BANORTE

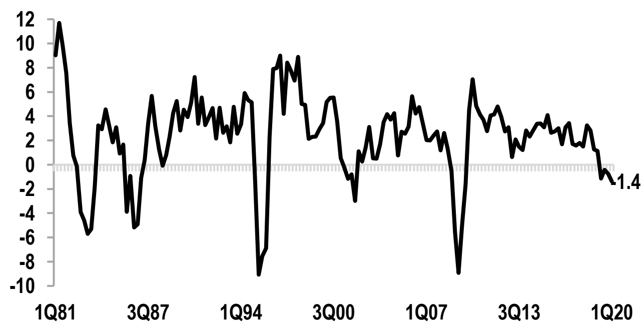
Economic Research
Mexico

1Q20 GDP – Slight upward revision in both industry and services

- **Gross Domestic Product (1Q20 F, nsa): -1.4% y/y; Banorte: -1.5%; consensus: -1.6% (range: -2.2% to -1.4%); preliminary: -1.6%**
- **Gross Domestic Product (1Q20 F, sa): -1.2% q/q; Banorte: -1.5%; consensus: -1.6% (range: -1.8% to -1.2%); preliminary: -1.6%**
- **As mentioned in the preliminary print, the annual figure is skewed to the upside due to the leap year effect. Adjusting for this, activity contracted 2.2%**
- **In sequential terms, industry was revised to -1.2% q/q (previous: -1.4%), while services were also higher, at -0.9% (previous: -1.4%). Primary activities grew 1.7% (previous 0.5%)**
- **March's *IGAE* declined 2.3% y/y (-1.3% m/m), above our -2.9%. Performance in this period was impacted by the COVID-19 pandemic, dragging the whole quarter down**
- **We continue believing that activity will decline more significantly in 2Q20, highly affected by the stoppage in activity in April and May**
- **We maintain our forecast of a 7.8% y/y decline in GDP in 2020. Nevertheless, we cannot rule out further decreases given the possibility that the attempt to restart operations is delayed further**

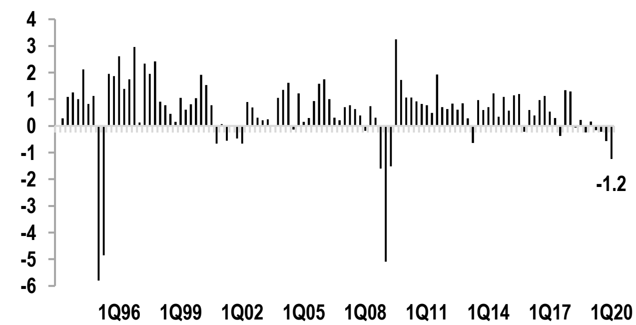
GDP contracts 1.4% y/y in 1Q20. This was above consensus (-1.6%) and the preliminary estimate, but closer to our -1.5% forecast. As noted at the time that the first estimate was released, this figure is skewed to the upside due to the additional day resulting from the leap year. Correcting for the latter, using seasonally adjusted figures, activity fell 2.2% y/y. While this represents a new low since the 2009 Global Financial Crisis (chart below, left), we believe that the probability of achieving new historical lows is quite high, as activity has been impacted more strongly by the pandemic in 2Q20. Inside, industry was revised up to -3.5% y/y (sa) from -3.8%. This was explained by a slightly better performance than implied in the period as opposed to upward revisions in previous months. Meanwhile, services were adjusted to -1.2% from -1.4%, also aided by a better performance than implied in March. Finally, agriculture stood at 1.1%.

GDP
% y/y nsa



Source: INEGI

GDP
% q/q sa



Source: INEGI

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GDP 1Q20
% y/y, nsa

	Final	Preliminary
Total	**-1.4**	**-1.6**
Agricultural	1.4	1.5
Industrial production	-2.9	-3.2
Services	-0.7	-0.9

Source: INEGI

GDP 1Q20
% y/y, sa

	Final	Preliminary
Total	**-2.2**	**-2.4**
Agricultural	1.1	1.2
Industrial production	-3.5	-3.8
Services	-1.2	-1.4

Source: INEGI

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Sequential performance also higher. GDP was adjusted to -1.2% q/q from -1.6%. Similar to annual data, IP was revised up, to -1.2% (previous: -1.4%). This was mainly due to a more modest decline in construction (-0.3%), albeit staying negative for one year in a row. Manufacturing was more affected (-1.9%), extending the -2.6% of the previous quarter, dragged by auto sector woes. These resented more clearly the early effects of the pandemic, including supply chain disruptions since the start of the year and a more direct impact from stoppages in the latter part of March. On the contrary, mining was positive (2.1%), benefiting from Federal Government efforts to boost Pemex's oil production.

Services were also stronger at the margin, to -0.9% from -1.4%. As expected, the breakdown showed recreational services as the weakest (-14.1%) given social distancing measures, followed closely by tourism-related sectors such as lodging (-11.0%) and transportation (-2.0%). We believe the latter was also hit by low underlying dynamism in industry, particularly manufacturing. We were somewhat surprised by education (-0.1%) which fell modestly despite classes being suspended in most of the country since the middle of March. This also applies for the 1.3% decline in healthcare, as demand likely increased due to the pandemic. Retail was significantly lower (-2.2%) despite preemptive purchases of essential goods by the end of the period, while wholesales plunged 1.5%. Corporates observed the best performance among all categories at 5.8%, in our view supported somehow by the possibility of utilizing home-office schemes. Lastly, government activities were also higher at 4.2%.

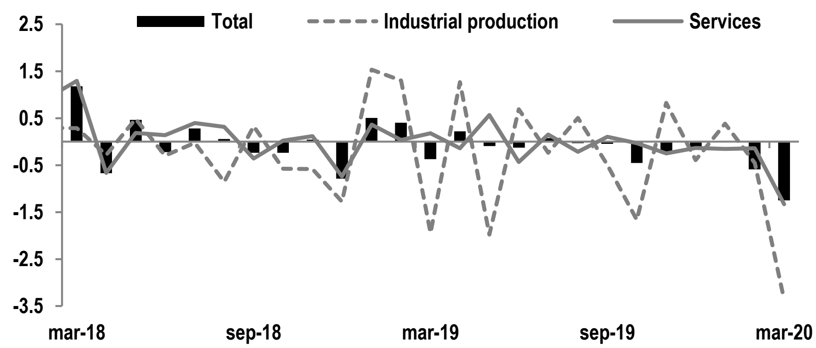
GDP
%y/y nsa; % q/q sa, %q/q saar

	% y/y, nsa		% y/y, sa		% q/q, sa		% q/q, saar	
	1Q20	4Q19	1Q20	4Q19	1Q20	4Q19	1Q20	4Q19
Total GDP	-1.4	-0.7	-2.2	-0.8	-1.2	-0.6		-2.3
Agriculture	1.4	-0.3	1.1	-0.2	1.7	-0.1	7.2	-0.4
Industrial activity	-2.9	-2.0	-3.5	-1.8	-1.2	-1.5	-4.9	-5.8
Mining	4.2	-0.3	4.2	-0.2	2.1	0.9	8.8	3.7
Utilities	0.3	4.7	0.7	4.5	-2.8	0.6	-10.7	2.3
Construction	-8.2	-5.7	-8.7	-5.2	-0.3	-1.8	-1.1	-7.0
Manufacturing	-2.9	-1.5	-3.9	-1.4	-1.9	-2.6	-7.6	-9.8
Services	-0.7	-0.2	-1.2	-0.3	-0.9	-0.3	-3.5	-1.1
Wholesale commerce	-4.4	-5.8	-5.4	-5.9	-1.5	-2.0	-6.1	-7.9
Retail sales	0.8	3.1	-0.3	2.9	-2.2	0.3	-8.7	1.1
Transportation and storage	-2.8	-0.5	-3.4	-1.0	-2.0	-1.7	-7.6	-6.8
Mass media and information	4.7	4.8	5.6	3.9	-1.2	1.6	-4.8	6.5
Financial services	-1.8	-5.9	-1.9	-5.6	3.2	-0.1	13.2	-0.2
Real estate	1.0	1.3	0.9	1.3	0.1	0.4	0.5	1.8
Professional services	-2.9	-0.6	-3.6	-0.3	-0.3	-0.8	-1.2	-3.3
Corporations	4.0	-5.6	4.1	-5.2	5.8	-3.0	25.1	-11.3
Business support	1.3	3.4	1.7	3.5	0.3	0.5	1.2	1.9
Education	-1.2	-1.3	-1.3	-1.4	-0.1	0.2	-0.6	0.8
Healthcare	-1.9	0.1	-1.8	0.0	-1.3	-0.2	-5.2	-0.8
Recreation, sports and cultural events	-14.1	-1.3	-13.9	-1.3	-14.1	-0.9	-45.5	-3.4
Temporary lodging services	-7.9	3.1	-8.0	3.2	-11.0	2.0	-37.1	8.1
Other services	-2.6	-2.2	-2.5	-1.9	-0.3	-2.0	-1.2	-7.7
Government activities	6.5	0.4	6.1	0.8	4.2	1.7	18.0	7.0

Source: INEGI

Economic activity in March fell as some restrictions started to bite. Specifically, the *Global Economic Activity Indicator* (IGAE), also released today, fell 2.3% y/y, above consensus (-3.5%) and our -2.9%. This is the sharpest contraction since October 2009. This was observed in a context in which the economy had remained in low gear for some time. Meanwhile, it is worth remembering that official countrywide restrictions to mobility and other economic activities were put in place until March 30th, with the declaration of the sanitary emergency. Despite of the latter, data shows these started to decelerate meaningfully since the middle of the month. By sector, primary activities were very positive at 9.3%, industry declined 5.0%, in line with the previous industrial production report. Meanwhile services plunged to -1.4%. With seasonally adjusted figures, activity declined 1.3% m/m, with industry as the weakest sector. This confirms the underlying weakness of the economy, with more advanced hard data such as April's trade balance making very clear that economic activity will likely plummet in coming months.

GDP monthly proxy (IGAE)
% m/m (sa)



Source: INEGI

Hefty decline in activity expected in 2Q20… Despite a more positive print relative to the preliminary estimate in today's report, we believe it does not represent a sign of relief and is not enough to imply an upside risk for activity during the rest of the year. Similar to the rest of the world, a plethora of data show that the shock to the economy from the pandemic in coming months will probably be much more than that observed in the depth of the 2009 financial crisis and will even surpass the decline in the "Tequila crisis" in 1995. These include historical declines in IMEF's PMI indicators, ANTAD's retail sales, several indicators from the auto sector (output, sales, and exports), tourism (hotel occupancy and air passenger traffic) and formal employment, among others. We should also mention that the impact is not only domestic but external, with activity data in the US and other important trade partners also showing historical declines. As we have already observed, this has led to an unprecedented plunge in trade volumes with the rest of the world.

Given current dynamics of the pandemic, including scarce evidence of a peak in new cases so far, we think weakness will extend at least until May. In this respect, social distancing measures remain in place in most of the country, with a gradual reopening only in some counties, as outlined in the government's plan. Although efforts by several companies have been made to establish sanitary protocols, reports suggest that compliance is complicated, further delaying the resumption of activities. Based on the latter, we believe that a more relevant reactivation could start in June, when the possibility of a clearer decline in new cases could be coupled with more streamlined processes to reinitiate productive activities. We also believe higher dynamism could be in store as people go out and try to return to normality, as observed in recent days in the US. Nonetheless, a headwind for a strong recovery in services will be the loss of purchasing power among the population on lower employment levels, limiting the potential advance in terms of consumption.

…with a modest recovery in the second half of the year. In our view, activity levels could start to strengthen more clearly in 3Q20 under the assumption of better dynamics of the pandemic and more significant steps in terms of reopening measures. One important factor to estimate how strong this possible recovery will be is the effect that several government support programs could have. Other programs have been announced as the pandemic has evolved, focused mainly on loans both to consumers and companies. Among them, the government aims to grant 4 million loans (with an estimated amount of $307.6 billion or US$ 13.8 billion, equivalent to 1.7% of 2019 GDP) to boost the economy. This is coupled with other actions by the central bank that have focused not only on ensuring an orderly functioning of financial markets, but also on strengthening credit to the real economy. Despite of this, we believe that the most important support will come from external demand, with stimulus measures in the US playing a key role in kickstarting activity in that country, and therefore benefitting some sectors in Mexico. Lastly, the nature of the shock implies relevant risks to our forecasts, as we cannot rule out a resurgence of contagions and additional business closures at least until an effective treatment and/or a vaccine is found. In this backdrop, we maintain our 2020 GDP forecast at -7.8% y/y, with balanced risks for now albeit despite the possibility of being biased to the downside once again.

GDP 2020: Aggregate supply
% y/y nsa; % q/q sa

% y/y	1Q20	2Q20	3Q20	4Q20	2020
GDP	**-1.4**	**-17.1**	**-9.9**	**-2.7**	**-7.8**
Agriculture	1.4	-2.5	-2.4	-0.6	-1.0
Industrial production	-2.9	-22.3	-9.2	-3.2	-9.4
Services	-0.7	-15.3	-10.4	-2.8	-7.3
% q/q					
GDP	**-1.2**	**-11.6**	**5.4**	**3.3**	**--**

Source: INEGI, Banorte

GDP 2020: Aggregate demand
% y/y nsa; % q/q sa

% y/y	1T20	2T20	3T20	4T20	2020
GDP	**-1.4**	**-17.1**	**-9.9**	**-2.7**	**-7.8**
Private consumption	-0.6	-16.5	-9.1	-2.5	-7.2
Investment	-11.2	-39.2	-18.2	-5.3	-18.4
Exports	0.1	-30.1	-5.8	3.3	-8.5
Imports	-5.2	-35.1	-8.9	-2.2	-12.9
% q/q					
GDP	**-1.2**	**-11.6**	**5.4**	**3.3**	**--**

Source: INEGI, Banorte

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We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Eridani Ruibal Ortega and Leslie Thalía Orozco Vélez, 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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