



Salles Sainz

Grant Thornton

An instinct for growth™

Economic perspectives for Mexico and the world



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Introductory Letter

C.P.C. Mauricio Brizuela Arce
Managing Partner



Welcome to the second edition of our document of analysis: "Economic Perspectives for Mexico and the World".

We continue to live moments that will change economic, political and social history in all economies and global markets, so we want to contribute with timely information and keep our clients and friends up to date, looking for the best possible decisions before the changes come true in 2018.

In this publication we will talk about topics of interest, from an international perspective but of relevance to Mexico, as well as specific aspects of our economy offering forecasts and recommendations.

2018 will be a key electoral process in Mexico that could delay the adjustments to a fiscal reform in the country capable of counteracting the effects of the recent reform of USA.

Being aware of the main macroeconomic variables of the Mexican economy is a necessary exercise to mitigate the risks of possible challenging scenarios that we may be facing. Here we will offer you how the specialists foresee that such scenarios will behave during the following months. The economic sectors of greater relevance also deserve a particular analysis, given that some of them will offer opportunities for our country even in challenging scenarios.

We intend that with our analysis you can learn about the main global and national events.

2017 was a year of change and uncertainty and we hope that 2018 will be one of great opportunities for companies in our country.

The world grows at moderate rates, but the shadow of protectionism appears on the horizon.

Executive Summary

2017 started with a panorama filled with uncertainty. Everything seemed to indicate that the world would face various economic, commercial, and social conflicts that would affect the growth rate of all nations. However, reality improved expectations. The main risks did not materialize; the big changes announced by the new U.S. President have not taken shape yet. The “Brexit” has made some progress this year, and the threat to trade protectionist trends is still present, but without any major implications. At the same time, there was certain stability and oil prices showed a positive trend.

The world is in a stage of moderate growth, though differentially in the distinct regions, which can lead to trade disputes in the future. On the other hand, the trend toward protectionism in some countries might have an effect on world growth, and in job creation and well-being. The world was a scenario of multiple terrorist attacks that brought about uncertainty and decreased expected consumption and investment in the zones affected. Regrettably, it is quite likely that this type of events continue to occur throughout 2018.

The renegotiation of NAFTA will be one of the main factors that will affect Mexico’s economic performance in 2018. Agree upon new exchange terms by incorporating new technologies and adjusting some current market conditions has become the main objective. However, the talks continue and the positions of each country in dealing with certain issues make negotiations complicated and are conducive to speculation and uncertainty. In the event that an agreement should not be reached and the treaty is cancelled, Mexico would adopt the trade rules of the World Trade Organization (WTO). These new rules would not have any

great impact on Mexico with regard to tariffs.

That scenario would affect the financial stability of Mexico in the short-term, and have consequences such as foreign capital outflow, currency mismatch, and the need to use interest rates as an adjusting instrument, an increase in levels of inflation, and a reduction of economic growth.

The national panorama appears to be complex, since 2018 will be a year of presidential elections, where both: political uncertainty and the renegotiation of NAFTA will cause volatility on the markets. A rise in interest rates, pressures on the exchange rate, and the possible withdrawal of foreign investment are some of the challenges that will be faced by the Mexican economy, as well as the new tax reform in the U.S., which would have an effect on the domestic economy.

Growth of the Mexican economy in 2018 will be set between 2.0 - 3.0%, driven mainly by consumption, domestic demand and investment. In addition, sectors such as energy, construction and automotive will be the engines for the following year. In spite of low GDBP growth rates, formal job creation has been consistent in the economy, as a result of the structural reforms.

The formal job creation rate is expected to be able to sustain itself as the economy continues to expand. It is necessary to generate creative formulas to successfully raise salaries without affecting inflation.

The high levels of inflation observed throughout the year are explained by diverse factors such as the release of gasoline prices, the inflationary



effect of accumulated depreciation of the currency over these latest years, the feedback of the effects of the rise in interest rates, and the buildup of inflationary expectations. Inflation is expected to resume levels between 4.4% and 4.9% for the coming year, and approach the inflationary goal of the Bank of Mexico.

In turn, the exchange rate had an upward performance in 2017, due to external factors that bring about movements in the supply and demand of dollars, such as the expectations of the U.S. campaign promises against Mexico, the start of NAFTA negotiations, electoral campaign promises in Mexico, and the strengthening of the dollar in the world. Estimates indicate that the average exchange rate for 2018 will be set between 19.20 and 20.20 pesos per dollar.

As inflation rises, it is necessary to adjust the interest rate to be able to offer interest that benefits investors; otherwise, there would be foreign investment capital withdraws. The

interest rate is likely to end the year within a range of 7.0 - 7.4%, and it is estimated that inflation might start its reduction process. We expect an interest rate to be around 5.9% to 6.5% for 2018.

Remittances are forecasted to decrease significantly this year, due to the threats against Mexican immigrants. However, this indicator has increased and it is expected to close the year with a flow of remittances between 27.9 billion to 28.7 billion dollars. Moreover, it is estimated that this growth pattern will continue for the next year, with a total of remittances approximating from 29 to 29.5 billion dollars.

Short-term expectations include a successful renegotiation that leads to prosperity for the nation, improves living conditions of the population starting with increased productivity, maintain financial and fiscal discipline that contains inflation, spur solid,

ongoing economic growth, and have well-managed electoral processes.

This document is intended to put forward various recommendations derived from the studies and analyses performed by the Salles Sainz - Grant Thornton team on the business world and reality that Mexico will experience throughout 2018. It further draws attention to the greatest risks that will have to be faced but, above all, how to make the best of them and convert them into opportunities to be able to be better prepared for the great challenges to come.



Expectations improved by the reality of 2017

Some of the external threats forecasted for Mexico in 2017 broke up

The beginning of this year was filled with challenges and uncertainty throughout the world, due to diverse events and circumstances that seemingly might have negative impacts on economies and companies. Over the days, weeks and months, the world has realized that such expectations had little support in some cases and others continue to be present.

In the document that we published toward the end of 2016 “Economic Perspectives of Mexico and the World”, we anticipated certain trends, risks, and opportunities that the world would have to face in 2017, among which we highlighted:

- [The entry of Donald Trump as President of the United States and the consequences of the various threats issued throughout his campaign;](#)
- [The implications of events such as Brexit and the trends of limiting world immigration;](#)
- [Protectionist movements and trends as a threat to world trade;](#)
- [The economic importance of China and maintaining its growth rate; and](#)
- [The variations in oil prices as a consequence of the oversupply.](#)

In the event that any of the risks forecasted should materialize, it seemed that the world would be faced with economic, commercial, social and all types of conflicts that would affect the growth rate of nations and, therefore, Mexico. However, reality has been somewhat different.

The changes announced by the new U.S. President such as the withdrawal from the TPP, the construction of a border wall with Mexico, the withdrawal of the United States from

NAFTA, and many others that have failed to materialize at all, thanks to the institutional strength of that country and the natural processes required to achieve it.

By the same token, even when protectionist tendencies and the limitation of migratory flows are still present, they have not had a relevant economic impact. The progress of Brexit has been minimal during this year, as well as its effects on the world economy. Nevertheless, we continue to observe the rebirth of the desire for independence in various regions of Europe, particularly in Catalonia, driven by pressures demanded by society.

On the other hand, the raw materials markets and, particularly the oil market, have shown certain stability where prices have maintained a positive trend and responded to favorable factors in the world economy.

Far from falling into economic stagnation, the world continues to grow at rates similar to those experienced in the prior year and even somewhat higher than those that will range between 2.5 and 2.7% at 2017 year end.

In this environment, Mexico has acted stably in the environment of its economy, and making the necessary

adjustments to do so successfully. The variables of the real economy show growth in employment, our international trade, and domestic consumption. Fiscal and financial indicators have shown themselves to be stable, although it has been necessary to take certain measures to assure its success, and we have anticipated them in several of our Firm's publications.

Some risks continue to be latent and should be a motive for oversight and attention. The increase in the levels of inflation together with the resulting rise in the interest rate can be factors that influence economic growth if they are overlooked.

It has been relevant for the Mexican economy to prepare, discuss, and negotiate the new terms and conditions of NAFTA. Many opinions have been put forward from the most extreme and pessimistic to those that foresee a promising future. The truth is that the doors have been opened to negotiating it. The results and consequences will have a bearing on the behavior of the economy. Correct strategy and negotiating skills are put to the test.

The negotiating periods have led to some instability and volatility in economic variables. Consequently, the exchange rate, though stable during the first half of the year, reflects volatility due to currency flows brought about by uncertainty. Nevertheless, we can consider these effects as temporary, as the rounds of negotiation end and solid agreements are reached.

2017 has been a year of reduced growth for Mexico, but with financial stability.



Global environment with some dark clouds on the horizon

2018 will continue to present a mixed panorama in terms of the global environment. The issues of economic growth, migration, protectionism, terrorism, and the possibility of armed conflicts will be paramount and part of the working groups between countries. By the same token, the dynamism of markets will continue and no sign of a marked decline is contemplated in economic activities.

Specifically, it is worth highlighting the renegotiation of NAFTA for Mexico, its outcome, and the effects emanating from it in the economy along with the reactions in political and social scenarios.

It seems that the future presents chiaroscuro in the international scenario, with some elements of risk for Mexico that must be addressed.

Moderate world growth

Almost 10 years after the start of the so-called "Great Recession", the world economy has gradually been recovering with more economic, geopolitical and social setbacks than desired, but efforts in this respect have been productive and a stabilization process is being experienced as well as moderate global economic growth.

According to the World Bank, a 2.7% increase is estimated for the end of the year, due mainly to the recovery of manufacturing and trade. 2018 is a year expected to have higher growth forecasted in the line of 2.9% overall. However, economic growth does not seem to occur with the same intensity in all regions.

GROWTH RATES BY REGION

Region	2015	2016	2017*	2018*
Growth world economy (%)	2.7	2.4	2.7	2.9
Growth developed economies (%)	2.1	1.7	1.9	1.8
Growth developing economies (%)	3.6	3.5	4.1	4.5
United States growth (%)	2.6	1.6	2.1	2.2
Japan growth (%)	1.1	1.0	1.5	1.0
China growth (%)	6.9	6.7	6.5	6.3
Growth Euro zone (%)	2.0	1.8	1.7	1.5

*Estimated data. Source: own preparation with World Bank data.

While the United States and Japan experience more vigor in their growth for both 2017 and the forecast for 2018, regions such as those of the Euro will have moderate growth performance, and China is undergoing a slowing down process of the growth of its Gross Domestic Product.

The positive thing is that the world is in a stage of moderate growth. However, these advances are differentiated depending on the regions of the world and this can be causing regional trade conflicts.

A large part of the global recovery is due to the growth of trade with levels close to 2.9% in 2017, which becomes relevant in dealing with the increasingly numerous expressions of protectionism that might weaken the pace of growth. In turn, the prices of raw materials are returning to their level.

It is worth noting the performance of oil prices, not only because of the importance it has for Mexico, but also as a reference of the vigor of the world economy. After the volatility observed during the previous years, it seems that the market has stabilized with multinational production agreements and dealing with world demand in such a way that prices have become more stable, and there is a moderate upward trend over time.

PRICE OF OIL PER BARREL



Description: Crude oil, an average of three prices, Dated Brent, Intermediate West Texas and Dubai Fateh, U.S. Dollars per barre Source: own preparation with World Bank data.

Even though production is expected to increase in the next year, it will be offset by the increase in demand derived from global economic growth itself, which will allow for estimating a stable oil price market during 2018.

In reference to Mexico, the price of the Mexican mix has maintained the same trend. The estimate presented in the General Economic Policy Criteria presented by the Ministry of Finance places the price of the Mexican mix at an average of 46 dollars per barrel for 2018, which seems to be an achievable objective. This way, this variable will not distort economic activity.

Unlike other periods, the world economic environment is put forward under a stable environment that will allow for economic growth, and it will be an environment conducive to commercial exchange.

China and the United States, two powers without agreements

Within the global context, two economies have stood out for their size, growth and interaction. China and the United States as a whole represent almost 40% of the world's Gross Domestic Product.

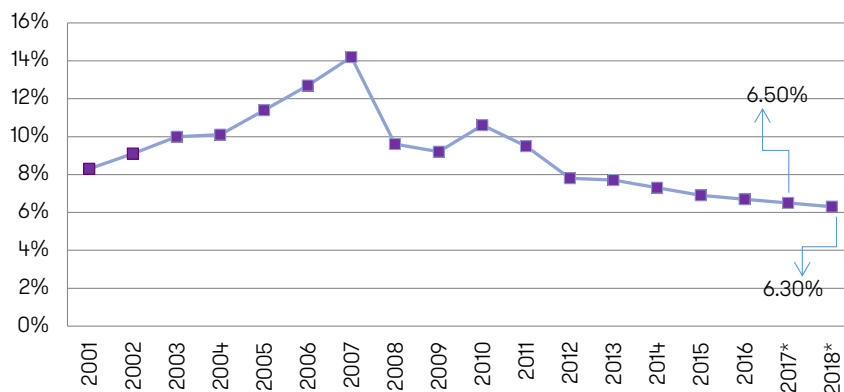
Both their economies and their population (1 billion 380 million in China and 326 million in the United States) make up a consumption alternative of great proportions, so that their economic performance has a high level of impact on world trade and growth.

Although they have been two economies with an extensive history of mutual trade and investment, commercial conflicts have recently

arisen due to the need of the United States to reduce the trade and fiscal deficit that hinders sustained growth.

Given this scenario, insisting on adjusting the parity of the Chinese currency and the imposing various obstacles to trade have been constant.

CHINA GDP



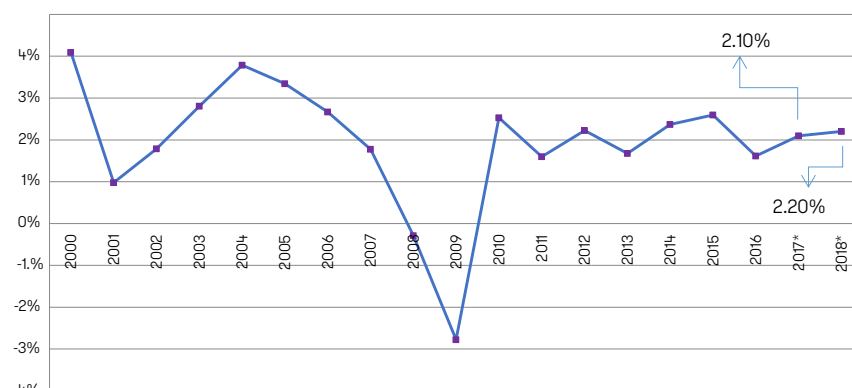
*2017 and 2018 estimates. Source: Own preparation with World Bank data.

China is in a process of deceleration resulting from lower domestic consumption.

The protectionist policy that the United States is attempting to implement generates a high level of nervousness on international markets. This controversy will continue to be one of the significant topics between both countries.

The United States is in the process of adjusting and implementing actions to reduce the enormous trade and fiscal deficit that it has been attempting, while not affecting growth and employment.

US GDP



*2017 and 2018 estimates. Source: Own preparation with World Bank data.

The estimated growth of the Gross Domestic Product continues to be positive and it will be around 2.2% for 2018, which will be a level consistent with what was experienced in previous years.

In the fight to improve the economic conditions of the United States in financial issues and to keep inflation under control, the FED has raised the benchmark interest rate twice from 0.75 in December 2016 to a rate of 1.25 in June of 2017.

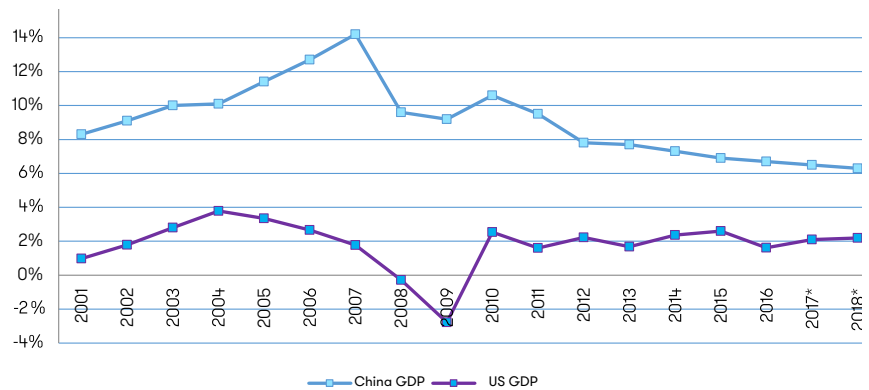
The levels of economic growth and general market conditions allow for anticipating that the benchmark interest rate in the United States will continue its upward trend and possibly reach 1.75 toward the end of 2018.

The 2018 budget proposes a fiscal reform that seeks to strengthen the domestic economy of the United States by reducing corporate income tax to 20%, in addition to promoting the return of capital with a minimum tax.

Should the budget and tax reform be approved, it will surely bring about a flow of dollars back to the United States and, therefore, strengthen the dollar and exert significant pressure on the exchange rate in Mexico.

Significant threat to Mexico, particularly the exchange rate will be the tax reform proposed by the United States

GDP COMPARISON - CHINA AND USA



*2017 and 2018 estimates. Source: Own preparation with World Bank data.

An analysis of the performance of both countries brings to light that high growth periods of for China are not shown in the same way they are for the United States. In recent years, the slowdown in China has allowed for maintaining favorable conditions for the economic growth of the United States. This is why trade differences have deepened in recent years.

Protectionist tendencies prevail

One of the main challenges facing global economic growth in the coming years is the tendency of some countries toward trade protectionism that hinders the free flow of goods and inhibits investment.

- Globalization has been a solid trend for more than two decades.
- It has become an efficient mechanism for allocating resources that has provided for specialization in a free trade framework and contributed to cost effectiveness.
- The condition for globalization to succeed is to have mechanisms that enable the free flow of goods and investment through multilateral agreements
- In addition, globalization has proven to be a tool for creating jobs.

The disappearance of these benefits and the return to protectionism could have consequences not only for world growth, but also for job creation and well-being.

Indeed, there are also harmful consequences of globalization, some of an economic nature and others of a social nature, which has unleashed a demand from companies to curb these effects. The response to such a demand should not be approached by closing borders, but rather by actions that lead to achieving similar conditions for development of countries and societies.

Canceling or limiting the free flow of trade and investment, among other things, may cause:

- A sharp increase in the world inflation rate
- A reduction in the economic growth rate
- Loss of jobs

Opinions are divided and there is no agreement on this issue, which is expected to cause tensions and unilateral actions.

Terrorism and possible wars affect trade and tourism

2017 has been the scenario of multiple terrorist attacks in different parts of the world leaving a total of approximately 4,000 persons dead. Despite prevention and surveillance measures, these events will continue to happen and may be difficult to avoid.

Besides personal misfortune among the population, these events affect economic performance, particularly in three areas:

- The effect on the confidence of the population causes uncertainty and, therefore, a decrease in expected consumption and investment.
- Safety conditions in countries are one of the factors taken into account at the time when decisions are made by foreign investors. Accordingly, safety becomes part of the cost
- The impact on specific sectors such as the tourism industry, which reduces the number of visitors due to such cause.

The presence of terrorist acts together with intensified migration flows have affected some economies and generated higher rates of unemployment. The population in conditions of poverty has increased and greater government

resources have been allocated to health issues and, of course, social and cultural differences that lead to acts of racial discrimination and feelings of rejection.

Unfortunately, it is very likely that terrorist acts will continue to occur with economic and social consequences during 2018.

NAFTA scenarios, risks and possibilities

One of the most significant issues for Mexico in 2017 and quite likely in 2018 is the renegotiation of the terms of the North American Free Trade Agreement promoted by the United States intended to reduce the alleged harmful effects generated by that agreement.

Besides the initial reason, agreeing upon new terms of exchange that incorporate aspects of new technologies and adapt to the different market conditions after more than 20 years of NAFTA's existence has become a viable and appropriate objective.

The four main objectives of the negotiation were put forward as:

1. **Strengthen the competitiveness of North America, through preferential access for goods and services that eliminate trade barriers.** Have more efficient customs procedures, thus avoiding free trade barriers. In this sense, certain frictions have emerged since the United States prefers to improve its trade balance and reduce its deficit than to promote free trade in the region.
2. **Moving ahead toward inclusive, responsible regional trade.** The three countries have a common objective of encouraging greater



participation of their respective SMEs and providing them with information and resources to export their products. Mexico is willing to meet international labor commitments, which requires a dialogue on trade and environmental issues, as well as improving border infrastructure.

3. Take advantage of the opportunities of the XXI Century economy. It is necessary to implement measures to encourage the use of the digital economy, maximize the benefits of e-commerce, electronic banking and digital financial services, as well as the protection of intellectual property.

4. Promote trade and investment certainty in North America. Mexico and Canada seek to modernize dispute settlement, anti-dumping, and countervailing mechanisms. This issue has become the most controversial since the United States seeks to eliminate Chapter 19, which establishes a mechanism for settling disputes and anti-dumping duties.

The negotiations have progressed in their various rounds. However, there are a number of issues on which positions have been found that prolongs the time of negotiation, which was scheduled to end in 2017 and, thus, be able to make presentations and have them authorized by their respective Congresses, an objective that will not be reached.

Many of the issues have been discussed, even where no agreement has yet to be reached, among other things:

- **Rules of origin: domestic content in the automotive sector 50% American parts and 85% regional parts**
- **Anti-dumping duties: authorize increased sanctions**
- **Conflict resolution: elimination of chapter 19**
- **Cross-border transportation: seeks to eliminate the opening in the modality of road freight**
- **Wages: reduction of wage differences in the three countries**
- **Sunset clause: treaty renewal every five years**

Meanwhile, the negotiations continue and are expected to be concluded; markets find uncertainty that becomes fertile ground for speculation, especially on the financial and exchange markets.

Negotiating scenarios are varied according to the positions of the members, the result may even entail a breakup and search for new options, which would affect the financial stability of Mexico while new points of agreement are being found and adjustments are made in the economy. Some of the consequences for Mexico could be:

- **Foreign currency outflows**
- **Exchange rate mismatch**
- **Need to use the interest rate as an adjusting instrument**
- **Increased levels of inflation**
- **Reduced growth**

It is correct to note that the effect on trade terms in dealing with the disappearance of NAFTA can be less serious as Mexico activates the protocols of the World Trade Organization (WTO), while applying as the Most Favored Nation in tariff issues. Nevertheless, the effect on investment

and other variables in the economy may be greater.

Changes and adjustments will have to be made as in all negotiations. The scenario of reaching the necessary agreements for NAFTA to be signed has a high probability of happening, which would allow for approaching 2018 with better tools and stability on the financial markets.

Irrespective of negotiations, it is worth noting that Mexico has become a leader within the group of those considered developing countries due to multiple reasons, among other things, such as the size of its economy, its high level of foreign trade, population number, and its performance in international financial fields.

This places Mexico as a protagonist in the international scenario and as such, it must accept that leadership and regional flag. For such purposes, it is essential for Mexico to have the capacity to define, design and implement long-term plans that serve priority sectors and build value chains.

National panorama

In accordance with what our Firm estimated in the national scenario one year ago, 2017 has elapsed without any surprises. We anticipated slow growth, difficulties in the external sector, increased inflation, and exchange instability due to external factors. All of this is combined with political and social factors that come forth in a climate of elections and political adjustments in preparation for the 2018 presidential elections.

In this line of ideas, 2018 will be characterized by two major scenarios: on one hand, the political scenario with presidential and legislative elections and on various levels of government with a high content of political clashes and power struggles. On the other hand, an external environment that will definitely influence the economic destiny of Mexico that will be defined by NAFTA, the monetary policy measures that will be adopted by the United States, as well as issues related to globalization, migration, and others that have a bearing on trade and investments in the world.

By combining both scenarios, Mexico finds itself in a delicate position where the balance of forces, defense of institutions, financial and fiscal discipline will be key factors for the country to find a positive way through those scenarios.

Social and political perspectives

2017 has turned into a political laboratory, since various elections were held for Governor and Mayors with mixed results for the winning political parties. Nevertheless, they were characterized by dirty campaigns and attacks with few proposals concerning daily life that benefits the citizenry.

Important states of the nation held elections and few won by a majority, which indicates polarized voting and differences of opinion on political issues.

The weariness of party political representation was revealed through the increasing participation of independent candidates and low voter turnout.

Good grades were not given for public safety, since this year is considered one of the years with the highest number of violent deaths due to criminal acts, 2017 ends with major questions about the validity of institutions and trust in them, which will all be reflected in a climate of hostility throughout 2018.

In another context, the earthquakes that struck on September 7 and 19, together with hurricanes and climate events have brought about great dissatisfaction in the population in general. Aside from unfortunate human losses, the economic cost is estimated to be in the order of 50 billion pesos. The attack on the lack of action by institutions is daily and voices demanding changes make themselves being felt.

Unfortunately, the issues concerning politics and society have not performed favorably in 2017, in addition to criminal activity involving drug trafficking that bring forth conditions of insecurity of the population and loss of credibility of institutions. This provides for putting forward new proposals and searching for new alternatives that will surely be experienced in the 2018 elections.

I. 2018 elections

As discussed in the previous sections, the international context brings about direct effects on Mexico's economic and social performance to a different extent. Events such as the decision made on the direction taken of the economic and fiscal policy of the United States and the resolutions adopted in the renegotiation of NAFTA will have a great impact on macro-economic variables for next year. However, it is clear that internal situations will also play a most significant role during 2018.



The political scenario will be highlighted by federal elections held whereby the President of the Republic will be elected as well as the Chamber of Deputies and the Senate will be renewed by the voters. Elections will be held in almost all the States of the Republic for both state and municipal officials. With a nominal base of more than 88 million voters, the electoral process has become the biggest in history

The 2018 electoral process represents a significant challenge for the credit rating of our country, with an economic risk equivalent to that of a badly negotiated NAFTA. Generally, implementing important reforms and projects is delayed in times of electoral campaigns. During political transitions, there is a slowdown in public investment in infrastructure.

The main rating agencies are concerned with the political risks that entail the upcoming elections and the course of NAFTA negotiations, which are likely to have a negative impact on Mexico's rating. In case of an eventual victory of a party with a tendency other than the current tendency, the reforms enacted during this administration would not be reversed, but they could delay investments in various sectors such as energy.

A significant aspect to consider for the economy and politics to perform well is not only the winner of the presidential elections, but also the majority in the Congress, which increasingly has greater influence on the decisions concerning the country. Political uncertainty might be conducive to exchange rate volatility, as well as on the markets.

The slow progress and few favorable results in the renegotiating of the NAFTA up to now indicate that the target of concluding negotiations will not be reached before the end of the year; therefore, it may interfere with the electoral campaigns and make them more complex depending on the positions adopted and statements made by the candidates.

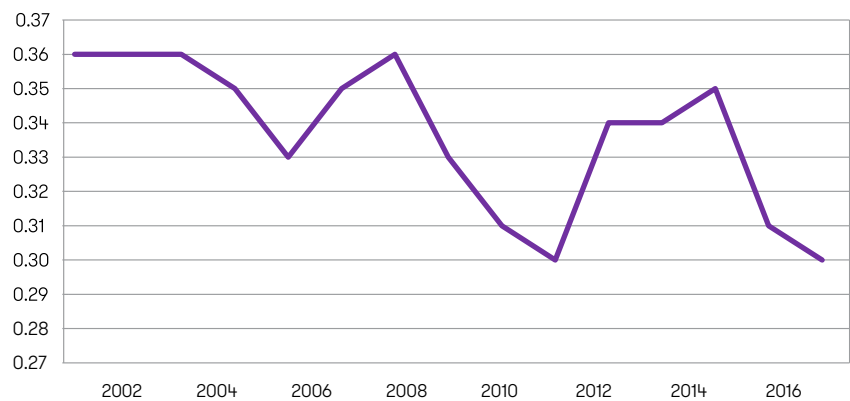
II. Crime and corruption, social and market repercussions

Without intending to carry out an exhaustive analysis of these issues, it is important to analyze them by virtue of the influence they have on the development and economy of countries. In particular, Mexico has had a recent history of violence, drug trafficking and corruption that affects economic and political processes with the consequent social deterioration.

Political party activity has been intense, particularly of the three most important parties (PAN, PRI and PRD). The emergence of a fourth important political force (MORENA) has been distorting the political panorama, due to the populist ideology attributed to it and the criticisms it has experienced. On the other hand, the movement towards independent candidates has been intense, even the resignation of leaders of political parties in favor of an independent candidacy have been a reality.

Corruption is an illicit activity that is difficult to measure; therefore, indexes are based on perception. The scale is between 0 and 1, where 1 = very clean and 0 = very corrupt. This indicator compiles information on both administrative and political aspects of corruption. During the last few years, Mexico has dropped in this indicator of perception, by classifying 123rd place out of 176 countries evaluated by Transparency International, undoubtedly a matter that merits special attention.

CORRUPTION PERCEPTIONS INDEX



Source: Own preparation with Transparency International data.

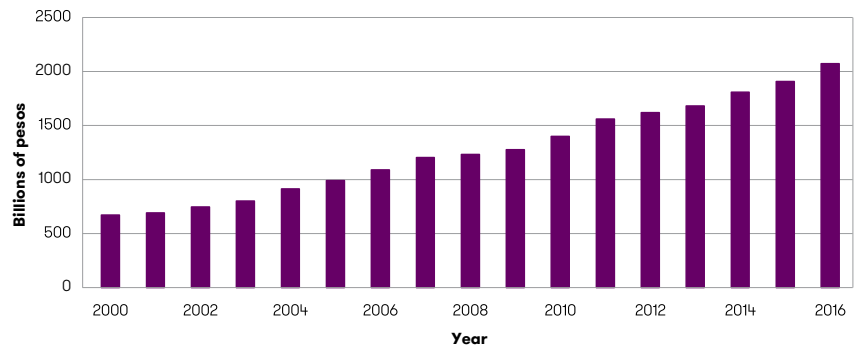
In accordance with a study carried out by INEGI in April 2017, the levels of perception of insecurity by the population over 18 years of age has increased 72.4%, a level that remained at 72.9% during the last 4 years, 3 percentage points higher than the last six-year period.

It is not surprising that 90.6% of the population surveyed in the State of Mexico has said that they feel insecure, since it is the place where problems have been observed to have increased the most. On the other hand, Yucatán is the State in the Nation that reports the highest perception of security (31.5%). It is important to note that the statistics discussed only refer to acts not related to organized crime or drug trafficking, which are classified under the concepts of “state-law crimes”.

The acts of corruption continue to be a constant. Cases of corruption of several Governors and officials that have had a high level of repercussions were revealed in 2017. According to some analysts, corruption has a cost of around 10% of the GDP every year.



ANNUAL COST OF CORRUPTION IN MEXICO



Source: Own preparation with INEGI data.

Situations such as discussed above have a direct impact on the image of Mexico abroad. Consequently, variables are affected such as investment and tourism. According to data from INEGI, corruption cost around 2 trillion pesos for 2016, a very high figure.

The influence of politics in the economy, though lower than it was in the past, continues to be relevant, particularly in electoral years such as 2018. Accordingly, we are able to estimate effects on the economy emanating from the political arena, such as delays in investment decisions and a first semester with resources flowing to political campaigns and an austere second semester.

Economy

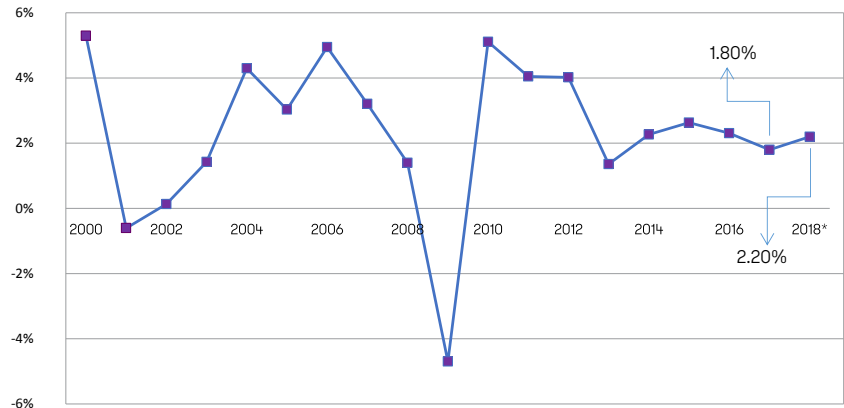
The Mexican economy will face a 2018 with peculiarities that will affect its behavior:

- Effects of NAFTA renegotiations
- Rise in international interest rates
- Possible withdrawal of foreign investment on the capital market
- Exchange rate pressures
- Presidential elections

For several years, Mexico has shown weak growth that does not exceed a 3% rate. The lack of dynamism of the economy is remarkable, above all, when growth is creating jobs.

Despite a low growth rate, formal employment grows due to the reforms.

GDP MEXICO



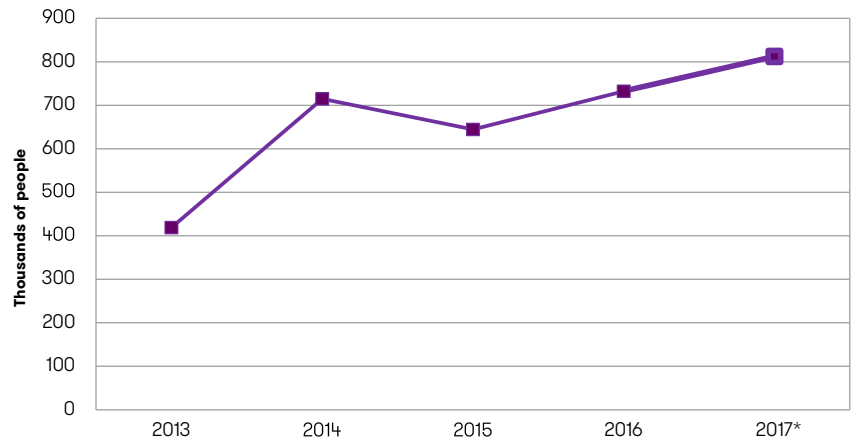
*2017 and 2018 estimates. Source: Own preparation with World Bank data.

Even in 2017, the estimate indicates growth that might be below 2%. The uncertainty experienced at the beginning of the year due to the adjustment period at the beginning of the administration of the new president of the United States reduced investment flows and they lagged the consumption.

In accordance with official estimates, GDP growth will be between 2 and 3% for 2018, driven again by consumption, domestic demand, investment, and supported by job creation. Sectors such as energy, construction, and automotive will be the engines for the following year. In addition, expansion of the U.S. economy will also be a contributing factor.

Despite the low GDP growth rates, steady creation of formal jobs in the economy is highlighted by just over 730,000 in 2016 and 820,000 at September 2017. Structural reforms (labor and fiscal) have brought about this phenomenon.

JOB CREATION



*2017 at september. Source: Own preparation with INEGI data.



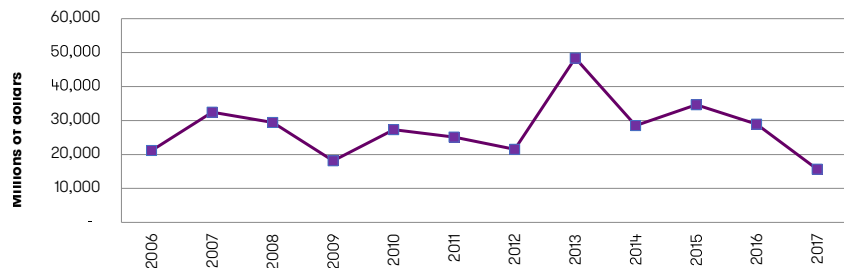
To the extent that the economy continues to expand, it could be expected to sustain the growth rate of formal employment which, in turn, is the base that spurs domestic consumption.

Notwithstanding the creation of formal employment, it is necessary to channel efforts toward improving wages and purchasing power. The energy driving the economy is based on strength in consumption, and better remunerations are required for this purpose. The issue is under discussion and it is necessary to find creative formulas to improve wage levels without raising inflationary expectations; it has even become part of the subjects included in NAFTA negotiations.

The expansion of the economy relies on external operations (imports and exports) that have shown better levels in 2017, and it is expected to be maintained in 2018. The amounts received from foreign investment continue to flow and 2017 will surely end with a figure close to 27 billion dollars.

The structural reforms have provided support for sustaining these foreign investment flows, especially in the infrastructure, construction, automotive, and energy sectors.

DIRECT FOREIGN INVESTMENT

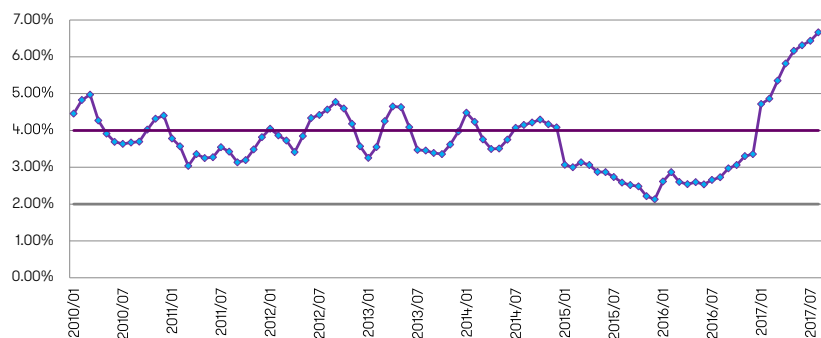


*2017 at June. Source: Own preparation with BANXICO data.

Stability and discipline in public finances is achieved through responsible management that is reflected by three interconnected variables, which are the exchange rate, inflation, and interest rates.

After several years of stable inflation levels by successfully going below 3%, 2017 has had a different behavior, since inflation levels have risen at rates ranging between 6% and 7%.

INFLATION IN MEXICO



*2017 at August. Source: Own preparation with INEGI data.

The unfavorable evolution of the indicator is explained by various factors including:

- The release of gasoline prices
- The impact of inflation of accumulated depreciation of the currency during these last years
- The price increase in raw materials and agricultural products
- The feedback of the effects on the rise of interest rates
- Drawing up inflationary expectations

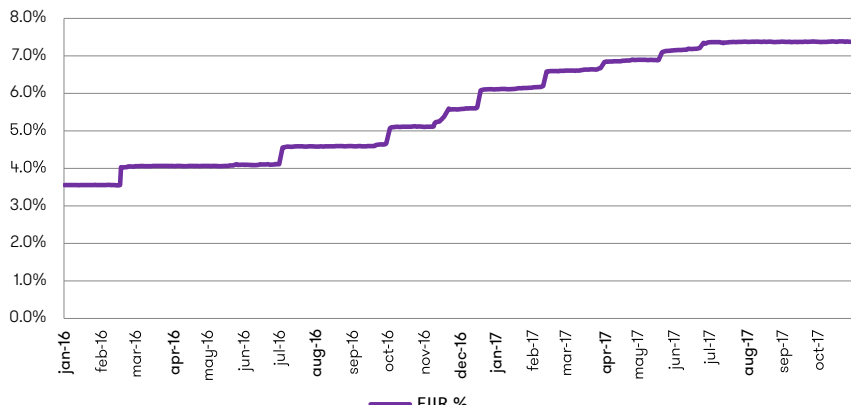
There are various estimates regarding this indicator. The authorities assure that inflation will end below 6% in 2017, and that the rise is due to temporary factors. However, the technical analysis places this value more in a range between 6.0% and 6.4% at the close of 2017.

The conditions that have been put forward in this document and estimated for 2018 calls upon us to consider that the reduction in the values of this indicator may not be immediate, the official estimate is 3% for 2018; our consideration places it in a range between 4.4% and 4.9%.

The renegotiation of NAFTA and the delays observed therein, the recovery of raw materials market prices, the rising interest rate scenario, and periods of unstable exchange rates are some of the reasons for the estimate.

Together with this indicator, the interest rate reacts in the same way. As inflation increases, the interest rate is required to be adjusted to successfully offer investors real interest income. Otherwise, capital is withdrawn and the profitability of projects decreases.

INTERBANK INTEREST RATE



*2017 at october. Source: Own preparation with BANXICO data.

The interest rate is likely to end the year within a range of 7.0 - 7.4%. If we consider that inflation might start to trend downward, we can estimate that interest rates will range from 5.9% to 6.5% for 2018.

The exchange rate has had a consistent upward trend, mainly due to external factors that cause movements in the supply and demand for dollars. In turn, the Mexican peso has become the most transactional currency in developing countries and, therefore, is affected by regional movements.

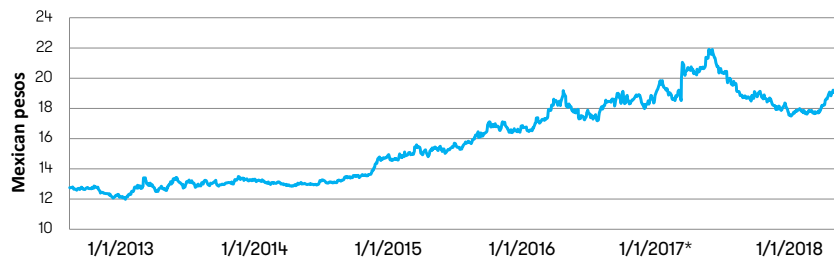
It is worth noting the depreciation of the currency and the instability suffered at the end of 2016 and the beginning of 2017, due to the elections in the United States and the campaign promises against Mexico. Consequently, the exchange rate almost reached 22 pesos per dollar at the end of January 2017.

As expected and already discussed herein, many of the campaign promises do not have any possibility of becoming reality and the credibility of the statements made by the U.S. government has been impaired.

This sought to calm the exchange market in the first half of 2017 and decrease the price of the dollar to 17.50 pesos per dollar by July 2017. However, the beginning of NAFTA negotiations and the events that have arisen related to it have once again caused markets to become nervous and return to levels from 19.50 to 19.70 pesos per dollar.



EXCHANGE RATE PESO-DOLLAR



*2017 at october. Source: Own preparation with BANXICO data.

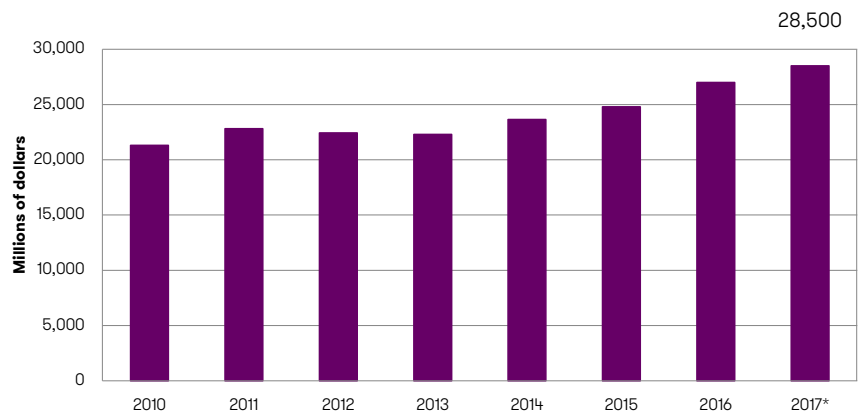
Negotiations will continue and some disturbing factors will have to be added in the following months, such as the beginning of political campaigns in Mexico and the strengthening of the dollar in the world, among other things, which will depend on how these factors evolve to be able to estimate the future of the exchange rate. However, we estimate that it will continue above 19 pesos per dollar for the remainder of 2017.

The General Economic Policy Criteria published by the Ministry of Finance indicate an estimate of 18.1 pesos per dollar as the average exchange rate for 2018. However, the conditions previously discussed place it more in a range of 19.20 to 20.20 in the average for the year. The exchange rate is estimated to close the year in the range of 19.90 to 20.50 pesos per dollar.

The nervousness, instability and swings of the exchange rate will continue throughout 2018. The planning and anticipation of holding dollars is important, if necessary.

The threats received in the presidential campaign of the United States in regard to massive deportations brought to mind that international remittances would decrease drastically.

REMITTANCES



*2017 estimate. Source: Own preparation with BANXICO data.

Notwithstanding the foregoing, this indicator, far from decreasing, has increased during 2016 and 2017, and the year is estimated to close with a flow of remittances ranging from 27.9 to 28.7 billion dollars. At the same time, 2018 will follow this growth pattern of estimated remittances approximating from 29 to 29.5 billion dollars for the year.

Perspectives and general projections of economic variables for 2018

The evolution of the Mexican economy and its prospects for the future are consistent not only with domestic events, but also with Mexico included on international markets and, therefore, the events that occur in the world, particularly those of our northern neighbors, must be considered in the decisions and definition of the direction of the country.

This frame of reference, which considers the estimates for 2018, is based on what happened in 2017. It further takes into account the elements that will be present in the following year, both domestically and internationally.



Economic variables toward 2018				
Variable	2017		2018	
	CGPE	Estimado	CGPE	Estimado
Real Sector				
Real GDP growth (annual variation %)	2.0- 2.6	1.6-2.1	2.0- 3.0	2.0-2.5
Inflation (annual variation %)	5.8	6.0 - 6.4	3.0	4.4 - 4.9
Workers enrolled in the IMSS (period)		750,000-850,000		730,000-820,000
Financial Markets				
Nominal Exchanged Rate (pesos per dollar at year end)	n.a.	19.00-19.50	n.a.	19.90-20.50
Nominal Exchange Rate (annual average pesos per dollar)	18.70	18.80-18.90	18.10	19.20-20.20
Benchmark Interest Rate (% at year end)	7.00	7.0-7.4	7.0	6.5-7.2
International Reserves (billions of dollars)		165,000-175,000		164,000-179,000
External Sector				
Exports (billions of dollars)		400,000-410,000		412,000-422,000
Imports (billions of dollars)		407-500-415,000		422,300-429,500
Trade Balance (billions of dollars)	n.a.	(7,500)-(5,000)	n.a.	(10,300)-(7,500)
Current Account Balance (billions of dollars)	(20,457)	(23,000)-(22,000)	(23,300)	(25,800)-(24,500)
Mexican Oil Blend (dollars per barrel)	43	44-46	46	44-48
Direct Foreign Investment (billions of dollars)		26,500-27,200		26,000-26,800
Family Remittances (billions of dollars)		27,900-28,700		29,000-29,500
US GDP (real growth %)	2.1	2.0-2.3	2.4	2.1-2.4

Source: Own preparation with data from Banco de Mexico, INEGI, Secretaria de Hacienda, World Bank

Challenges, Risks and Recommendations

Many events have happened and will continue to happen within the framework of a global world. In the course of the analysis, we have tried to provide an orderly overview of what our firm considers important to review and take precautionary measures for the future.

Organizations must have solid, reliable information to be able to then analyze and establish courses of action considering the environment in which the country and the organization operate.

Great challenges are on the horizon for Mexico:

- Renegotiate NAFTA successfully, thereby generating prosperity for the country
- Improve the living conditions of the population, based on increases in productivity and wages
- Maintain financial and fiscal discipline that contains inflation
- Promote dynamic, sound continuous economic growth
- Ensure the institutionality and good management of electoral processes, and assure peaceful elections and proactive campaigns
- The exercise of justice as a fundamental value for better coexistence and development

As a matter of fact, the list is extensive and the challenges are not over. However, in the economic environment, Mexico needs to create long-term plans that allow for reaching these objectives.

It is a time for reflection and action for organizations within an environment that will offer great opportunities, while an appropriate analysis and good decisions are made, and implemented as best as possible. In this line of ideas, it is necessary to be alert for indicators and their evolution:

- Draw up budgets and keep control thereof.
- Be agile in making decisions and changes in required cases.
- Investments must be analyzed in light of evolving economic indicators and the political and social indicators that will have a bearing on the result in 2018.
- Be mindful that market uncertainty and instability will be a constant in 2018. Appropriate information is a powerful light that guides and does not enable paralysis, which is often caused by this type of moments.
- Successful organizations have successful people in their staff. Investing in recruiting processes, selection, and training of human resources is a success factor, particularly at times when good judgment and good decisions are key.
- We have constantly suggested to organizations that the care given to liquidity and indebtedness indicators allow for having resources in high volatile times.



**2018 will be special;
politics and the economy
will come together
and external factors
will be an influence.**

**It is a time of great
opportunities.**