

WEEKLY ECONOMIC REPORT

SEPTEMBER 25, 2020.

Banxico's monetary policy decision weakens the peso

Banxico's Governing Board decided to reduce the reference rate by 25 basis points (bps) to 4.25%. The rate cut, which contrasts with the previous five consecutive 50 bps cuts since March 2020, was justified by the following arguments:

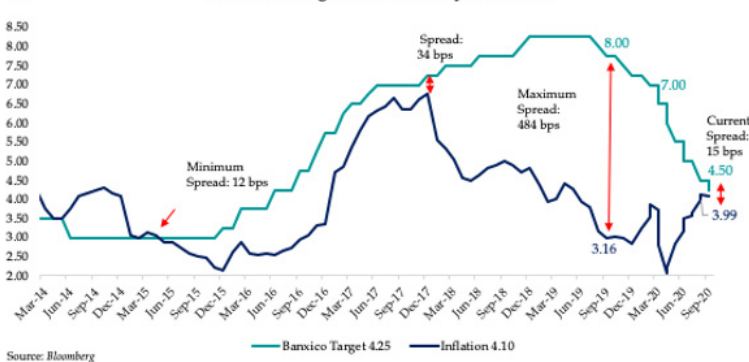
1. Banxico estimates that the demand for goods and services will continue to be lower than the supply, given the uncertainty in Mexico's economic recovery.
2. The central bank claims that the recent increases in headline and core inflation have a short-term effect on the overall path of inflation. Despite this, the Board estimates that in the next 12 to 24 months, both are expected to be around 3.0%.
3. They foresee the possibility that the persistence of distancing measures will reduce the demand for certain goods and services, so prices could fall.

The decision could be classified as unorthodox given that annual inflation in the first half of September stood at 4.10%, and core inflation, which is the most relevant for monetary policy decisions, was at 3.99%, practically in the limit of the central bank tolerance range (3.0% +/- 1.0%). Regarding future monetary policy decisions, the statement acknowledges that the space for monetary policy is limited by the recent increase in inflation; this effect raises since the decline in the reference rate was joint by greater pressure from the rise in the peso-dollar exchange rate.

Stock Exchange

The spot exchange rate closed September 25th operations at MX\$22.34 per dollar for a (-) 5.70% weekly depreciation, which leaves the year-to-date (YTD) decline at (-)18.08%. In a context of widespread risk aversion, which hurt most equity markets in the middle of the week, the peso was affected significantly; Banxico's monetary policy decision aggravated the exchange rate pressure. The above leaves no incentives for Mexican investors to participate in the local money market, since once inflation (4.10%) and the tax rate (1.40%) are discounted, a negative real interest rate of (-)1.25% is obtained.

Banxico Target & Bi-Weekly Inflation



Mexican Stock Exchange

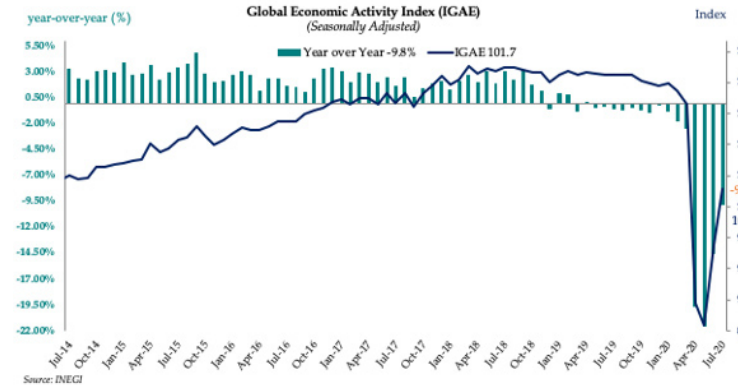
Mexbol closed September 25th at 36,049 points, a 1.57% weekly advance in pesos, although the strong depreciation of the peso prompted a (-)4.83% decline in US dollars. Therefore, the YTD loss totals (-)15.03% in the Mexican currency and (-) 28.46% in US dollars. The resilience that the index shows around the 36,000 points is based on:

1. Mexbol's current Price/Earnings forward ratio (P/E), which stands at 14.1 times (14.1x), considerably lower than the P/E of the S&P 500, Dow Jones, and Nasdaq, which stand at 21.3x, 20.12x, 30.1x, respectively.
2. The 3Q20 earnings season will take place in the first half of October. Positive results would contribute to rally in the index.
3. The publication of economic indicators that display the recovery of the Mexican economy continues. July's IGAE showed that, since the minimum of the year (May), the indicator has had a 14.98% recovery.

Economic Indicators

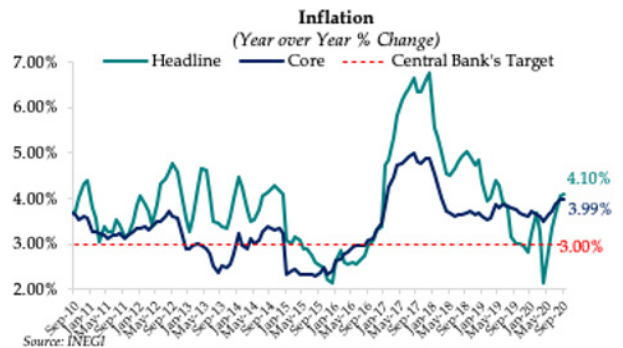
IGAE

The Global Indicator of Economic Activity had a (-)9.8% annual fall in July. By activities, primary grew 10.6%, secondary fell (-)11.6% and, tertiary activities dropped (-)10.0%. Despite the indicator showed an annual drop, it shows a significant recovery since May (minimum of the year due to COVID-19), as the indicator shows a 14.98% recovery of 14.98%. Noteworthy, the recovery of the economy is the result of an improvement in secondary activities and specifically in the manufacturing industry (15.04% of gross domestic product (GDP)) as a result of the growth in US demand. The above, since secondary activities had a 26.10% recovery compared to May's data.



Inflation

In the first fortnight of September 2020, the National Consumer Price Index (INPC) had a 4.10% annual inflation. The core price index increased 3.99%, and the non-core price index grew 4.44% annually. In all three cases, inflation is above Banxico's tolerance range, which, according to the words of the Governor of the Bank of Mexico, Agustín Díaz de León, limited the Governing Board to reduce the rate by 50 bps at the monetary policy meeting of September 24th.



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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.

Consumer Price Index (INPC): Is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

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.

Global Indicator of Economic Activity (IGAE): Allows to know and monitor the monthly evolution of the real sector of the economy.

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.

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

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.

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.

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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