

The Mexican stock market tumbled due to an economic slowdown and higher systemic risk

On Friday, May 10th, the Mexbol Index closed at 43,385 and interrupted the downward trend which lasted 13 consecutive days, the most extended period of consecutive falls since 1981; this represents cumulative losses of (-) 4.38% since April 17th, when the Mexbol surpassed the resistance of 45,000. A decline of this magnitude had not occurred since the cancellation of Mexico City New Airport (NAIM) project —the losses between October 23rd and November 16th, 2018 were (-) 8.57%—. This drop leaves year-to-date gains at 4.89%. Among the factors that contributed to this performance are:

- The expectation of a lower Gross Domestic Product growth in 2019, after a (-) 0.2% negative growth in 1Q19 quarter-over-quarter.
- The (-) 2.5% Gross Fixed Investment decline in February; the most significant drop for the second month of the year since 2015.
- The industrial production downward trend which fell (-) 2.6% in March.
- The decision to assign one of the main infrastructure projects of the current administration, the Dos Bocas refinery in Tabasco, to Pemex, a company in financial distress.



Source: Bloomberg

By the end of the second week of May, the US increased its tariffs from 10% to 25% on Chinese products worth 200 billion dollars. Technically, the 25% tariff does not apply to the merchandise that left Chinese ports before May 10th. That gives a margin of one or two weeks for the parties to reach an agreement, a minimal timeframe.

On Friday, May 10th, the spot exchange rate was 19.10 Mexican pesos per dollar and continues the upward trend that began on April 15th; since then, the Mexican peso has depreciated 1.30%. Nevertheless, year-to-date appreciation is 2.86%. The Mexican peso weekly depreciation is explained by:

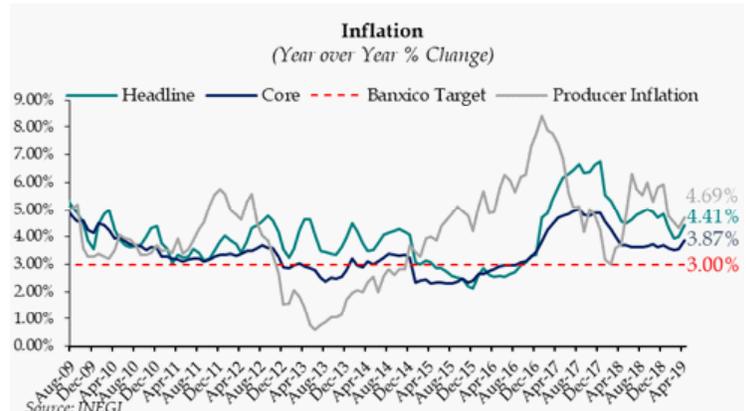
- The increase in the systemic risk caused by the increased trade tensions between the US and China. Noteworthy this is a short-term effect, since in the medium-term it may favor a higher trade surplus between Mexico and the US.
- The decrease in the foreigner positions in Mexican debt instruments, which fell (-) 1.32% in April.
- The uncertainty in the financial markets after the Federal Government declared void the bidding process for the Dos Bocas and announced that the construction would be carried out by PEMEX and the Energy Ministry.

In the second week of May, the 10-year M bond yield rate remained in the range between 8.12% and 8.16%, a 565-basis point spread against the 10-year US Treasury bonds, the highest spread in 8 weeks. This risk premium remains in the context of a (-) 1.6% decline in the position of foreigners in Mexican debt between March and April, which leaves the balance at 2.19 billion pesos (115.32 billion dollars). This figure also represents a decline of (-) 3.6% compared to February 8th when the position reached a 10-year maximum of 2.27 billion pesos (118.06 billion dollars). The rebound of inflation from 3.94% in February to 4.41% in April also contributed to higher interest rates, which should be considered by Banxico next monetary policy meeting on Thursday, May 16th.

Economic indicators

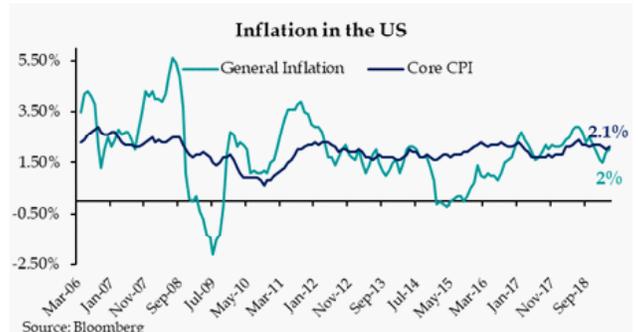
Inflation in Mexico

The annual rate of consumer inflation went from 4.0% in March to 4.41% in April, again outside the target range of the Bank of Mexico (Banxico) (3% ± 1%). Core inflation also experienced an increase of 32 basis points and stood at 3.87%. On the other hand, non-core inflation -which considers the prices of energy and agricultural products exclusively- was 6.08% annually. Noteworthy, inflation was not as low this month as there is a lower weighting of electricity rates in the National Price and Quotation Index (NCPI) with the new base year; this effect could be repeated in May. To the extent that inflation remains above the target range, the possibility of any decrease in Banxico reference rate will be hindered.



Inflation in the US

Inflation in the US was 2.0% in April, and underlying inflation 2.1%, in line with the US Federal Reserve's target of 2.0%; this favors the current monetary policy and immobility in the main reference rate that is located within the range of 2.25% to 2.50%.



Industrial production

Industrial production in March fell (-) 2.6% year-over-year and confirms the downward trend of industrial activities in Mexico, which in the first quarter of the year decelerated (-) 0.9%. The above contributed to the (-) 0.2% Gross Domestic Product decline in the first quarter of the year. Noteworthy, this is the fifth consecutive drop in production since October and that all its components showed a contraction. The sectors that fell the most were mining and construction, with a significant decrease of (-) 6.7% and (-) 5.8% respectively. In its monthly comparison, production decreased (-) 1.3% in the face of a significant setback in the construction of (-) 3.4%; this interrupts two consecutive months of increases in its monthly comparison.

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Definitions

MEXBOL INDEX: 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.

Spread: Measure of the value added by the portfolio or investment manager in excess of a particular benchmark, or index with similar level of risk.

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

Core CPI: The core Consumer Price Index refers to core inflation which systematically excludes food and energy prices because, historically, they have been highly volatile and non-systemic.

NAIM. Mexico City New International Airport in Texcoco.

Gross Domestic Product. A monetary measure of the market value of all the final goods and services produced in a period of time, often annually.

Gross Fixed Investment. Is a term used to describe the net capital accumulation during an accounting period for a country. The term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity.

Dos Bocas Refinery. Mexican government project to build a refinery in Dos Bocas, Tabasco.

S&P500. Is a basket of 500 of the largest U.S. stocks, weighted by market capitalization. . It is not possible to invest in an index.

Debt Instruments. Is a paper or electronic obligation that enables the issuing party to raise funds by promising to repay a lender in accordance with terms of a contract.

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, 2019 the Fund investment in the security is 0.00%.

Banxico. Mexico Central Bank, lender authority and lender of last resort.

Core Inflation. Is the change in costs of goods and services, but does not include those from the food and energy sectors.

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