

WEEKLY ECONOMIC REPORT

MARCH 20, 2020.

Aggressive stimulus programs around the world, but not in Mexico

During the past week, the World Health Organization (WHO) declared that the epicenter of the COVID-19 pandemic moved from China to Europe. Italy and Spain are the most affected countries, with almost 61 thousand confirmed cases. Practically all the European economies are at a standstill, which motivated the reaction of most of the region's governments and central banks:

- i. The European Central Bank (ECB) announced the "Pandemic Emergency Purchase Programme" that consists of the acquisition of public sector bonds for €750 million, additional to the €120 million announced last week.
- ii. The Bank of England (BoE) unveiled a quantitative easing program that will inject £645 billion into the economy. This program is in addition to the one already in place for £325 billion. Besides, in extraordinary meetings, the BoE reduced its overnight rate from 0.75% to 0.1%.
- iii. The German government will allocate loans of US\$550 million for micro and small businesses. The movement was made through the state bank KfW.

Although the epidemic in the United States is not yet at its critical point, the measures announced by both its central bank and government exceed those of the European economies. Specifically, the following decisions have been made:

- i. The Federal Reserve (Fed) announced it would start buying bonds to increase its balance by US\$700 billion. Additionally, it reduced the rate of bank reserve requirements to 0.0%.
- ii. The Fed reduced two times its reference rate from a range of 1.0% - 1.25%, to the current 0.0% - 0.25% level.
- iii. The United States government announced a rescue package proposal, that will range from US\$850 billion to US\$1.3 trillion. The funds will be used in cash payments for the poorest families, extraordinary extensions in student debt payments, loans to the airline sector, and zero-rate loans to micro and small businesses.

In Mexico, there is no official statement from the federal government regarding economic measures to mitigate the economic costs that the COVID-19 pandemic will cause. The Senate has already called on the federal government to design an action plan to combat COVID-19. The Chamber of Deputies presented an initiative to reduce the 2020 primary surplus from 0.7% to 0.6% and use those resources (approximately US\$1.12 billion) to support the health system; the initiative has not been voted. Finally, the Business Coordinating Council (CCE) requested to eliminate the 2020 primary surplus.

Stock Markets

The spread of the virus in different countries and the acceleration of its contagion rate, together with the announced stimulus packages, caused the stock indexes to have another week of high volatility. Below are the results of the leading indexes at the end of March 20:

- i. The S&P 500 ended at 2,304 points, which implies a weekly loss of (-) 14.95%, and a Year to Date (YTD) decline of (-)28.33%.
- ii. The Dow Jones ended at 19,173 points, a WoW drop of (-)17.29%, and YTD loss of (-) 32.41%.
- iii. The Nasdaq closed at 6,879 points, being the most defensive index of the three NYSE indexes, this year. The WoW loss was (-)12.62%, and the YTD decline is (-)23.10%.
- iv. Mexbol ended the week at 34,269 points for a weekly collapse of (-)16.24%. Therefore, the YTD loss totals (-) 38.43%.
- v. Europe's Stoxx 600 ended at 293 points, implying a WoW fallout of (-) 5.60% in dollars. The above indicates a YTD decline of (-)32.65%.

Spot Exchange Rate

The spot exchange rate closed March 20th operations at MX\$24.41 per dollar. The above implies a weekly depreciation of 11.35% of the Peso, which increases the YTD depreciation to 28.94%. Noteworthy, this is the highest value that the exchange rate has reached in all history. The Exchange Commission, chaired by the Ministry of Finance and the participation of Banxico announced, on March 9th, the expansion of the exchange hedges program to US\$30 billion (+US\$ 10 billion). This program began in 2017 with a fund of US\$20 billion because of the volatility caused by the threat of president Trump to cancel the North American Free Trade Agreement (NAFTA). Two auctions have been held under this program:

- i. On March 12th, Banxico auctioned US\$2.0 billion; the demand was US\$ 2.78 billion, and US\$ 460 billion were assigned.
- ii. On March 18th, it held a second auction for US\$2.0 billion in currency hedges; the demand was US\$3.76 billion and US\$1.53 billion was placed.

Additionally, on March 19th, Banxico announced an agreement with the United States Federal Reserve for the implementation of reciprocal and temporary mechanisms for the exchange of currencies or "swap lines". The entire line is for US\$60 billion with a validity of at least six months. Banxico has similar arrangements with the central banks of Canada, England, Japan, Europe and Switzerland.

Banxico's Decision

In a decision, ahead of its meeting scheduled for March 26th, the Board of Governors of Banxico reduced the target for its reference rate by 50 basis points (bps). This movement implies a reduction of 175 bps since Banxico started the adjustments cycle last August, when the rate was at 8.25%. Additionally, it announced new measures to inject liquidity into the markets:

- i. Decrease in the Monetary Regulation Deposit (DRM) by MX\$50 billion for various banking and development institutions. Before the change, the DRM amounted MX\$320 billion.
- ii. Reduction in the interest rate of the ordinary liquidity facility that normally ranged from 2 to 2.2 times the Banxico target rate to 1.1 times the target.

COVID-19 Projections

Based on China's and Europe recent cases as well as Mexican experience with the H1N1 virus ten years ago, Mexican health authorities presented an official projection of the approximate duration of the crisis (that should be overcome by June) as well as the number of people that might get infected and require hospitalization. These are the figures:

- i. The coronavirus will infect 70% of the Mexicans, approximately 90 million people.
- ii. Only 250 thousand Mexicans (2% of total Mexican population) will develop the COVID-19 disease.
- iii. From the 250 thousand ill people, 70% (175 thousand) will seek medical help, 80% (140 thousand) will require outpatient treatment, 20% (35 thousand) will require hospitalization, 14% (24.5 thousand) would not enter intensive care, 6% (10.5 thousand) will require intensive care.
- iv. The mortality rate that the federal government is waiting for coronavirus is 2.5% of patients, about 4 thousand.

To deal with COVID-19 crisis, Mexican policy makers announced a three stages plan. So far Mexico is in the first stage (contention), with efforts focused on limiting the spreading of the infection by the identification and isolation of confirmed and suspected cases (164 so far). Stage 2 of the plan will begin by the end of March with the extension of school spring holidays in April-May, and a strong recommendation for citizens to keep social distance, for companies to allow "home office" for their employees whenever possible and for families to remain home. Stage three, should imply strong isolation measures such as the one adopted by China, Italy or Spain with huge economic costs. It might be called upon if the number of cases grows at an explosive rate; possibly by mid-April if contention efforts fail.

Economic indicators

Global Supply and Demand

In the fourth quarter of 2019 (4Q19), the global supply of goods and services presented a (-)0.8% QoQ decrease. The above is the result of a QoQ contraction of (-)0.1% of the GDP, and a fall of (-)2.4% in the import of goods and services. Components of global demand had the following quarterly results: exports of goods and services fell (-)4.6%, gross fixed investment decreased (-) 1.4%, government consumption increased 0.9%, and private consumption had no variation.

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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.

Bank of England (BoE): Is the United Kingdom's central bank.

Basis points (bps): Refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001.

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.

Dow Jones: Is a stock market index made up of the 30 companies with the largest market capitalization on the NYSE, with the exception of transportation and public services.

European Central Bank (ECB): Is the central bank responsible for monetary policy of those European Union member countries which have adopted the euro currency.

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.

H1N1: Was a pandemic caused by a variant of Influenza virus A (subtype H1N1), which emerged in 2009.

KfW: Is a German state-owned development bank based in Frankfurt.

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.

Monetary Regulation Deposit (DRM): Mandatory long-term deposits that the national credit institutions have to establish in the institute central.

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.

New York Stock Exchange (NYSE): It is the largest stock market in the world in monetary volume and the first in number of affiliated companies.

North American Free Trade Agreement (NAFTA): A regulation implemented January 1, 1994 in Mexico, Canada and the United States to eliminate most tariffs on trade between these nations.

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

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.

Stoxx 600: Is a stock index made up of the top 600 companies by European market capitalization.

The Federal Reserve System (Fed): Is the central bank of the United States and arguably the most powerful financial institution in the world.

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.

The World Health Organization (WHO): Is the body of the United Nations Organization specializing in the management of health prevention, promotion and intervention policies worldwide.

Week over Week (WoW): Refers to the mathematical process of comparing one week of data to prior week'.

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.

4Q19: Period that starts the fourth and last quarter of the year 2019 which ends on December 31.

Disclosures

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