2Q20 GDP – Historical plunge of 18.9% y/y on the COVID-19 shock

- **Gross Domestic Product (2Q20 P, nsa): -18.9% y/y; Banorte: -19.5%; consensus: -19.4% (range of estimates: -21.4% to -16.7%); previous: -1.4%**
- **Gross Domestic Product (2Q20 P, sa): -17.3% q/q; Banorte: -17.9%; consensus: -17.0% (range of estimates: -20.6% to -15.0%); previous: -1.2%**
- **We note that the annual decline is the largest since the series is available (1981), with the economy strongly affected by the COVID-19 pandemic**
- **In a similar fashion, both industry and services showed their steepest downfall in sequential fashion, at -23.6% q/q and -14.5%, in the same order. On the other hand, primary activities retraced 2.5%, benefited at the margin by their essential status**
- **Taking into account that the monthly GDP-proxy (IGAE) plunged 21.3% y/y on average in April-May, today's print would imply an improvement in June to around -13.5%, in our view supported by higher external demand and the gradual reopening of the economy**
- **We reiterate our expectation of a gradual economic recovery in the second half of the year, still limited by the high degree of uncertainty about the evolution of COVID-19. Considering today's modest surprise, we maintain our full-year GDP forecast of -9.8% y/y**
- **The revised figure will be published on August 26th**

GDP falls an historic 18.9% y/y in 2Q20. This figure was higher than consensus (-19.4%) which was virtually in line than our -19.5% forecast. We note that the annual decline is the greatest since the series is available (1981, see Chart 1), with the economy deeply affected by restrictions to fight COVID-19 –both globally and domestically– particularly in April and May. The shock to industry remained very high, falling 26.0% y/y on top of the -2.9% of the previous quarter. Services were relatively stronger, albeit also very low at -15.6% (Chart 2). Primary activities managed to show more resiliency as they benefited from their status as essential, standing at -0.7%. Considering also the contraction of the previous quarter, the economy plunged by 10.2% during the first semester (Table 1). Although the Easter holiday took place in a similar period than last year and despite the leap-year effect which resulted in some distortions in working days, seasonally-adjusted figures for the quarter showed activity fell also by the same magnitude (-18.9% y/y).

Sequential performance also very affected. Using seasonally adjusted figures**,** GDP fell 17.3% relative to the previous quarter, which is also an unprecedented fall (Chart 3). Although this is a preliminary figure (final data will be released on August 26th), it would be its fifth consecutive quarterly decline. Industry was again the weakest, standing at -23.6% (Chart 4). In this respect, it should be noted that only essential activities were officially allowed during the first two thirds of the quarter, before expanding them in June based on the plan to reopen the economy.

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Other factors, such as the effects of the OPEC+ output cut agreement in which Mexico also took part, were also negative. Going to services, the decline was also very steep at -14.5%, with mobility restrictions and high uncertainty taking a heavy toll. Although the breakdown is not yet available, data already released keeps showing a high degree of differentiation, favoring those deemed as essential but also the most capable to operate through home office and virtual schemes (*e.g.* financial, health and education). On the other hand, the effect of the pandemic on sectors such as recreational, lodging and transportation, has been more sizable and structural in nature, given their reliance on more social interactions. One very relevant example is the fact that the Easter holiday –which took place in April– was practically inexistent due to the pandemic. Lastly, primary activities remained stronger at -2.5% (Table 2) given the need to limit, to the least extent possible, disruptions to food supply chains.

Today's report implies an improvement of the economy in June. Taking into account that the monthly GDP-proxy (IGAE) plunged 21.3% y/y on average in April-May, today's quarterly estimate would imply an improvement in June to around -13.5% y/y. Given the accumulated decline of the past two months, this would be enough to result in estimated growth near 8.5% m/m, from -2.6% in May. In our view, this was mostly supported by two factors: (1) Higher external demand; and (2) the gradual reopening of the economy. On the former, we stress the relative recovery in trade as highlighted by non-oil exports in the trade balance, and especially given extraordinary support measures –both fiscal and monetary– in the US. This is likely to be more positive to manufacturing within industry, with mining and construction likely more challenged. On the latter, we flag the rebound in IMEF's PMI non-manufacturing indicator. Other available data, such as passenger traffic in privately-owned airports, was also better at the margin despite remaining very low. This is consistent with increased mobility in the month, which extended to July. In our view, this will probably be relatively more beneficial to small businesses –with lower capabilities of using alternative distribution channels, such as internet sales– and the informal sector of the economy.

We maintain our year-end GDP forecast at -9.8%, with a gradual recovery in the second half of 2020. Considering today's relatively modest upward surprise relative to our expectations –on stronger services–, we maintain our full-year GDP forecast unchanged at -9.8% y/y (see Table 3 and Table 4), with risks broadly balanced. In monthly frequency, available data suggests the bottom in terms of activity (in seasonally adjusted terms) was likely in May despite remaining quite low in June. Our base-case is that strict lockdowns –such as those experienced in 2Q20– will not be repeated, with less willingness by authorities to implement them given their economic impact. Nevertheless, the degree of uncertainty remains very high mainly because of two factors, both related to the pandemic: (1) The possibility that restrictions are re-imposed domestically as the curve of new cases has not reached a peak yet, albeit more focalized given the 'traffic-light' system used by the government to differentiate which activities may be carried out; and (2) additional disruptions of external supply chains cannot be ruled out either, as some countries have shown a 'second wave' of contagion, most importantly among them the US.

Given this backdrop, we continue expecting only a gradual recovery in the second half of the year, driven by external demand. In this respect the latter has shown some encouraging signs, in our view aided by stimulus measures in the US –both fiscal and monetary– that have limited the downfall in families' incomes, and which are expected to be extended. Moreover, a modest tailwind could also be observed after USMCA entered into force on July 1st, with certainty over trade relationships in the region increasing while simultaneously seeing higher tensions between the US and China, and which are expected to remain high given the electoral process in the US. In our view, this is an opportunity for Mexico to position itself as a relatively more attractive investment destination at the expense of the Asian country, which is our main competitor in the US market.

In contrast, domestic demand is likely to stay limited at least for the rest of the year. First, we believe consumer and companies' behavior will remain impacted by high uncertainty, particularly as an effective treatment and/or vaccine has not been found yet, let alone made widely available to the population. Moreover, and even with relatively fast and favorable developments in this front (with some positive news recently in terms of the stages of vaccine trials), we think a relevant adverse effect has already been felt and will some take time to heal.

Regarding consumers, employment and the quality of jobs have deteriorated since March, resulting in an important loss of families' incomes. In this respect, we highlight that INEGI's president, Julio Santaella, stated that according to one of the institute's surveys, 65.1% of households reported a decline in income as a result of the pandemic. A more cautious approach will likely be seen not only because of weaker fundamentals, but also due to precautionary motives. Going to companies, the pandemic shock has led to some business closures and at least deteriorated balance sheet health for those that maintained operations, with revenues hit and higher debt –as suggested by the acceleration in banking credit to corporates in recent reports–. In our view, this will be mostly felt in terms of lower gross fixed investment, with companies waiting for a relative normalization and to recover some of their financial strength before exploring new opportunities. We should also mention that the full usage of installed capacity will probably remain constrained due to social distancing guidelines. Moreover, we also consider that sectors more dependent on social interactions, such as those mentioned above, are likely to see limited demand for a more extended period. Lastly and in terms of government spending, the Federal government has kept austerity measures in place, as they remain concerned of a deterioration in public finances and debt dynamics, signaling a limited effect from this component of aggregate demand.

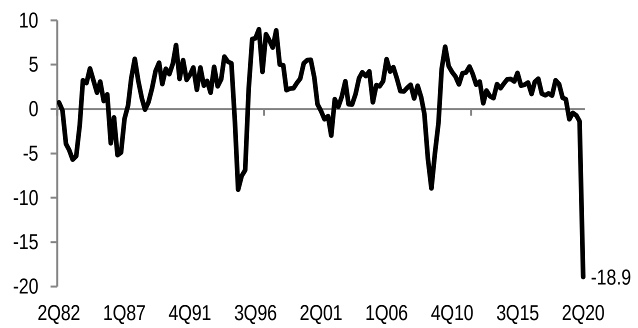
All in all, we estimate a sequential recovery in economic activity of 4.4% q/q in 3Q20 and 6.3% in the fourth quarter, although with annual rates still negative in both of those periods. This recovery will likely be mostly due to external drivers, with domestic conditions still challenging and healing only in a gradual fashion, at least until more favorable dynamics are observed in terms of the global and domestic evolution of the virus that provides the groundwork for a more rapid rebound led by higher confidence levels.

Table 1: GDP
% y/y nsa, % y/y sa

	nsa						sa					
	2Q20	1Q20	2Q19	1Q19	Jan-**Jun'20**	Jan-**Jun'19**	2Q20	1Q20	2Q19	1Q19	Jan-**Jun'20**	Jan-**Jun'19**
Total	-18.9	-1.4	-1.1	1.1	-10.2	0.0	-18.9	-2.2	0.0	0.1	-10.5	0.0
Agricultural	-0.7	1.4	-1.2	1.6	0.3	0.1	-0.3	1.1	-1.0	1.1	0.3	0.1
Industrial Production	-26.0	-2.9	-3.0	-0.2	-14.4	-1.6	-26.0	-3.5	-1.7	-1.6	-14.7	-1.7
Services	-15.6	-0.7	-0.3	1.6	-8.2	0.6	-15.6	-1.2	0.7	0.8	-8.4	0.7

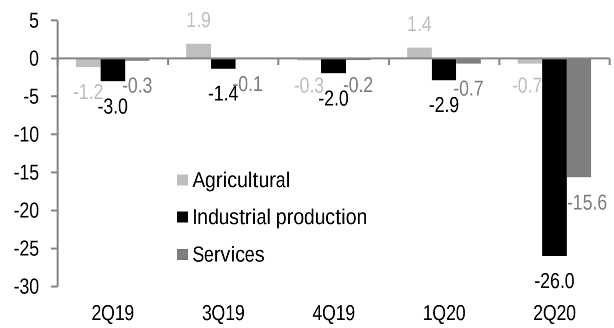
Source: INEGI

Chart 1: GDP
% y/y nsa



Source: INEGI

Chart 2: GDP by sectors
% y/y nsa



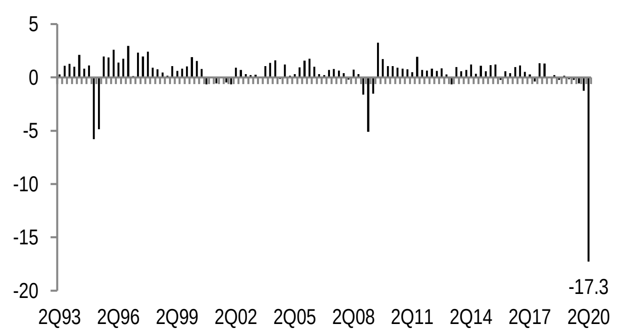
Source: INEGI

Table 2: GDP
% q/q sa, % q/q saar

	% q/q				% q/q saar			
	2Q20	1Q20	2Q19	1Q19	2Q20	1Q20	2Q19	1Q19
Total	-17.3	-1.4	-1.1	1.1	-53.1	-4.9	-2.3	-0.9
Agricultural	-2.5	1.4	-1.2	1.6	-9.6	7.2	-0.4	9.4
Industrial Production	-23.6	-2.9	-3.0	-0.2	-65.9	-4.9	-5.8	-1.7
Services	-14.5	-0.7	-0.3	1.6	-46.7	-3.5	-1.1	-0.5

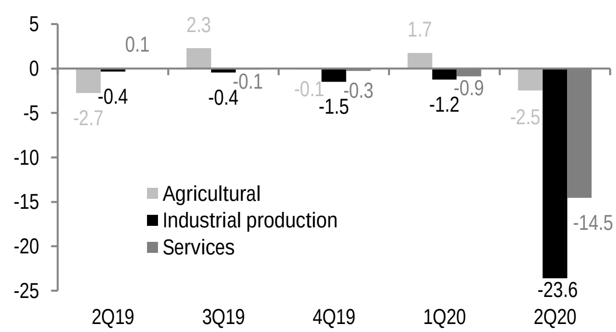
Source: INEGI

Chart 3: GDP
% q/q sa



Source: INEGI

Chart 4: GDP by sectors
% q/q sa



Source: INEGI

Table 3: GDP 2020: Supply
% y/y nsa; % q/q sa

% y/y	1Q20	2Q20	3Q20	4Q20	2020
GDP	-1.4	-18.9	-14.5	-4.3	-9.8
Agricultural	1.4	-0.7	-2.1	0.3	-0.2
Industrial Production	-2.9	-26.0	-15.6	-4.5	-12.3
Services	-0.7	-15.6	-14.7	-4.8	-9.0
% q/q					
GDP	-1.4	-17.3	4.4	6.3	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

Table 4: GDP 2020: Demand
% y/y nsa; % q/q sa

% y/y	1Q20	2Q20	3Q20	4Q20	2020
GDP	-1.4	-18.9	-14.5	-4.3	-9.8
Private consumption	-0.5	-17.5	-14.7	-4.1	-9.2
Investment	-9.3	-35.1	-24.7	-9.2	-19.5
Government spending	3.4	1.5	-6.1	-8.5	-2.4
Exports	1.7	-36.0	-5.0	3.6	-9.3
Imports	-3.4	-35.4	-9.9	-3.1	-13.0
% q/q					
GDP	-1.4	-17.3	4.4	6.3	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

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