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The Company Newsletter for Supply Chain Finance.

E FACTOR NETWORK NEWSLETTER

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Company News and Highlights

Supply Chain Finance Solutions for Cash Requirement.

Fintech products and market development based on Fundamentals of Economic Theory and Financial Risk.

ECONOMIC EXPECTATIONS FOR 2019

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The International Panorama. In the last quarter of 2018, some doubts appeared about the vigor of the global economy and especially the risk of probable recession in the United States and in general in advanced economies. The fear of the market is based on three important pillars: the trade War of China and the United States, the stoppage of labors of the Trump government and the perplexing sustained growth without any setback in the American economy.

The trade war against China has led the United States to impose a tariff of 25% to 50 billion of dollars (MMD) of the imports of China and one of 10% to 200 billion additional of this country, which can be raised to 25% at the end of the trade truce the ProX IMO March first. China responded with a tariff of between 5 and 10% at 60 MMD of U.S. imports. There is a significant risk if there are no other ways to settle trade disputes between these countries before starting another round of tariff hikes once the trade truce is over. For the time being, the Chinese economy has resented tariff measures, the gross domestic product (GDP) grew by approximately 0.5% less (from 6.9% to 6.2%) And this coupled with the high debt of banks and the need to reinforce financial regulation, makes it quite probable the scenario of a slowdown in the growth of the Asian giant, but without losing a growth of 6%.

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The work stoppage of the Trump administration does not actually have substantial macroeconomic consequences per se, but rather it sends a signal of division and the absence of political competence to achieve consensus, important analysts argue that unemployment Alarm the markets as it reveals the lack of leadership to face a recession or a financial crisis in the future. Finally, deep down, America's growing concern is that it is almost 10 years without any recession, which increases the perception that some should come in the future. If we add that it is rare for a recession to be supposed to be extrapolated from the recent present, it is reasonable for markets to react even as the economy continues to expand vigorously.

While we believe these risks are plausible, the US continues to have high growth compared to its trend, which will close the 2018 to around 2.9%. Neither the latest indicators such as the increase in December of 2018 of 0.3% of industrial activity and 1.1% of manufacturing or the interest rate curve indicate a probable recession. What analysts expect is that the growth of the United States begins to slow, the International Monetary Fund (IMF) in its World Economic Outlook Update places growth at 2.5% in 2019 and 1.8% in 2020, while the Survey of Professional Forecasters, with the opinion of 37 analysts, locate the growth of 2019 in 2.7%, 1.8% in 2020 and 1.5% in 2021.

The slow growth of the Euro zone must be added to the US slowdown, owing to the uncertainty of Brexit, idiosyncratic factors in Germany and Italy, and Turkey's contraction.

The Panorama of Mexico. It must be recognized that 2019 can be more complicated in Mexico due to the uncertainty in the economic policy of the present administration, the learning curve of the government and the over-reaction of the markets in a more complicated international framework. Still, we believe that the base scenario is far from alarming. Table 1 contains the predictions for the most important macroeconomic variables, including growth, inflation, the Bank of Mexico reference rate, the Cetes days and the exchange rate. The table presents the expectations of the survey of specialists in economy of the private Sector (EEESP) that carried out Bank of Mexico in December of 2018, also the survey Citibanamex of most recent expectations (January 22, 2019) and the Update of the World Economic Outlook of the IMF (January 21, 2019). Additionally, we include ranges where we believe that these variables can most likely be located during the 2019, the details of the construction of these can be consulted in the methodological note presented at the end of the Newsletter.

Table 1
Summary of Perspectives for 2019 and 2020 of different analysts

		Perspectives on the main macroeconomic variables in Mexico				
		Analyst expectations				
		Banxico a)	Banamex b)	FMI c)	Rango Propuesto	
Growth GDP	2018	2.1	2.1	2.1		
	2019	1.8	1.8	2.1	1.5	2.1
	2020	2	2	2.2	1.7	2.3
Inflation	2018	4.83	4.83	4.83		
	2019	3.89	3.96	3.618	3.6	4.4
	2020	3.79	3.5	3.009	3.4	4.2
Target rate Banxico	2018		8.25			
	2019				8.25	8.5
	2020				7.75	8.25
Cetes 28 days	2018	8.1	8.25			
	2019	8.12	8.25		8.17	8.43
	2020	7.5			7.66	8.17
Exchange rate	2018	20.3				
	2019	20.7	20.33		20.1	20.9
	2020	20.81	20		20.6	21.2

Source: A) median survey of private Sector economics specialists, Banxico; B. Citibanamex survey, 22 January 2019; The World Economic Outlook Update, IMF, January 2019. The range was built according to methodological note

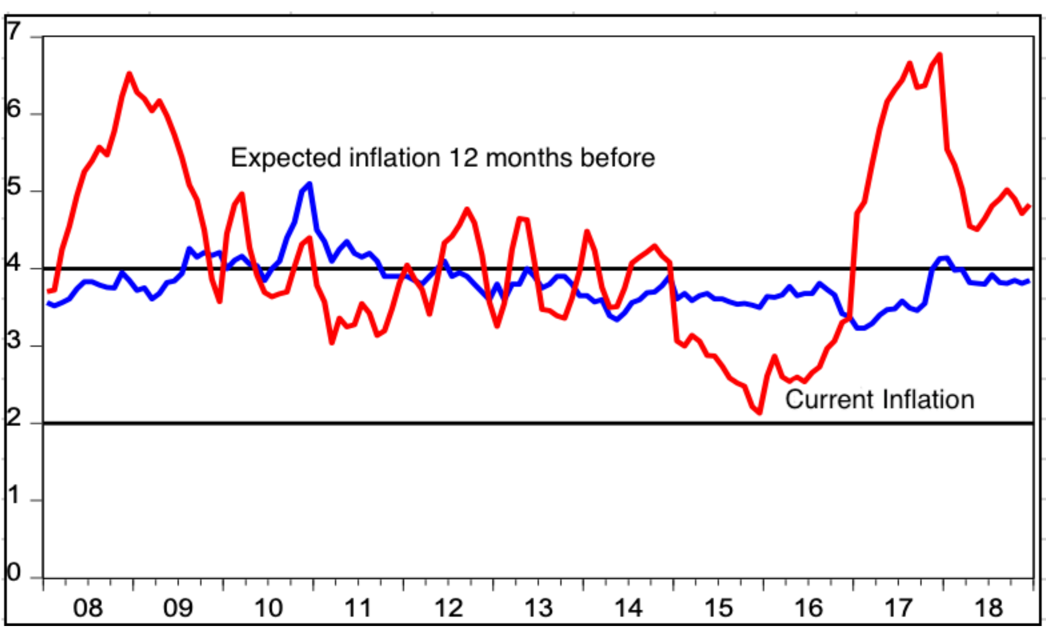
Slight contraction in the growth rate. Although the markets reacted abruptly to the cancellation of the New Mexico City International Airport (NAICM), and a more uncertain business environment was anticipated, the most recent indicators of economic activity only confirm a slight Slowdown. In November 2018, the industrial activity remained stagnant with respect to October (seasonally figures), but the manufactures grew almost 1%. The gross fixed investment still grew by 0.2% per month in October. On the external side, as mentioned, the United States continues to grow rapidly which supports the scenario of a slightly lower growth of 2%, with the lower limit being 1.5% that coincides with the range of the general economic policy criteria 2019, which It's from 1.5 to 2.5%.

However, we must stress that we are considering that the shortage of internal petrol is a transitory problem, if not the case we would have to revise the forecast. Other risks to the growth of the next year is that the trade war in China and the United States is escalated or that the political environment is thinned for the eventual approval of the new version of the North American Free Trade Agreement (T-MEC).

Inflation returns to target range. More consensus on inflation, most analysts suggest that the 2019 will mark the return of the inflation rate to the range of 2% to 4%, although the prediction points to the upper limit. Graph 1 shows how the expectations of the analysts converge to the objective and although the inflation was left of it for almost two years, always took for granted the correction to the objective, slowly but surely. Indeed, the inflation expected a year earlier has never come out of the target range of inflation, which is consistent with the phenomenon of anchored expectations. Given that the main component of inflation is its expectations and that there are no significant increases in energy prices, both national and international, it is highly probable that the planned scenario will be given.

Graphic 1

Current and expected annual inflation in Mexico



Source: Survey of Specialists in private Sector economics, Banxico and INEGI

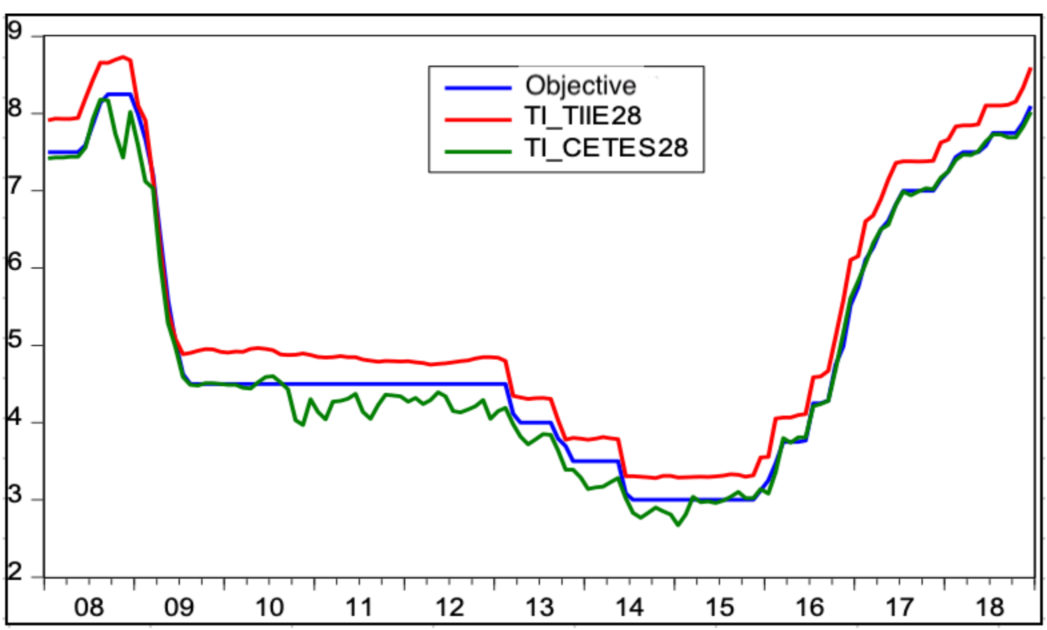
The main risk in inflationary matters is the increase to the minimum wage of 100% in the northern border, and 16% in the rest of the country. However, both in January 2017 and 2018, minimum wages increased 10%, and contractual salaries continued to grow at the same rate as in 2016, i.e. about 4%. This is evidence that contractual revisions are no longer anchored to the minimum increments. In this regard, the greatest risk would be in the border states, but only the sectors of non-tradable services would be able to transfer the increase in labor costs to the consumer.

Moderation in the elevations in the target interest rate. To the extent that inflation follows the downward trend towards the target range and that the Fed assumes a more dovish attitude, it is reasonable to anticipate the Bank of Mexico assuming a more moderate position. It must be recognized that in Mexico the mandate is unique, inflation, but once controlled, there is no reason to inhibit further growth in aggregate demand if the economy is slowing down and whether the expectations that the US will eventually take a Path of less growth. For these reasons even some analysts believe that they could lower the target rate in the short term.

Another factor that makes us think that the recent upward trend in the target rate tends to end in 2019, is that even at a rate of inflation of 4%, real interest rates would be above 4%, levels that seem high compared to the recent evidence and the estimates of the neutral interest rate of advanced countries. Additionally, the two new sub-governors of the Bank of Mexico will surely have a less orthodox or hawkish position compared to previous meetings.

In our position, we believe that a more appropriate range would be to think of being kept at the same level or that they could increase again 25 PB in the event that the deflation is slower. As illustrated in graph 2, Banxico's target interest rate determines the trend of interbank Fund (TIIE) and government (e.g. Cetes) interest rates in the short term, so we would expect relative stability in the same during 2019.

Graph 2
Objective interest rates, Cetes 28 and TIIE 28



Source: Banxico and INEGI

High, but stable exchange rate. The long-time exchange rate that has ceased to respond to the fundamentals of the economy, whether it is inflation or interest rate differentials. The bad news is that its extreme volatility and dependence on market sentiment make it unpredictable. The good news is that both inflation and growth and employment have ceased to depend on exchange dynamics. Under a fixed exchange rate, the currency pressure that was given from the end of the 2016 would have plunged the country into a stagnation but far from that, inflation continued to descend to the lower limit until it was diverted from the target by the "Gasolinazo", and the growth It continued to grow by about 2% with an unemployment rate below 4%. Those are the advantages of the flexible exchange rate.

To the extent that alarming economic or political events do not arise, the widespread expectation is that it remains slightly below 21 pesos per dollar. The ranges we propose using the methodology described at the end of the Newsletter is 20.1 to 20.9 pesos per dollar for 2019, and 20.6 to 21.2 in 2020.

Methodological Annex

The proposed ranges for GDP growth, inflation, and exchange rate consist of a standard error up and down the base forecast. Ie f t ± se (f t), where F is the prognostic and "se" is the standard error of the same, the time can be 2019 or 2020. The base forecasts of growth, inflation and exchange rate for 2019 are 1.8%, 4% and 20.5 pesos per dollar respectively, for the 2020 are 2%, 3.8 & and 20.8 pesos per dollar. Standard errors were estimated using the bootstrapping re-sampling technique using the history of growth and inflation of the past seven years as a basis, and in the case of the exchange rate the averages of the last twelve months were used and in this case for Build the range two times the standard error was used.

In the case of the objective interest rate of the Bank of Mexico the rank is imposed by the analyst. Once determined, the interest rate of Cetes is forecasted by a simple linear regression between the interest rate of Cetes 28 annual average against the average annual target rate.

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