

WEEKLY ECONOMIC REPORT
Week Ended May 11, 2018.

NAFTA and the political environment: two factors of concern for Mexican markets. Banxico: What is going on with the integrity of the payment system?

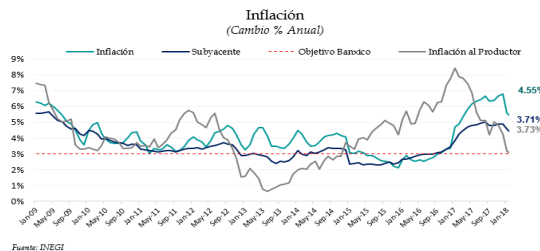
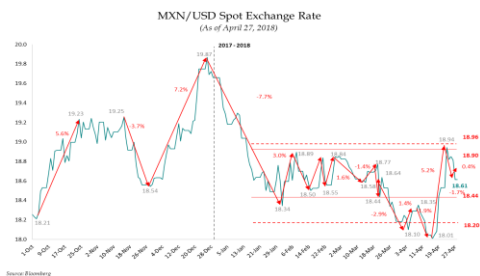
The IPyC lost 0.49% in the week ended May 11th and is down 4.86% against the dollar year to date. The peso also registered its fourth straight losing week (0.79%) closing at \$19.42 to the dollar and, lowering its year-to-date gain to 1.21%. Mexico's equity and foreign exchange markets were impacted by greater investor risk aversion in response to:

1. The delay with an agreement in principle regarding the North American Free Trade Agreement (NAFTA). Specifically, on May 7th, the main negotiating parties from Mexico, Canada and the U.S. resumed negotiations to modernize NAFTA. During this round, the issues at dispute are: (i) the "Sunset clause"; (ii) dispute resolution mechanisms; (iii) farm product seasonality, and (iv) auto sector rules of origin. Regarding the latter, the Trump administration has proposed increasing the regional content of autos to 75% from 62.5% with 40% coming from areas with wages above or equal to US\$16 per hour. Mexican negotiators responded with their first counterproposal to increase regional content from to 70% from 62.5%. At the end of the week, it was announced that May 17th is the deadline for sending the modified agreement to the current U.S. Congress—which has a Republican majority—to be voted on prior to the arrival of new legislation.
2. A political scenario in which the candidate for the "Together We Will Make History" coalition—who has proposed public policies that fly in the face of the current administration's structural reforms— remains ahead in the polls.

U.S. inflation reached 2.5% in April, much higher than what the Federal Open Market Committee had estimated in its March meeting for full-year 2018 (1.9%). This jump could generate the conditions that force the FOMC to implement another hike in its reference rate on top of the two already expected for the rest of the year. U.S. equity markets, however, appear to have underestimated this possibility along with the recent oil price increase after the country terminated its agreement with Iran. Thus, main U.S. stock markets, Dow Jones, S&P 500 and NASDAQ recorded gains of 2.51%, 2.49% and 2.73%, respectively, for the week, and 1.26%, 2.72% and 7.64% year-to-date.

Index	1 week	1 year	YTD	Country
DOW JONES INDUS. AVG	2.51%	21.45%	1.26%	US
S&P 500 INDEX	2.49%	16.15%	2.72%	US
NASDAQ COMPOSITE INDEX	2.73%	22.38%	7.64%	US
S&P/BMV IPC	-0.49%	-4.02%	-4.86%	MX

In other relevant information, Banco de México's Governing Board will hold its monetary policy meeting on May 17th. The overnight rate is expected to remain at 7.50% due to the downtrend in Mexico's year-on-year inflation, which according to INEGI reached 4.55% in April (its lowest level since December, 2016). Although no hikes are expected in the reference rate in 2018, risk factors that could generate an adverse scenario include: the NAFTA negotiations, the Fed's monetary normalization process and the July elections in Mexico. Regarding Banco de México, in contrast with the administrations of Agustín Carstens and Guillermo Ortiz, whose priority was to preserve the integrity of the payment system, a series of events recently called it into question. During the week ended May 11th, Banco de México's payment system faced a series of issues the monetary authority was unable to resolve or explain, casting doubt over Alejandro Díaz de León's management of the Central Bank.





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Definitions

FED – The Federal Reserve System is the central bank of the United States and arguably the most powerful financial institution in the world.

INEGI - The National Institute of Statistics and Geography. It is the institution responsible for performing the population census every ten years; as well as the economic census every five years and the agricultural, livestock and forestry census of the country.

IPyC – The *Indice de Precios y Cotizaciones (IPyC)* is a capitalization-weighted index of the leading stocks traded on the Mexican Stock Exchange. The index was developed with a base level of 0.78 on October 30, 1978.

Mexican Stock Exchange – The Mexican Stock Exchange headquartered in Mexico City, is the full service securities exchange of the country, dealing in cash equities, derivatives and fixed income products.

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. The three countries phased out numerous tariffs, (with a focus on those related to

Experience

Consistency

Vision