

Ahead of the Curve

September 18, 2020

We expect Banxico to cut the reference rate by 25bps to 4.25%

- Banxico’s monetary policy decision (September 24th).** We expect a 25bps reference rate cut, to 4.25%. This would be the first of this magnitude since February, after five consecutive 50bps reductions. We expect a majority vote, with at least one and even possibly two members still favoring -50bps. This is based on: (1) Our assessment of the [latest minutes](#), in which one member was markedly dovish, other two more neutral, and the remaining two definitely hawkish; and (2) financial market dynamics since the last decision. We expect the tone of the statement to lean towards a less accommodative stance given accumulated rate cuts and short-term inflation pressures. We do not expect significant changes on growth, that they will elaborate on current price dynamics –possibly showing more concern–, and with financial stability risks remaining relevant
- Inflation (1H-Sep).** We expect the headline at 0.11% 2w/2w, and the core at 0.16%. If we are right, price dynamics would be quite favorable for the period relative to their five-year averages, which stand at 0.32% and 0.26%, in the same order. As a result, annual inflation would stabilize virtually at the upper bound of the central bank’s variability range, to 4.04% from 4.05% in August –highest since May 2019–. Similarly, the core would show a marginal increase, to 3.98% from 3.97%. The latter should keep benefiting from services, highlighting a very modest contribution from education. The non-core would also show a positive performance, with energy subtracting on lower gasoline prices

www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores
Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*



Document for distribution among the general public

Mexico weekly calendar

| DATE | HOUR (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|------------|-----------|---|--------|---------|---------|-----------|----------|
| Mon 21-Sep | 7:00am | Aggregate supply and demand | 2Q20 | % y/y | -19.0 | -- | -1.6 |
| | | Private consumption | | % y/y | -22.1 | -- | -0.5 |
| | | Government spending | | % y/y | 0.5 | -- | 3.4 |
| | | Gross fixed investment | | % y/y | -34.0 | -- | -9.3 |
| | | Exports | | % y/y | -16.0 | -- | 1.7 |
| | | Imports | | % y/y | -19.7 | -- | -3.4 |
| Tue 22-Sep | 10:00am | International reserves | Sep-18 | US\$ bn | -- | -- | 193.3 |
| Tue 22-Sep | 3:30pm | Citibanamex bi-weekly survey of economic expectations | | | | | |
| Wed 23-Sep | 7:00am | Retail sales | July | % y/y | -12.3 | -12.3 | -16.6 |
| | | sa | | % m/m | 5.7 | 5.9 | 7.8 |
| Thu 24-Sep | 7:00am | CPI inflation | 1H Sep | % 2w/2w | 0.11 | 0.11 | 0.17 |
| | | | | % y/y | 4.04 | 4.04 | 4.11 |
| | | | | Core | % 2w/2w | 0.16 | 0.18 |
| | | | | % y/y | 3.98 | -- | 4.01 |
| Thu 24-Sep | 2:00pm | Banxico’s monetary policy decision | Sep-24 | % | 4.25 | 4.25 | 4.50 |
| Fri 25-Sep | 7:00am | Global economic indicator | July | % y/y | -9.7 | -10.1 | -13.2 |
| | | sa | | % m/m | 5.7 | 5.1 | 8.9 |
| | | Primary activities | | % y/y | -4.2 | -- | -2.0 |
| | | Industrial production | | % y/y | -11.3 | -- | -16.7 |
| | | Services | | % y/y | -9.8 | -- | -12.1 |

Source: Banorte; Bloomberg

Proceeding in chronological order...

Aggregate demand plunged in 2Q20 as a result of the lockdown. We expect both aggregate supply and demand to show a 19.0% y/y contraction, a new historical low since the series is available (1993). We should remember that most of the impact from COVID-19 was observed in April and May, with a modest recovery in June. We see significant weakness in both domestic and external demand (with some trade partners, such as the US, also with widespread lockdowns at least during the first part of the period).

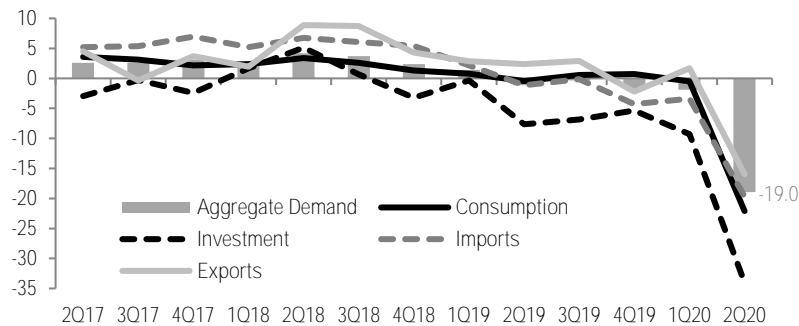
On supply, [GDP declined 18.7% y/y](#), with weakness in both industry and services as several activities were suspended to ensure compliance with social distancing guidelines. Meanwhile, we expect imports at -19.7%. Although both the trade balance –which considers goods– and the current account –that also includes services– showed stronger declines when measured in USD terms of -33.8% and -34.6%, respectively, the depreciation of the Mexican peso partially limited the blow. Specifically, the currency averaged 23.33 per dollar, a 22.0% y/y loss relative to the dollar, helping explain the more moderate decline expected in this indicator.

Turning to demand, exports were also very weak at -37.5% y/y in the trade balance and at -40.1% in the current account. In our view, relatively weaker shipments were mostly due to differences in reopening times, with China already back online in the early part of the quarter –boosting imports– while industry in our country remained mostly halted –hampering exports–. Despite of the latter, we expect these to be higher in annual terms (-16.0%) than imports. We anticipate this mainly on the strength of ‘other manufacturing exports’ which have relatively high value added, even after some drag to them stemming from likely important inventory buildup. This is consistent with [July data](#), in which imports now lag exports, and which could be due to a previous inventory build-up, especially of raw materials and intermediate goods. On consumption, [the monthly indicator](#) declined 21.8% y/y in the quarter. Nevertheless, there are some differences between them, mainly that imported services are not accounted in the high-frequency indicator. Taking this into account, we anticipate a 22.1% contraction. Inside, we expect significant declines in durable and semi-durable goods on changing consumption patterns and lower available income. We also see a slowdown in non-durables, albeit more modest, mainly impacted by the latter driver.

In investment, the monthly GFI index is at -34.0%, which we believe will be the final quarterly figure. As mentioned in [our latest report](#), M&Eq. was hit sharply in the first two months, albeit recovering with greater dynamism in June. In contrast, construction is showing signs of lagging behind. We see a 0.5% increase in government spending, mainly due to a base effect. Public finance reports from the Federal Government show a nominal increase in total spending of only 1.0% y/y. This is likely because of austerity measures compensating for the rise in categories boosted on efforts to combat the pandemic, both healthcare and other economic support programs.

All in all, the report will be relevant to confirm trends in other data, as well as to set a baseline for the recovery we expect in 2H20. As repeatedly mentioned, we expect the rebound to be led by external demand on the back of strong stimulus in other countries. Domestically, we believe uncertainty and a weaker backdrop in terms of fundamentals will continue weighing heavily both on consumption and investment, at least in the short-term.

Aggregate demand
% y/y, nsa



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves increased by US\$65 million, closing at US\$193.3 billion. According to Banxico’s report, this was mainly explained by a positive valuation effect in institutional assets. The central bank’s international reserves have increased by US\$12.4 billion so far in 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US\$, million

| | 2019 | Sep 11, 2020 | Sep 11, 2020 | Year-to-date |
|---|---------|--------------|--------------|--------------|
| | Balance | | Flows | |
| International reserves (B)-(C) | 180,877 | 193,316 | 65 | 12,438 |
| (B) Gross international reserve | 183,028 | 198,970 | 221 | 15,942 |
| Pemex | -- | -- | 450 | 4,429 |
| Federal government | -- | -- | -93 | 6,005 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | -136 | 5,508 |
| (C) Short-term government's liabilities | 2,151 | 5,654 | 156 | 3,504 |

Source: Banco de México

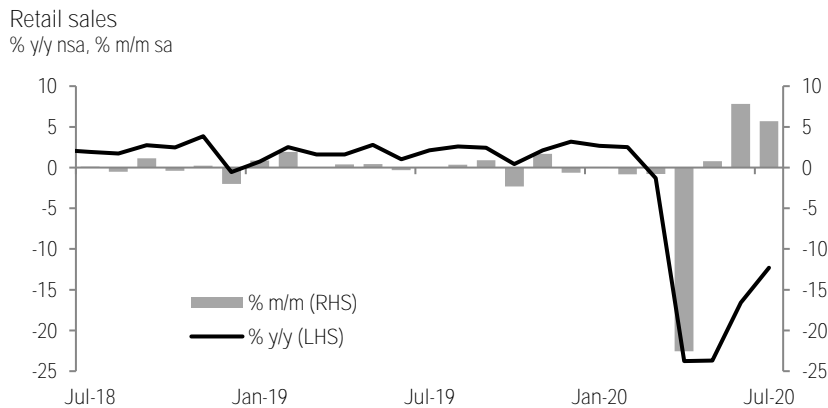
Retail sales keep climbing in July. We anticipate a 12.3% y/y contraction, better than the -16.6% of the previous month, accelerating on additional efforts to reopen the economy, reflected once gain in higher mobility. With seasonally adjusted figures we expect a 5.7% m/m increase, which although slowing down relative to the +7.8% of the previous month –a new historical high–, would be driven to some extent by a more challenging base effect.

Similar to June, practically all figures suggest a better performance, although still impacted by the lockdown. Specifically, ANTAD’s same-store sales fell 12.3% y/y in real terms, improving relative to the -20.5% of the previous month. Supermarket sales were relatively stable at -0.5% (previous: -0.9%), while departmental picked-up strongly, to -25.3% from -46.4%. We believe this is mainly related to the reopening of shopping malls in Mexico City and the State of Mexico, among others, since the start of the month.

Gasoline sales came in at -24.2% y/y (previous: -26.1%), while vehicles posted a 31.3% decline vs. -41.1% in June. Despite of the improvement in the latter, we believe this is a relatively clear signal of the strong shifts in consumption patterns, with people still favoring spending in essential goods. On the contrary, one of the few negative factors was that [non-oil consumption goods imports](#) decelerated by 3.8%-pts to -35.0%, still reflecting weakness.

Consumer fundamentals remain deteriorated, which is an important headwind for the sector. Although [employment recovered broadly in the month](#), its quality is still somewhat lacking, with gains centered in the informal sector. Meanwhile, [consumer credit](#) has extended its fall, limiting to some extent the rebound. On the contrary, [remittances remain strong](#), which will continue supporting spending by low-income households in a significant manner.

Going forward, signals are still pointing to gains, although they are more mixed. Although ANTAD sales improved strongly in August (-6.8%), other indicators have moderated, such as [IMEF's non-manufacturing PMI](#), vehicle sales and even mobility indicators. We will be looking to the performance of other timely data, as well as this indicator, to evaluate the possible path towards the end of the year. In either case, we believe the annual comparison will stay negative for a relatively prolonged period.



Source: INEGI, Banorte

Expecting low inflation in the first half of September. We expect headline inflation at 0.11% 2w/2w, below the 0.17% in the previous fortnight. We forecast the core at 0.16% (previous: 0.18%). If we are right, price dynamics would be quite favorable for the period relative to their five-year averages, which stand at 0.32% and 0.26%, in the same order. As a result, annual inflation would stabilize virtually at the upper bound of the central bank's variability range, to 4.04% from 4.05% in August –highest since May 2019–. Similarly, the core would show a marginal increase, to 3.98% from 3.97%, with the non-core at 4.22 from 4.30%.

The core should keep benefiting from services (0.05% 2w/2w). Specifically, we flag our view of a very modest contribution in education (1.5bps), remembering that we typically observe a seasonally high print this period due to the return of elementary and middle school students (five-year average: +7.5bps). We estimate that the potential of higher tuitions is much less due to the pandemic, both because of the effect that it has already had on families' incomes but also as the return has been only via virtual classes.

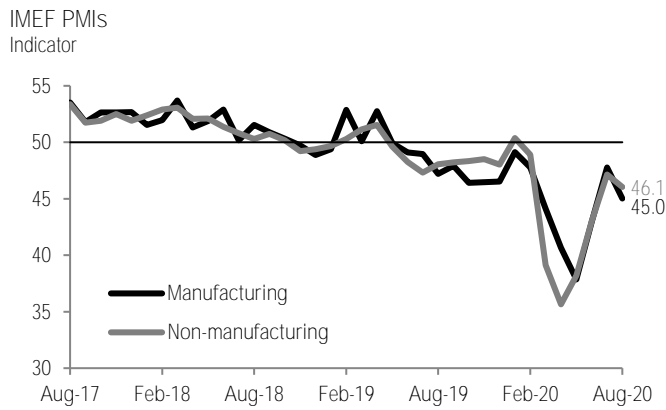
Partial evidence is already available as colleges resumed classes in the 1st half of August, practically without contribution as opposed to an average of 3.7bps. On the other hand, we anticipate few changes in airfares and services related to tourism –also distorted by COVID-19–. Other services would also be favorable, with an important seasonal drop in professional services that would help compensate potential increases in other categories due to the reopening of activities (e.g. cinemas, beaches, archeological sites, nightclubs and the extension of restaurants’ service hours, among others). In contrast, we still anticipate some pressures in goods (0.25%). Processed foods would add 3.6bps –relatively low, in part because of MXN gains– and other goods +6.5bps, with the latter affected since the previous fortnight on the end of the summer discount season (mainly in clothing).

The non-core would also show a positive performance, falling 0.06% 2w/2w (contribution: -1bp). We anticipate energy to subtract 2bps, highlighting an expected fall in gasoline prices. In this sense, we see a reversal of pressures in the second half of August driven by disruptions to the US oil sector due to Hurricane Laura in the Gulf of Mexico (from August 20 to 29). Gasoline prices in that country declined 11.7% afterwards, with an additional benefit because of the 2.1% gain of the Mexican peso. Fresh fruits and vegetables would fall 1bp, with our monitoring identifying mixed changes, such as an additional uptick in onions but lower tomato prices. On the other hand, we expect a modest increase in meat and egg after three consecutive prints to the downside.

Banxico to pen the final cut of the current easing cycle. On Thursday, the central bank will carry out its seventh monetary policy meeting of the year, in which we expect a 25bps reference rate cut, to 4.25%. This would be the first of this magnitude since February, after five consecutive 50bps reductions. We expect a majority vote, with at least one and even possibly two members still favoring -50bps. This is based on: (1) Our assessment of the [latest minutes](#), in which one member was markedly dovish, other two more neutral, and the remaining two definitely hawkish; and (2) financial market dynamics since the last decision. We expect the tone of the statement to lean towards a less accommodative stance given accumulated rate cuts and short-term inflation pressures, probably signaling the end of the current easing cycle. While we do not expect significant changes on growth, we believe they will elaborate on current price dynamics –possibly showing more concern–, with financial stability risks also remaining relevant. We also highlight that consensus in the last *Citibanamex* survey matches our forecast (16 out of 25 respondents, including us). Meanwhile, seven expect it unchanged this time around, with the remaining two seeing a 50bps cut.

On growth we expect comments to highlight positive data for June and July and show a recovery from the low in May. Nevertheless, we might also get some discussions for August, in which forward-looking data such as [IMEF’s PMIs](#) (see chart below, left) and auto production (chart below, right), among others, have shown weaker signals. This might raise some concerns and could help to their evaluation about which may be the most likely of the three scenarios outlined in the [Quarterly Report](#).

In either case, we expect the balance of risks to remain skewed to the downside, with comments on the degree of slack potentially relevant to infer the actual position of activity relative to their forecasts.

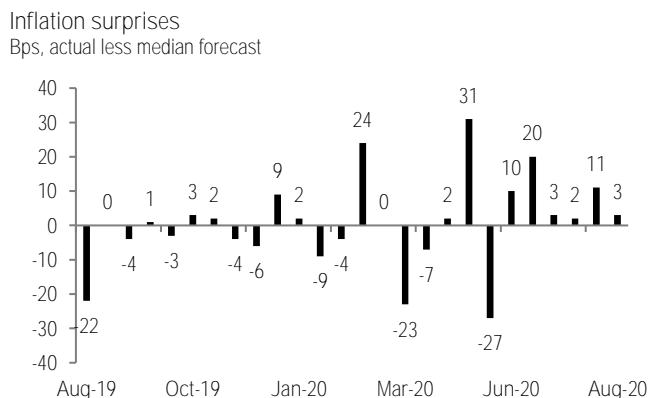


Source: IMEF

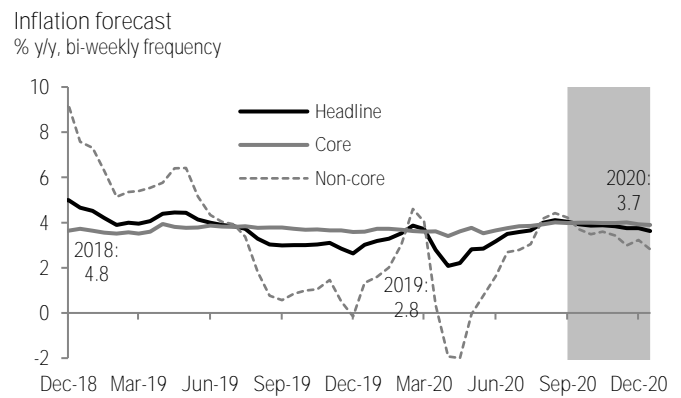


Source: INEGI

Regarding inflation, the annual rate has picked up from the 3.62% known at the time of the last decision, to 4.05% [at the end of August](#) –virtually the upper bound of the variability range around the target–. Although the last few bi-weekly prints have been somewhat closer to expectations, they still have surprised to the upside (chart below, left). However, we will be looking for the print of the first half of September (see the section above for our forecast) as we expect it relatively low. We should mention that the recent increase in annual terms has been influenced to some extent by adverse base-effects, both in fresh fruits and energy (mostly gasolines). Therefore, the recent uptick should be transitory and start reversing soon, consistent with both our estimates (chart below, right) and those of the central bank. Specifically, headline inflation should return to the target range by year-end. Meanwhile, core goods have remained pressured, staying as the main concern for most members and with a relevant rise not only in processed foods but also in other goods since the lockdown ended in early June. In contrast, services have decelerated more strongly, providing some comfort as these are arguably more sensitive to domestic slack. Overall, we believe the balance of risks will remain characterized as uncertain, with markets focused on any updated on the risks, both to the upside and downside, in order to evaluate which might have a higher chance of materializing.



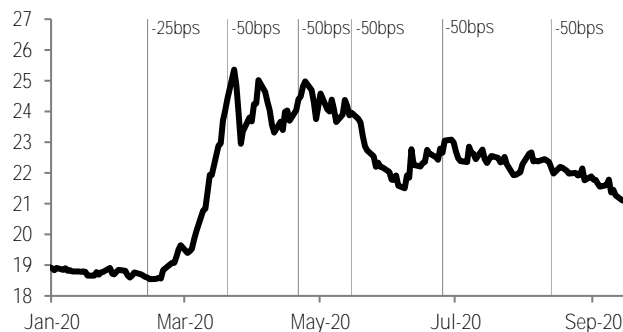
Source: INEGI, Bloomberg



Source: INEGI, Banorte

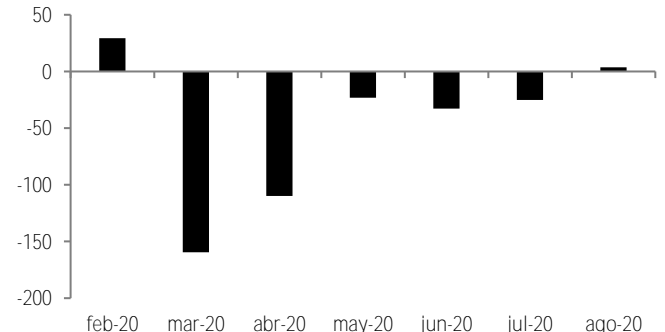
Financial stability risks have waned, judging by recent market performance. In this respect the peso has appreciated 5.1% since the last policy meeting, to USD/MXN 21.09 (chart below, left). In our view, this has been mostly because of broad dollar weakness because of the Fed, which unveiled its new long-term strategy with a markedly more dovish shift. Moreover, capital flows to local government bonds turned positive in the last month. For example, Mbonos holdings increased marginally after five months down (chart below, right). It should be remembered this was one of the key concerns of Deputy Governor Irene Espinosa in August, possibly supporting the call for the dissenters. Also, Governor Alejandro Díaz de León argued in recent months about the need to be cautious due to the financial shock, which has stemmed outflows. This week, the central bank [extended the period of availability for most of its liquidity and credit-enhancing facilities](#), as additional market stress cannot be ruled out. Other risks remain unchanged, such as those related to public finances and Pemex. In this sense, Deputy Governor Jonathan Heath stated recently that the state-owned company “...is currently a headache for the Federal Government and public finances...”, and that actions are needed in the short-term to address its financial situation. Considering this, as well as the persistent uncertainty about the outlook, we believe the central bank will continue favoring a cautious and prudent stance.

Mexican peso
USD/MXN



Source: Bloomberg

Net foreign flows into Mbonos
\$ billion



Source: Banxico

On the depth of the easing cycle, comments regarding future actions will possibly be updated, especially about the “...available room for maneuver...” as the rate is closer (if not already at) to the level desired by most Board members. Despite of this, we believe they will not completely rule out the possibility of additional easing, if conditions allow it in the medium-term. In this sense, the latest comments have been more cautious over the path going forward. Deputy Governor Jonathan Heath stated that the room for additional cuts is more limited. On the other hand, comments from other Deputy Governors such as Irene Espinosa –who was the dissenting vote in the previous decision– and Javier Guzmán have been more hawkish. On the dovish side, one member within the minutes, which we believe was Deputy Governor Gerardo Esquivel, is clearly leaning towards aggressive cuts and extending the cycle further (even with the possibility of a negative real rate, which could mean cutting close to or even below 3.50%). However, it is our take that a more conservative approach will prevail, thus resulting in this being the last rate cut.

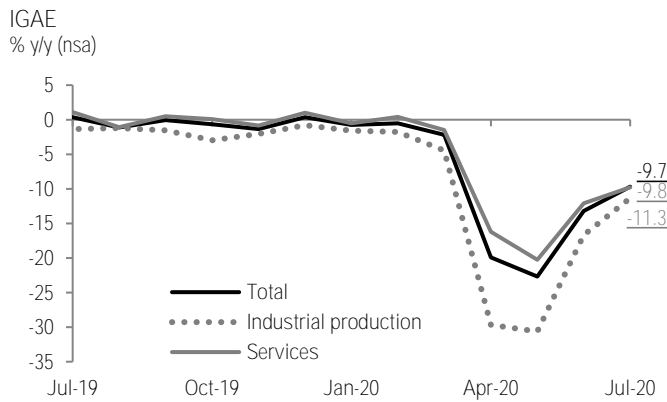
After this decision, we expect the central bank to maintain the rate unchanged for the rest of the year and all 2021. In the short-term, we think the US election still looms large on the scenario, not ruling out higher volatility (as already anticipated in some option markets) especially in the exchange rate. In addition, there are still many unknowns ahead, leading us to expect a more orthodox approach by the central bank. Despite of this, we believe risks are tilted towards more easing instead of a tighter policy stance considering risks for economic activity and the central bank's inflation outlook, among the most relevant factors.

July's IGAE to continue moving upwards. We expect the *Global Economic Activity Indicator* (IGAE) at -9.7% y/y, stronger in annual terms for a third consecutive time. With seasonally adjusted figures, we estimate a sequential recovery of 5.7% m/m on top of the +8.9% in June, confirming that the bottom in terms of activity has likely already been left behind –in May–. Nonetheless, this would still be about 8.4% below the level in February, before the pandemic hit. In general terms, we see two main drivers: (1) Strong external demand, mainly benefitting industry, but also some externally driven sectors in services; and (2) an additional reopening of domestic activities, helping services more extensively. Regarding the latter, we had news which were also backed by improved mobility data. On the other hand, the traffic-light indicator showed few changes. Specifically, 14 states were in red and 18 in orange at the end of June. One month later, two were added in the former and subtracted from the latter. Nevertheless, we should mention that the State of Mexico –with the highest population in the country– went from red to orange. Other states with important metro areas such as Nuevo Leon (red) and Mexico City (orange) stayed the same, while Jalisco deteriorated, among the most relevant.

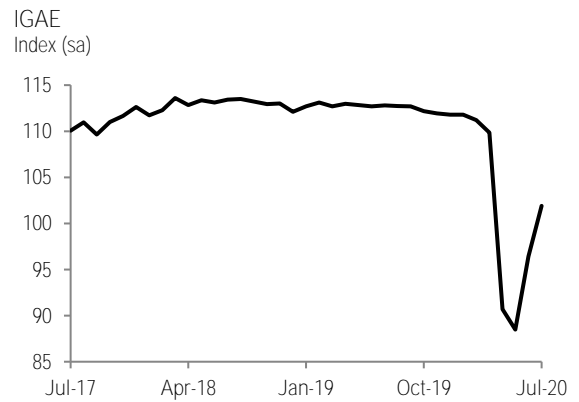
As already published, [industrial production stood at -11.3% y/y](#), stronger than in June and advancing 6.9% m/m in seasonally adjusted terms. All sectors saw sequential gains, with manufacturing outperforming, particularly transportation. In our view, this sector has been more successful in adjusting to the 'new normality', partly because of the possibility of producing without direct contact with clients, but also as demand for their goods has not been as affected, particularly for export-oriented sectors –in turn, likely supported by strong stimulus measures, particularly in the US.

In services, we expect a 9.8% y/y contraction. Seasonally adjusted, we anticipate a 4.7% m/m increase. First, the [IMEF non-manufacturing indicator picked-up meaningfully](#), particularly in the 'new orders' and 'production' components. Second, we believe transportation services may have been helped by the improvement in manufacturing, while retail sales would also be better, as explained above. [Employment gains were observed, led by the informal sector](#). INEGI's aggregate trend indicator index on non-financial services (excluding commerce) recovered to 51.2pts from 50.3pts in June, with generalized increases within. Other data in sectors most hit by the pandemic, such as air passenger traffic (-68.2% y/y from -82.5% in the previous month; using data for privately operated airports) and hotel occupancy rates (14.9% vs 5.7%) were also better. We believe some fatigue about distancing measures may have helped, even with modest advances in terms of the evolution of the pandemic, as described above.

Going forward and as shown in the chart below to the right, dynamics so far resembles a ‘V-shaped’ recovery. Although more data to assess this is necessary, we believe risks for a ‘U-shape’ are still relevant. In this respect, available data until now for August (such as IMEF indicators and auto sales, along dampened gains in mobility) suggest the recovery may have hit a bump in the road after recent gains, without ruling out a sequential decline. On the other hand, if our forecast is correct, the economy would have accumulated a 9.9% y/y contraction up to July, virtually in line with our -9.8% forecast. We reiterate our estimate given mixed signals going forward, staying focused on performance to gauge both the possible skew for the balance of risks –which currently seem slightly skewed to the upside– and the overall shape of the recovery that we still see during the second half of the year (albeit more modest after the rebound in the latest months).



Source: INEGI, Banorte



Source: INEGI, Banorte

Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V. for the provision of our services.

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| | |
|-----------|---|
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| HOLD | When the share expected performance is similar to the MEXBOL estimated performance. |
| SELL | When the share expected performance is lower than the MEXBOL estimated performance. |

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| Research and Strategy | | | |
|--|--|--|-------------------------|
| Gabriel Casillas Olvera | IRO and Chief Economist | gabriel.casillas@banorte.com | (55) 4433 - 4695 |
| Raquel Vázquez Godínez | Assistant | raquel.vazquez@banorte.com | (55) 1670 - 2967 |
| Lourdes Calvo Fernández | Analyst (Edition) | lourdes.calvo@banorte.com | (55) 1103 - 4000 x 2611 |
| Economic Research and Financial Market Strategy | | | |
| Alejandro Padilla Santana | Executive Director of Economic Research and Financial Markets Strategy | alejandro.padilla@banorte.com | (55) 1103 - 4043 |
| Itzel Martínez Rojas | Analyst | itzel.martinez.rojas@banorte.com | (55) 1670 - 2251 |
| Economic Research | | | |
| Juan Carlos Alderete Macal, CFA | Director of Economic Research | juan.alderete.macal@banorte.com | (55) 1103 - 4046 |
| Francisco José Flores Serrano | Senior Economist, Mexico | francisco.flores.serrano@banorte.com | (55) 1670 - 2957 |
| Katía Celina Goya Ostos | Senior Economist, Global | katia.goya@banorte.com | (55) 1670 - 1821 |
| Luis Leopoldo López Salinas | Economist, Global | luis.lopez.salinas@banorte.com | (55) 1103 - 4000 x 2707 |
| Market Strategy | | | |
| Manuel Jiménez Zaldivar | Director of Market Strategy | manuel.jimenez@banorte.com | (55) 5268 - 1671 |
| Fixed income and FX Strategy | | | |
| Santiago Leal Singer | Senior Strategist, Fixed Income and FX | santiago.leal@banorte.com | (55) 1670 - 2144 |
| Leslie Thalía Orozco Vélez | Strategist, Fixed Income and FX | leslie.orozco.velez@banorte.com | (55) 5268 - 1698 |
| Equity Strategy | | | |
| Marissa Garza Ostos | Director of Equity Strategy | marissa.garza@banorte.com | (55) 1670 - 1719 |
| José Itzamna Espitia Hernández | Senior Strategist, Equity | jose.espitia@banorte.com | (55) 1670 - 2249 |
| Valentín III Mendoza Balderas | Senior Strategist, Equity | valentin.mendoza@banorte.com | (55) 1670 - 2250 |
| Víctor Hugo Cortes Castro | Senior Strategist, Technical | victorh.cortes@banorte.com | (55) 1670 - 1800 |
| Eridani Ruibal Ortega | Analyst | eridani.ruibal.ortega@banorte.com | (55) 1103 - 4000 x 2755 |
| Juan Barbier Arizmendi, CFA | Analyst | juan.barbier@banorte.com | (55) 1670 - 1746 |
| Corporate Debt | | | |
| Tania Abdul Massih Jacobo | Director of Corporate Debt | tania.abdul@banorte.com | (55) 5268 - 1672 |
| Hugo Armando Gómez Solís | Senior Analyst, Corporate Debt | hugoa.gomez@banorte.com | (55) 1670 - 2247 |
| Gerardo Daniel Valle Trujillo | Analyst, Corporate Debt | gerardo.valle.trujillo@banorte.com | (55) 1670 - 2248 |
| Economic Studies | | | |
| Delia María Paredes Mier | Executive Director of Economic Studies | delia.paredes@banorte.com | (55) 5268 - 1694 |
| Miguel Alejandro Calvo Domínguez | Senior Analyst, Economic Studies | miguel.calvo@banorte.com | (55) 1670 - 2220 |
| Wholesale Banking | | | |
| Armando Rodal Espinosa | Head of Wholesale Banking | armando.rodal@banorte.com | (81) 8319 - 6895 |
| Alejandro Aguilar Ceballos | Head of Asset Management | alejandro.aguilar.cebillos@banorte.com | (55) 5268 - 9996 |
| Alejandro Eric Faesi Puente | Head of Global Markets and Institutional Sales | alejandro.faesi@banorte.com | (55) 5268 - 1640 |
| Alejandro Frigolet Vázquez Vela | Head of Sólida Banorte | alejandro.frigolet.vazquezvela@banorte.com | (55) 5268 - 1656 |
| Arturo Monroy Ballesteros | Head of Investment Banking and Structured Finance | arturo.monroy.ballesteros@banorte.com | (55) 5004 - 1002 |
| Carlos Alberto Arciniega Navarro | Head of Treasury Services | carlos.arciniega@banorte.com | (81) 1103 - 4091 |
| Gerardo Zamora Nanez | Head of Transactional Banking, Leasing and Factoring | gerardo.zamora@banorte.com | (81) 8318 - 5071 |
| Jorge de la Vega Grajales | Head of Government Banking | jorge.delavega@banorte.com | (55) 5004 - 5121 |
| Luis Pietrini Sheridan | Head of Private Banking | luis.pietrini@banorte.com | (55) 5004 - 1453 |
| Lizza Velarde Torres | Executive Director of Wholesale Banking | lizza.velarde@banorte.com | (55) 4433 - 4676 |
| Oswaldo Brondo Menchaca | Head of Specialized Banking Services | oswaldo.brondo@banorte.com | (55) 5004 - 1423 |
| Raúl Alejandro Arauzo Romero | Head of Transactional Banking | alejandro.arauzo@banorte.com | (55) 5261 - 4910 |
| René Gerardo Pimentel Ibarrola | Head of Corporate Banking | pimentelr@banorte.com | (55) 5268 - 9004 |
| Ricardo Velázquez Rodríguez | Head of International Banking | rvelazquez@banorte.com | (55) 5004 - 5279 |
| Víctor Antonio Roldan Ferrer | Head of Commercial Banking | victor.rolan.ferrer@banorte.com | (55) 5004 - 1454 |