican sovereign debt and of Pemex. For these reasons, on Friday, June 7th, the spot exchange rate was $ 19.74 pesos per dollar, which represents a weekly depreciation of (-) 0.63%. In this order of ideas, the annual appreciation of the peso scaled back to (+) 0.15%. All the above suggest that the fluctuation range of the exchange rate upwards; so, it goes from $ 19.00 - $ 19.50 to $ 19.50 - $ 20.00.

The Mexbol had the opposite effect as the exchange rate since the index closed on Friday, May 7th, at 43,291 points. This represents weekly gains of 1.94% and a year-to-date yield of 5.87%. The good performance of the index reflects the rise in the price of companies with a high weight in the index, which also have a significant volume of sales abroad and therefore benefit from a higher exchange rate parity. Although the trade tariffs and the adjustments of the rating agencies did not interfere with the good performance of the Mexbol, they did so in terms of volatility, since the index ranged between 42,748 and 43,583 units. The companies with the highest gains in the week were: PE&OLES (11.10%), ASURB (5.69%) and AMXL (4.93%). Those with the poorest performance were LIVEPOLC (-5.81%), ALSEA (-5.64%) and GENTERA (-3.48%).

In the trading week of June 3rd to 7th, the yield of the 10-year M bond fell from 8.02% to 7.95%. This, despite the downgrade of Mexico's debt credit rating by Fitch Ratings. This leaves the spread compared to the 10-year US Treasury bond at 586 basis points, which is consistent with last week's figure. The weekly drop in rates suggest that, so far, the credit rating revision has not reduced the attractiveness of Mexican bonds to foreign investors. Furthermore, the high spread against the US treasuries, is also coupled with the Mexican government determination of maintaining healthy public finances.

The international markets had an interesting weekly recovery. This was due to a decrease in the systematic risk caused by the announcement of the meeting held prior to the G-20 by Steven Mnuchin, Secretary of the Treasury of the United States and Yi Gang, Governor of the Central Bank of China. In addition, some indicators on the rates in the US show signs that the FED could begin to make reductions in its reference rate earlier than expected.

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Definitions

Tariffs: A tax or duty to be paid on imports or exports.
Pemex: Petróleos Mexicanos, which translates to Mexican Petroleum, is the Mexican state-owned petroleum company, created in 1938 by nationalization or expropriation of all private, foreign, and domestic oil companies at that time. As of April 30, 2018 the Fund investment in the security is 0.00%. For a list of full securities please visit: http://www.mxefund.com/portfolio_holdings.html.
Trade Surplus: A trade surplus is an economic measure of a positive balance of trade, where a country's exports exceed its imports.
Stagnation: Is a prolonged period of little or no growth in an economy. Economic growth of less than 2 to 3% annually is considered stagnation, and it is highlighted by periods of high unemployment and involuntary part-time employment.
Fitch Ratings: Fitch Ratings is a leading provider of credit ratings, commentary and research. Dedicated to providing value beyond the rating through independent and prospective credit opinions, Fitch Ratings offers global perspectives shaped by strong local market experience and credit market expertise.
Moody's: Moody's Corporation is the holding company that owns both Moody's Investor Services, which rates fixed income debt securities and Moody's Analytics, which provides software and research for economic analysis and risk management. Moody's assigns ratings on the basis of assessed risk and the borrower's ability to make interest payments, and its ratings are closely watched by many investors.
Mexbol: The S&P/BMV IPC 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.
Banxico: Mexico Central Bank, lender authority and lender of last resort.
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.
Treasury Bills: It is a government debt instrument issued by the United States Department of the Treasury to finance government spending as an alternative to taxation.
FED (Federal Reserve System): Is the central bank system of the United States that includes the Board of Governors in Washington, D.C., and 12 independent regional Reserve banks.
Peñoles: *Mining company. As of May 31, 2019 the* the security represents 0.00% of Portfolio Net Assets
Gentera: *Financial services company. As of May31, 2019 the* the security represents 0.00% of Portfolio Net Assets
Asur: Grupo Aeroportuario del Sureste: As of May 31, 2019 the security represents 0.00% of Portfolio Net Assets.
AMXL: América Móvil: *Communication Services. As of May 31, 2019 the security represents 11.20% of Portfolio Net Assets.*
Alsea: *Consumer Discretionary. As of May 31, 2019 the security is not included in the Fund Top 10 Portfolio Holdings*
Livepol: *Consumer Discretionary. As of May 31, 2019 the security is not included in the Fund Top 10 Portfolio Holdings.*
For a list of full securities please visit: http://www.mxefund.com/portfolio_holdings.html
An investment grade: *Is a rating that indicates that a municipal or corporate bond has a relatively low risk of default.*
Risk rating companies: *Have their own rating systems and methodologies, which must be approved by the national securities commission or similar body. They usually all use a standard system internationally. Thus, a title rated "AAA" represents the highest credit quality and, at the other extreme, a "D" note represents default securities (default). Between these two extremes, ratings are in turn divided into two sub-groups or categories: titles rated from AAA to BBB - are considered "investment grade", while those rated between BB and C are "speculative degree" or "non-Investment grade" issues. Finally, the letter E is used when the rating cannot be issued.*