Aggregate supply and demand – Broad decline in 1Q20 as the pandemic hit activity

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- **Aggregate supply and demand (1Q20): -1.9% y/y; Banorte: -2.0%; consensus: -2.8% (range: -4.2% to -1.0%); previous: -1.7%**
- **We should remember that this figure is skewed to the upside due to the additional day from the leap year. Correcting for the latter, the contraction came in at -2.7%**
- **Dynamics in the latter part of the period were explained by the effects of the COVID-19 pandemic, exacerbating some trends to the downside that had been developing since last year**
- **Weakness concentrated in the domestic component, mainly in investment, falling 9.5% y/y sa, with consumption also negative (-1.2%). Regarding the external sector, imports fell sharply (-5.1%), while exports were relatively more resilient (1.7%)**
- **In sequential terms, we see a similar story, falling 1.1% q/q. We observed significant declines in investment (-2.2% q/q) and imports (-1.9%). Consumption fell more modestly (-1.4%), while exports bounced (3.1%) after a significant decline in the previous quarter**
- **The outlook going forward is negative, anticipating a substantial impact in 2Q20 due to measures to combat the pandemic and the global recession. Moreover, we believe risks to the downside remain for the rest of the year, as uncertainty about the virus is still elevated**

Aggregate supply and demand fell 1.9% y/y in 1Q20. This was higher than consensus (-2.8%) but practically in line with our -2.0% forecast. We should mention that this figure is skewed to the upside due to the additional day from the leap year. Correcting for this, using seasonally adjusted figures, demand contracted 2.7% y/y (Chart 1). Quarterly dynamics were heavily influenced by the effects from the COVID-19 pandemic. Although the first affected channel was imports, declining 5.1% y/y (sa), we also observed an impact in domestic demand, which was already weak even before this shock. Specifically, investment was the worst category, accumulating a 9.5% decline, with the private sector, surprisingly, leading losses (Table 1). Private consumption also contracted, coming in at -1.2%. Inside, the fall was concentrated in the imported component (-1.8%), consistent with the depreciation of the Mexican peso at the end of the period. Moreover, government spending showed a strong uptick of 3.3%, benefited by a less challenging base effect but also higher non-capital spending by the Federal Government. Finally, exports managed to stay relatively resilient, showing a 1.7% expansion, aided by the relative delay in contagion in our country compared to the rest of the world.

Quarterly dynamics also reflected the impact of the pandemic. Aggregate supply and demand declined 1.1% q/q, in line with the previous quarter (Table 2). Similar to the annual comparison, imports fell (-1.9%), extending the decline observed in 4Q19 (Chart 8), which was affected by the strike by GM workers in the US. This was not the case for exports, which rebounded 3.1%, although with a less challenging base effect. As mentioned above, in general terms we think that this spread is explained by differences in the timing of the pandemic's impact, which was first seen in Asia and Europe. Moreover, it is likely that some of the support in exports is related to lower inventories (-67.5%), with companies using available inputs along goods already manufactured beforehand to keep selling abroad despite disruptions. Nevertheless, and given this situation, exports in 2Q20 could be relatively more impacted given the delay in the reopening of the domestic economy.

In the domestic front, investment contracted 2.2%, with four consecutive quarters down. Contrary to 4Q19, losses were led by the private sector at -2.2%, while the public sector declined 1.5%. It is our take that this was driven to a great extent by a base effect, as shown in Chart 6. Consumption declined 1.4%, with the imported component much weaker at -5.1%. We think this is related both to a more adverse base effect and distortions in the external front because of the pandemic. Another factor that could have had an impact, as mentioned in the previous section, is the depreciation of the Mexican peso in the last part of the period, disincentivizing these purchases. The domestic component stood at -1.2% (Chart 5), with goods stronger at -0.2%, while services retraced 2.3%. This could have been helped by the skew to buy essential goods, along the suspension of some services in March, shifting usual consumption patterns. Lastly, government spending was up 3.2%, its second consecutive quarter to the upside (Chart 7). Nevertheless, dynamics going forward are not very clear, with the expansion in health spending possibly compensated by austerity measures in other ministries.

Weakness will extend to coming quarters, especially 2Q20, which we expect to be the most impacted. Although today's report started to show some distortions from COVID-19, its effect was relatively modest. In this sense, available figures point to historical contractions in activity in April (with IGAE to be released next week) and signs of a modest sequential recovery in May. Moreover, according to the reactivation plan and the evolution of epidemiological conditions so far, it is our take that the restart could be more gradual than we had anticipated, adding downward risks to our -7.8% y/y GDP estimate for 2020.

For 2Q20, we expect generalized and strong declines in practically all components of aggregate demand, exposed to social distancing measures as well as the global economic deceleration. In particular, we believe the external sector might be hit strongly, with important distortions in both exports and imports given halted activities in Mexico as well as other countries in the world. Nevertheless, signals from the US suggest external demand could bounce back relatively fast. This comes on top of some US businesses calling for the reactivation of some economic activities in our country to reestablish supply chains. This is consistent with our view that the key driver of the recovery in the second half of the year will be external sector.

Domestically, the main impact will likely be in investment, affected by the stoppage in activity –with construction designated as non-essential in April and May–, surging uncertainty, and lower growth expectations. We believe the latter two, coupled with likely weaker balance sheet positions, will result in an important delay of businesses' capex decisions. Consumer sentiment will also be hit, affecting decisions on residential investment. Specifically, we believe these conditions will prevail at least until fears about the virus start to dissipate substantially, which might not happen until we have a vaccine, or at least an effective treatment that can be made widely available. We also see a contraction in consumption, with people increasing their savings on a higher risk perception and job losses taking a toll on total incomes. We believe we will see relevant changes in consumption patterns, both from businesses and consumers. This is consistent with some forward-looking data that shows a deferral in durable goods' purchases in favor essential items. On government spending, several reports point to important cuts in government branches driven by the Federal government's plan of cutting current, non-capital spending up to 75%, which will most likely will impact the sector's performance going forward.

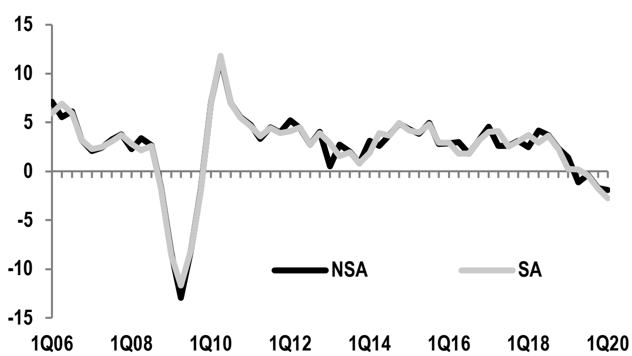
Overall, we believe weakness this year will center on the domestic component, particularly investment, while consumption will remain muted. On the contrary, external demand might bounce more quickly, aided by different stimulus measures, both fiscal and monetary, particularly in the US.

Table 1: Aggregate demand
% y/y nsa, % y/y sa

	% y/y nsa						% y/y sa	
	1Q20	4Q19	3Q19	2Q19	2019	2018	1Q20	4Q19
Aggregate supply	-1.9	-1.7	-0.3	-1.1	-0.5	3.2	-2.7	-1.8
GDP	-1.4	-0.7	-0.4	-1.1	-0.3	2.2	-2.2	-0.8
Imports	-3.4	-4.3	-0.1	-1.2	-0.9	5.9	-5.1	-4.4
Goods	-3.0	-4.2	-0.3	-1.1	-0.8	6.3	--	--
Services	-11.4	-7.1	2.4	-3.2	-3.7	-2.9	--	--
Aggregate demand	-1.9	-1.7	-0.3	-1.1	-0.5	3.2	-2.7	-1.8
Private consumption	-0.5	0.7	0.5	-0.4	0.4	2.4	-1.2	0.7
Domestic	-0.7	0.3	0.3	0.1	0.5	2.3	-1.4	0.3
Goods	0.7	0.6	0.9	-0.5	0.4	1.6	-0.3	0.8
Services	-2.0	-0.1	-0.2	0.7	0.5	3.1	-1.9	-0.1
Imported	-1.7	5.0	4.6	-2.0	2.5	2.9	-1.8	5.1
Goods	-1.3	5.1	4.8	-0.9	3.1	3.1	--	--
Services	-15.5	2.0	-2.3	-29.1	-13.1	-0.8	--	--
Government spending	3.4	-0.4	-1.7	-2.8	-1.4	2.8	3.3	-0.3
Investment	-9.3	-5.3	-6.8	-7.7	-5.1	1.0	-9.5	-5.1
Private	-9.6	-4.4	-6.7	-6.7	-4.3	1.4	-9.8	-4.3
Public	-7.4	-10.0	-8.0	-13.7	-9.7	-1.5	-7.3	-9.6
Exports	1.7	-2.2	2.9	2.4	1.4	5.9	1.7	-2.1
Goods	2.5	-2.6	2.9	2.0	1.2	6.3	--	--
Services	-8.5	2.5	3.4	7.4	5.2	0.7	--	--
Inventories	-23.5	-23.1	-17.8	-10.6	-26.0	-10.5	-45.4	-20.8
Statistical discrepancy	-387.1	-39.5	-22.7	-301.1	-11.8	28.7	--	--

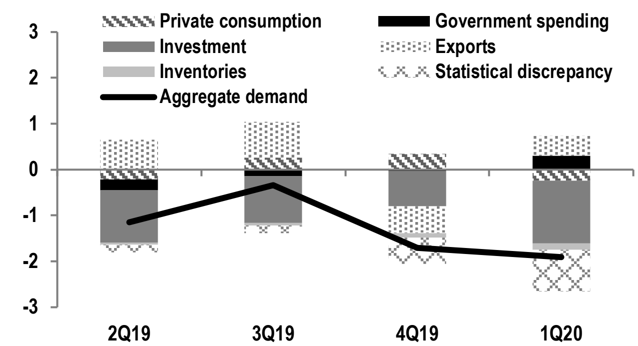
Source: INEGI

Chart 1: Aggregate demand
% y/y nsa, % y/y sa



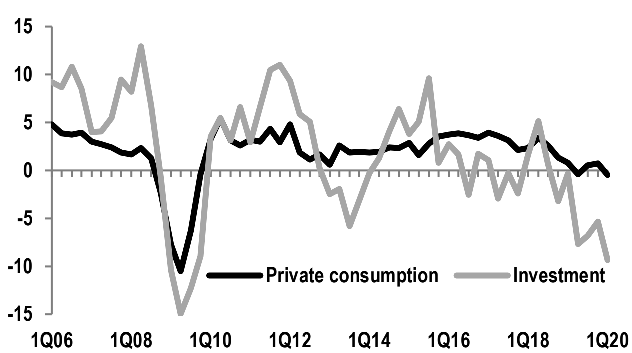
Source: INEGI

Chart 2: Aggregate demand
% y/y, contribution to the annual change, nsa



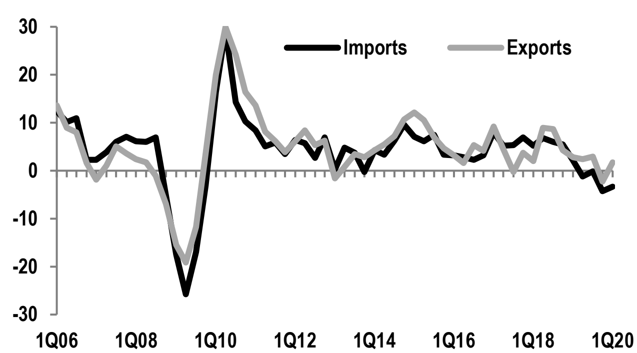
Source: INEGI

Chart 3: Private consumption and investment
% y/y nsa



Source: INEGI

Chart 4: Exports and imports
% y/y nsa



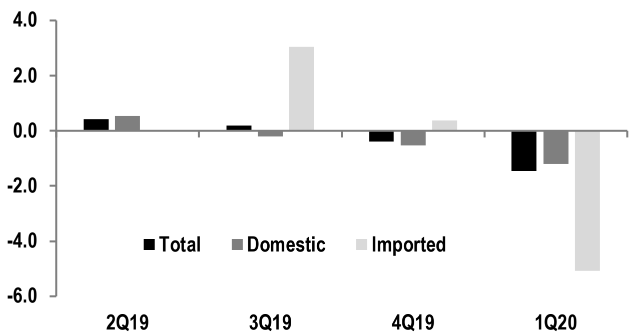
Source: INEGI

Table 2: Aggregate supply and demand
% q/q sa, % q/q saar

	% q/q sa				% q/q saar	
	1Q20	**4Q19**	**3Q19**	**2Q19**	**1Q20**	**4Q19**
Aggregate supply	-1.1	-1.1	-0.2	-0.3	-4.4	-4.3
GDP	-1.2	-0.6	-0.2	-0.2	-4.9	-2.3
Imports	-1.9	-2.6	0.2	-0.9	-7.3	-10.2
Aggregate demand	-1.1	-1.1	-0.2	-0.3	-4.4	-4.3
Private consumption	-1.4	-0.4	0.2	0.4	-5.7	-1.5
Domestic	-1.2	-0.5	-0.2	0.5	-4.7	-2.1
Goods	-0.2	-0.7	-0.2	0.9	-0.9	-2.9
Services	-2.3	0.3	0.0	0.1	-9.0	1.1
Imported	-5.1	0.4	3.0	0.0	-18.8	1.5
Government spending	3.2	0.7	-0.2	-0.3	13.4	2.8
Investment	-2.2	-1.7	-2.4	-3.6	-8.3	-6.6
Private	-2.2	-1.3	-2.8	-3.9	-8.5	-4.9
Public	-1.5	-3.9	0.1	-2.1	-6.0	-14.9
Exports	3.1	-3.9	-0.1	2.8	13.0	-14.8
Inventories	-67.5	-13.7	32.5	47.1	-98.9	-44.6

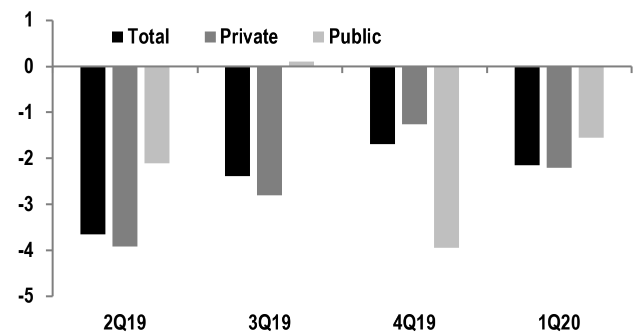
Source: INEGI

Chart 5: Private consumption
% q/q sa



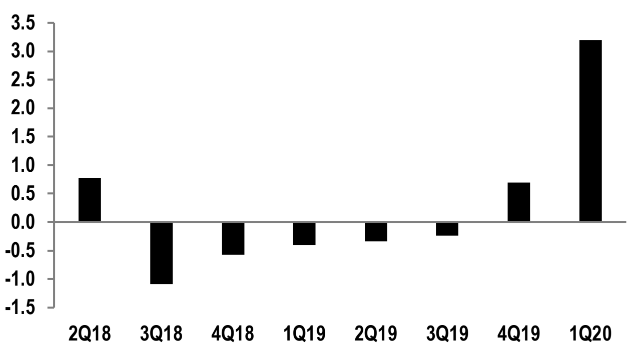
Source: INEGI

Chart 6: Investment
% q/q sa



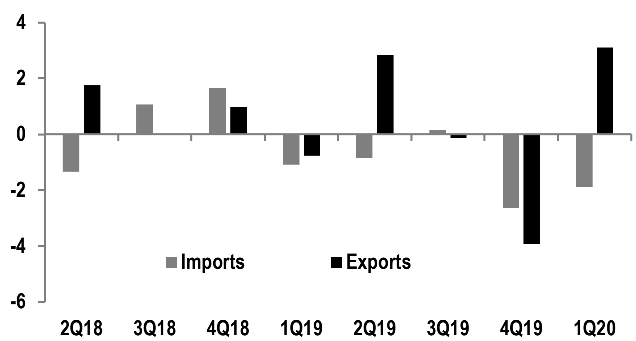
Source: INEGI

Chart 7: Government spending
% q/q sa



Source: INEGI

Chart 8: Exports and imports
% q/q sa



Source: INEGI

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