

WEEKLY ECONOMIC REPORT

SEPTEMBER 11, 2020.

2021 Economic Budget: No effects in Mexbol

Mexican Stock Exchange

The Mexican Stock Exchange closed September 11th operations at 36,334 points, a flattish movement vs the previous week (-0.31% in pesos and 1.02% in dollars); thus, the year-to-date (YTD) decrease stands at (-)15.60% in the Mexican pesos and (-)25.19% in the US dollars. Unlike the US indexes, Mexbol showed resilience due to:

1. The lag in valuations that Mexbol has compared to its US peers. In terms of the forward price-earnings multiple (P/E), the Mexican index trades at 12.3x, (-)22.15% below its average of the last 10 years while the Nasdaq and S&P 500 trade at 31.23 times and 22 times, respectively; 62.65% and 51.7% above their average in the same period.
2. The 2021 economic budget presented by the Ministry of Finance (SHCP) which is forecasting that the 2021 growth estimate (4.6%) appears to be optimistic compared to the analysts' consensus (3.5%). However, there is likely upside risk to projections if there is a reactivation of private investment and the good performance of external accounts prevails.

Exchange Rate

The spot exchange rate closed September 11th operations at MX\$21.27 per dollar, a weekly appreciation of 1.29% that decreases the YTD depreciation to (-)12.38%. Consequently, the peso continues immersed in the appreciation trend that began on April 8th, when the exchange rate fluctuated at MX\$22.67 per dollar, since then the recovery of the Mexican peso amounts to 6.01%. The good performance of the Mexican currency in the previously mentioned period is due to the substantial improvement that the Mexican external accounts have shown as a consequence of the economic recovery in the United States.

Economic Indicators

2021 Economic Budget

On September 9th, the SHCP sent the 2021 Economic Package to the Legislative authorities. The proposal consists of the General Criteria of Economic Policy 2021 (CGPE), the Initiative of the Federal Income Law (LIF), and the Budget of Expenditures of the Federation (PEF); besides, tax reform initiatives are included. This process marks the beginning of discussions within the chambers of deputies and senators and concludes with the approval of those documents whose deadlines stipulated by law are October 31st for the LIF and November 15th for the PEF.

The CGPE include the expectations of the SHCP on the evolution of the main economic variables in 2021, as well as the estimates for the end of 2020:

1. An estimated 2020 GDP contraction of (-)8.0%, and a 4.6% growth in 2021e. According to the expectations of the analysts surveyed by Banco de México (Banxico), both scenarios are optimistic, as the consensus expects a (-)9.85 decline in 2020 and a 3.5% recovery in 2021.
2. The government expects the oil production platform to increase to 1.85 million barrels per day (mbd) in 2021. According to July's data (latest available), Pemex production totaled 1.62 mbd, therefore a 14.2% increase must be reached to meet the goal. The objective is complicated if we consider that so far in 2019, with the support of the federal government, Pemex has only been able to increase production by 0.65%.
3. The exchange rate is expected to close at MX\$21.90 in 2021, like current levels (the average in the first ten days of September was MX\$21.63 per dollar). The figure is plausible considering the strength of the Mexican external accounts, which we have referred to in previous weekly reports.

In 2021 the budgetary income would total MX\$5.53 trillion (-3.0% than in 2020), and the expenditure would total MX\$6.25 trillion (-0.03% less than the previous year). The above would result in a negative economic balance of MX\$718 billion, corresponding to 2.9% of GDP; if the financial cost of the public sector is subtracted from this figure, there would be a minimum primary surplus of MX\$6.20 billion (0.0% of GDP).

In 2021, the budgetary income (MX \$ 5.54 billion) would have a (-)3.0% fall compared to 2020. Some of the most important changes within its components are:

1. Oil revenues (16.9% of budget revenues) will total MX\$936.8 billion, a (-)8.3% drop compared to 2020. The data is consistent with the poor performance that Pemex has had for some years and that has recently intensified.

2. Tax revenues (63.78% of budgetary revenues) that is, taxes, would total MX\$3.53 billion, (-)2.6% less than in the 2020 LIF. The three most important taxes would have the following behavior:

- a. Income Tax (32.91% of budget income) collected in 2021 would total MX\$1.82 trillion, (-)4.8% regarding the LIF 2020.
- b. The Value Added Tax (16.89% of budget income) in 2021 would be for MX\$936 billion, (-)10.2% compared to 2020.
- c. The Special Tax on Production and Services (gasoline, tobacco, soft drinks, beers, which represents 8.19% of budget income) in 2021 would total MX\$454 billion, a (-)14.9% decline.

These tax revenues depend on the growth of the economy in 2021. This could explain the optimistic bias of the SHCP when estimating an economic growth of 4.6% in 2021. A lower growth would result in a lower collection of the three previously mentioned taxes.

3. In contrast to most budget revenue items, non-tax revenue (3.68% of budget revenue) will total MX\$204.1 billion, which will represent a 19.2% increase regarding 2020. It is possible that the extinction of the trusts announced by the president is accounted for in this item and hence its increase.

The federation's total spending (MX \$ 6.53 billion), which normally shows an increase year after year, will have a minimal (-)0.3% fall. The changes in the items are as follows:

1. Current spending, which represents 43.54% of the PEF and is sent to the state ministries (Ministry of Health, Ministry of Economy, etc.), will be MX\$2.74 billion, (-)1.3% regarding 2020. The ministry that will most benefit from this budget will be tourism, since its income would increase by 667%, although noteworthy this increase mainly reflects the budget allocated for the construction of the Mayan train. In contrast, the most affected ministry will be the Labor and Social Welfare since its income will decrease by (-)17.5%; This leads to a reduction in resources for one of the most important programs of the current administration "Young People Building the Future".
2. The funds that the federation sends to the states without specific instruction (14.72% of the PEF), will total MX\$921 billion. This figure represents a (-)6.4% decrease compared to 2020 or a smaller flow of MX\$62.70 billion.
3. Subsidies (0.23% of PEF), which are a component of investment spending given their impact on lower-income households through the development of the neediest areas, will have the strongest adjustment since they will total MX\$14.4 billion, (-)33.0% less than last year.

Industrial Activity

The Industrial Activity Indicator (IMAI) registered a 6.9% monthly increase in July. By components, manufacturing industries rose 11.0%, electric power, water, and gas 5.5%, construction 0.9%, and mining 0.8%. In its annual comparison, industrial production fell (-)11.6%. The good performance of the manufacturing industry that derives from the economic reactivation of the United States and the close industrial link between the two countries stands out. Despite the above, it should be noted that the IMAI still needs to recover 8.40% to reach the levels observed prior to the crisis caused by COVID-19.

Gross Fixed Investment

Gross Fixed Investment (IFB) in June had a (-)25.2% annual decrease. By components, construction expenses decreased (-)26.6%, and total machinery and equipment (-)25.3%. Despite the fact that the IFB shows negative annual growth, in its monthly comparison, it had a 20.1% growth. Despite the above, the indicator still needs a 23.14% recovery to return to levels prior to COVID-19. In this sense, the proposal made by the Business Coordinating Council (CCE) of an investment package in the energy sector that could total MX\$2.09 billion stands out. If this proposal is approved, the indicator could resume the momentum it lost since the current federal administration began.

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Definitions

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.

Budget of Expenditures of the Federation (PEF): Public policy document prepared by the Ministry of Finance and Public Credit that describes the amount, form of distribution and destination of public resources of the three branches (Executive, Legislative and Judicial), of the autonomous bodies, as well as transfers to state and municipal governments.

Business Coordinating Council (CCE): It is an autonomous body that represents the business sector and regulates actions of organizations from various business sectors in Mexico, in order to boost the country's economic growth and the level of competitiveness of Mexican companies.

COVID-19: The disease caused by the coronavirus, a family of viruses that were discovered in the 60s but whose origin is still unknown. Its different types cause different diseases, from a cold to a severe respiratory syndrome.

General Criteria of Economic Policy 2021 (CGPE): Document that raises a macroeconomic context that has a direct impact on Public Finance.

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

Gross Fixed Investment (IFB): Describes 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.

Industrial Activity Indicator (IMAI): Indicator to follow up on the evolution of the industrial sector, providing valuable information for decision making.

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.

Nasdaq: Is the second largest automated and electronic stock exchange in the United States, the first being the NYSE, with more than 3,800 companies and corporations.

Petróleos Mexicanos (PEMEX): 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 August 31, 2020 the security represents 0.00% of Portfolio Net Assets. For a list of full securities please visit: http://www.mxefund.com/portfolio_holdings.html.

Price to Earnings Ratio (P/E): Is a valuation ratio of a company's current share price compared to its per-share earnings.

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.

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

The Ministry of Finance and Public Credit (SHCP): Is the government entity responsible for proposing and controlling the economic policy of the Mexican Federal Government regarding the financial, fiscal, expenditure, income and public debt sector.

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.

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