Domestic demand extended its weakness in May

- **Gross fixed investment (May): -39.7% y/y (nsa); Banorte: -39.6%; consensus: -39.5% (range: -55.0% to -30.0%); previous: -36.9%**
- **Private consumption (May): -24.8% y/y (nsa); previous: -22.3%**
- **Similar to the previous month, performance was highly impacted by the stoppage in activities and social-distancing measures to fight the COVID-19 pandemic**
- **In sequential terms, investment declined 4.5% m/m, extending the 28.9% fall of the previous month. As a result, the seasonally adjusted index is hovering at levels not seen since mid-1997. The main drag was machinery and equipment, down 9.5%, while construction stood at -0.5%**
- **On the other hand, consumption fell 1.7% m/m after dipping 19.6% in April. Within, domestic goods and services stood at -1.4%, while imported goods came in at -6.7%**
- **We anticipate domestic demand to stay limited as fundamentals for consumption remain impacted while uncertainty in investment is still elevated, with a recovery likely led by external demand**

GFI contracts 39.7% y/y in May. This was lower than consensus (-39.5%), but slightly closer to our forecast (-39.6%). We should say this is even lower than the -36.9% of the previous month and is also among the weakest in the historical series, only higher than some months in 1995 (Chart 1). The decline is mostly explained by the effects of the COVID-19 pandemic, including the stoppage of certain activities and strict social-distancing measures, which were mostly unchanged when compared to April. Moreover, the month had two less working days relative to the same period of 2019, which also impacted performance. Machinery and equipment (M&Eq.) remained as the weakest sector, falling 46.7% (Chart 2), while construction contracted 33.7%. Within the former, the imported component was the one that exacerbated its decline the most, standing at -40.1% from -28.9% in the previous month, albeit with the domestic also staying very weak, at -56.0% (Table 1).

With seasonally adjusted data, investment declined 4.5% m/m despite the strong fall of 28.9% observed in April (Chart 3) which led to a significantly less challenging base effect. As a result, the index is hovering at lows not seen since mid-1997 (Chart 4). In our view, this clearly shows the difficult environment and lower expected growth that is first observed in this component of aggregate demand, as companies reduce capex to the bare minimum required while favoring liquidity levels. In this context, construction dipped 0.5%, with the residential sector higher, albeit with the non-residential showing additional losses (Table 2). It should be mentioned the latter took place despite favorable spending data by the Federal Government.

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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

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On the other hand, M&Eq. was much weaker at -9.5%. Specifically, here we highlight the imported component (-10.0%) fell more relative to domestic (-1.6%). In our view, one important driver that could help explain this is the accumulated depreciation of the Mexican peso since the initial shock in March. This has made imports substantially more expensive. We also noted the performance within transportation equipment increasing sharply domestically (+17.5%) but declining further in imports (-29.8%), which is relevant considering that activity in auto plants remained practically closed in both Mexico and the US.

Third consecutive annual contraction in private consumption, with a stronger performance in non-durable goods. Specifically, the decline was -24.8%, worsening with respect to the -22.3% in April (Chart 5). Broadly speaking, this is consistent with the signal already provided by retail sales, which improved only marginally in the annual comparison. As in that month, we keep seeing a clear difference in the dynamics of durable and non-durable goods (both domestic and imported), with more modest contractions in the latter (Table 3). In the case of semi-durables, those classified as domestic were much weaker while imported ones were slightly better. On the other hand, services were lower, reaching -23.4% after plunging 22.1% in April. This was observed despite a gradual increase in mobility indicators by *Apple* and *Google.* On the contrary, it is more in line with supply-side data, particularly the services sector in the GDP-proxy IGAE for the same period.

With seasonally adjusted figures, consumption shrank 1.7% m/m after the -19.6% of the previous month, adding four consecutive months to the downside (Chart 7). In this case, the indicator is close to a level last seen in mid-2009, in the middle of the last global crisis (Chart 8). Imports were weaker (-6.7%) than domestic (-1.4%), in our view also reflecting exchange rate dynamics. Meanwhile, domestic services declined 1.3%. In this context, the 3m/3m sa rate fell to -15.8% from -8.5% in April, a new historical low. We believe this indicates that consumption worsened strongly during the second quarter of the year, in which the impact from the pandemic is likely to have been greatest.

We expect the economic recovery to be led by external demand. With today's results, private consumption and investment accumulate a 9.9% and 20.6% y/y contraction so far this year, respectively. In this backdrop, we highlight that supply-side indicators suggest that the valley in terms of activity was observed in May, which is confirmed by these figures. Therefore, it will be very important to see the relative dynamics of these components in June on signals of a rebound and the gradual reopening of the economy, which started in this period. So far, we highlight that the trade balance showed an improvement in both exports and imports, led by manufacturing. Non-oil consumption –more related to purchases of goods– and capital goods imports –associated more closely with investment– were also stronger. Nevertheless, the magnitude of the recovery was more modest in both, failing to reverse losses of the previous month (using seasonally-adjusted data).

These figures are consistent with our expectation that the recovery will most likely be led by external demand, with domestic demand more modest. First of all, consumption fundamentals have deteriorated and will take time to heal. Indicators pointing in this direction include employment levels and consumer credit. Another variable worth monitoring is recent inflation pressures, particularly in goods, which would be an additional adverse factor for families' purchasing power. We believe this is compounded by cautiousness due to the difficult domestic dynamics of the pandemic, which so far has not shown a peak in terms of new cases. On the contrary, the most positive development has been the evolution of remittances, which in our view will be mostly directed to the purchase of basic goods and services. Nevertheless, regarding the latter component as a whole, we still expect some of them to be particularly affected –such as lodging, restaurants and entertainment– which would be an important headwind for a stronger performance.

On investment, recent data also suggest an extension for longer of the decline, especially in the private sector. First of all, business confidence remains near multi-year lows despite an incipient recover in June and July. We think this is a reflection of a series of factors, of which we highlight: (1) High uncertainty, mainly because of the effects and the possible length of the pandemic, both locally and globally; (2) lower economic growth expectations, limiting possibilities of sales' growth; (3) a weaker financial position of companies, with higher leverage to deal with immediate liquidity needs particularly during the months of stricter confinement; and (4) limitations to operate at full capacity given social distancing restrictions at the workplace and establishments.

In this respect, we believe appetite will remain muted despite efforts to maintain a wide supply of financial resources, including facilities announced by Banxico and the banking sector, along rate cuts by the central bank. In this backdrop, the impact will be felt more in services and companies more oriented to the domestic market. On the other hand, foreign-direct investment and companies more specialized in exports could show relatively more strength, more so after the start of USMCA. Lastly, we believe the public sector will keep pushing to develop key projects, although we cannot rule out a delay or even temporary stoppages in others as flexibility in public finances remains low.

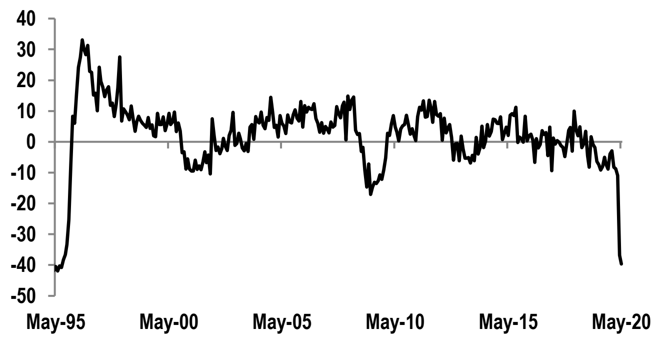
Gross Fixed Investment

Table 1: Gross fixed investment
% y/y nsa

	nsa				sa	
	May-20	**May-19**	**Jan-May '20**	**Jan-May '19**	**May-20**	**May-19**
Total	**-39.7**	**-7.4**	**-20.6**	**-3.0**	**-38.4**	**-37.1**
Construction	**-33.7**	**-8.7**	**-17.8**	**-2.0**	**-33.1**	**-36.1**
Residential	-36.8	-8.7	-18.8	-0.8	-36.1	-40.8
Non-residential	-30.5	-8.7	-16.8	-3.2	-29.8	-31.5
Machinery and equipment	**-46.7**	**-5.7**	**-24.6**	**-4.4**	**-43.8**	**-38.0**
Domestic	-56.0	-6.4	-28.0	-4.9	-54.3	-53.5
Transportation Equipment	-60.0	0.3	-33.1	2.6	-58.1	-64.1
Other machinery and equipment	-46.7	-19.2	-18.8	-16.0	-44.5	-34.1
Imported	-40.1	-5.2	-22.4	-4.1	-36.0	-28.0
Transportation Equipment	-69.8	7.9	-34.2	1.6	-70.0	-53.5
Other machinery and equipment	-34.6	-7.3	-20.3	-5.0	-29.3	-24.2

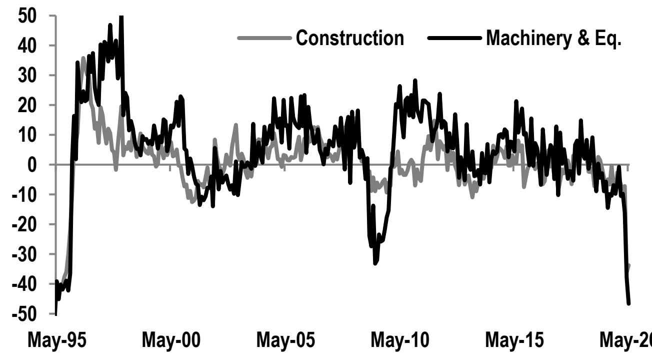
Source: INEGI

Chart 1: Gross fixed investment
% y/y



Source: INEGI

Chart 2: Gross fixed investment by sector
% y/y



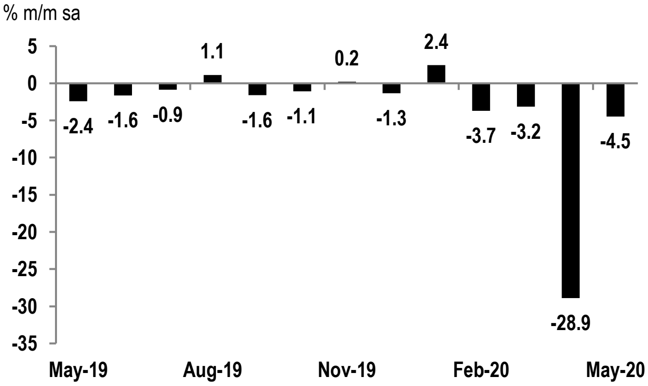
Source: INEGI

Table 2: Gross fixed investment
% m/m sa; % 3m/3m sa

	% m/m			% 3m/3m	
	May-20	**Apr-20**	**Mar-20**	**Mar-May'20**	**Feb-Apr'20**
Total	**-4.5**	**-28.9**	**-3.2**	**-24.2**	**-13.7**
Construction	**-0.5**	**-30.8**	**-2.5**	**-23.0**	**-12.0**
Residential	2.8	-38.4	-0.2	-25.9	-14.3
Non-residential	-1.7	-22.4	-2.9	-18.8	-10.5
Machinery and equipment	**-9.5**	**-25.1**	**-6.4**	**-26.0**	**-16.4**
Domestic	-1.6	-45.7	-7.3	-35.8	-20.1
Transportation Equipment	17.5	-54.8	-10.8	-40.0	-22.6
Other machinery and equipment	-17.7	-31.1	-3.6	-28.0	-14.1
Imported	-10.0	-11.9	-8.5	-20.8	-14.1
Transportation Equipment	-29.8	-47.2	-12.5	-42.3	-19.2
Other machinery and equipment	-7.3	-6.5	-6.9	-17.3	-13.7

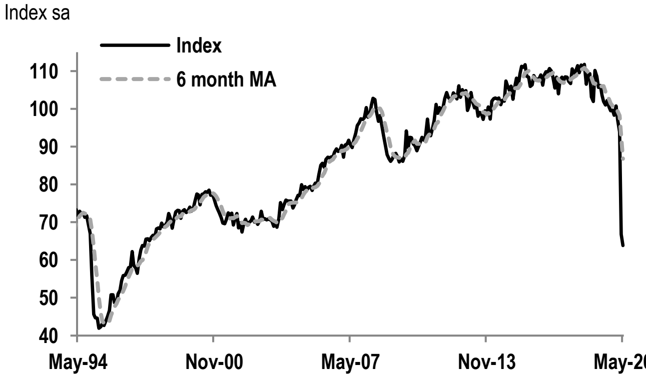
Source: INEGI

Chart 3: Gross fixed investment
% m/m sa



Source: INEGI

Chart 4: Gross fixed investment
Index sa



Source: INEGI

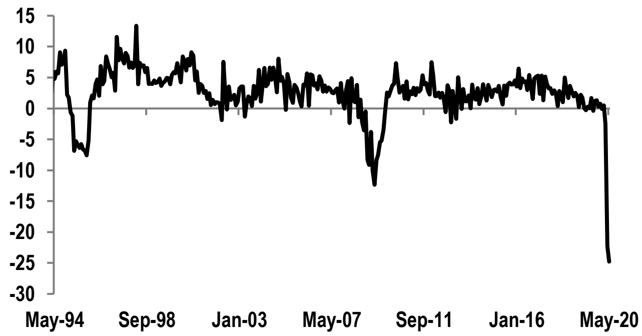
Private consumption

Table 3: Private consumption
% y/y nsa

	nsa				sa	
	May-20	**May-19**	**Jan-May '20**	**Jan-May '19**	**May-20**	**May-19**
Total	**-24.8**	**0.3**	**-9.9**	**0.8**	**-23.5**	**-22.2**
Domestic	**-23.2**	**0.3**	**-9.3**	**0.6**	**-22.4**	**-21.1**
Goods	-23.1	-0.1	-8.2	0.1	-21.5	-20.3
Durables	-49.9	-16.8	-20.3	-12.2	--	--
Semi-durables	-80.0	-1.7	-36.0	3.8	--	--
Non-durables	-8.6	2.8	-1.2	1.1	--	--
Services	-23.4	0.6	-10.3	1.1	-23.4	-21.8
Imported goods	**-38.3**	**0.5**	**-15.2**	**2.2**	**-33.8**	**-30.6**
Durables	-59.5	-6.8	-27.6	-2.5	--	--
Semi-durables	-24.9	12.8	-15.5	7.9	--	--
Non-durables	-26.3	1.9	-4.0	3.6	--	--

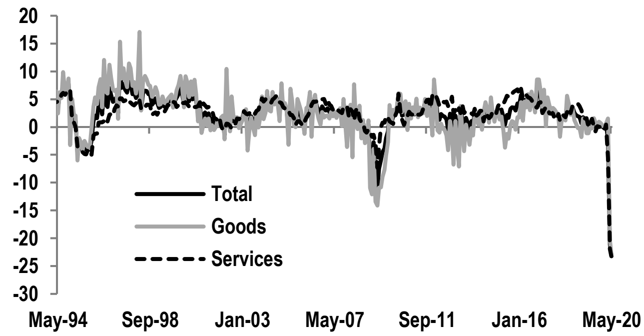
Source: INEGI

Chart 5: Private consumption
% y/y



Source: INEGI

Chart 6: Domestic consumption: Goods and services
% y/y



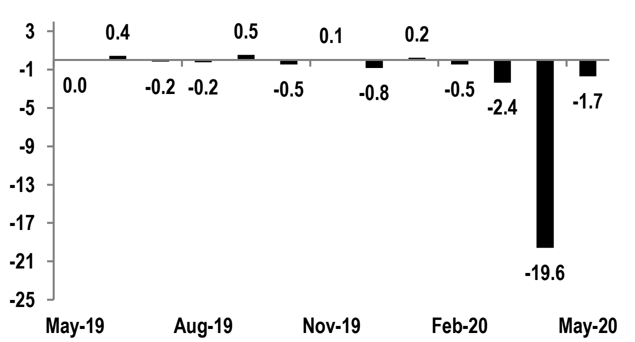
Source: INEGI

Table 4: Private consumption
% m/m sa; % 3m/3m sa

	% m/m			% 3m/3m	
	May-20	**Apr-20**	**Mar-20**	**Mar-May'20**	**Feb-Apr'20**
Total	**-1.7**	**-19.6**	**-2.4**	**-15.8**	**-8.5**
Domestic	**-1.4**	**-19.0**	**-1.8**	**-14.7**	**-7.7**
Goods	-1.4	-20.1	0.4	-13.2	-6.4
Services	-1.3	-17.7	-5.5	-16.9	-9.3
Imported goods	**-6.7**	**-21.2**	**-9.0**	**-25.8**	**-16.0**

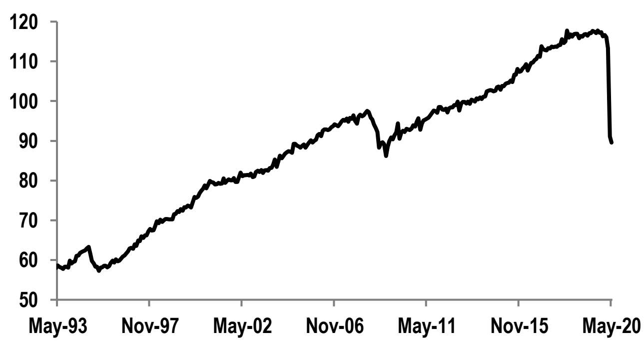
Source: INEGI

Chart 7: Private consumption
% m/m sa



Source: INEGI

Chart 8: Private consumption
Index sa



Source: INEGI

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	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
Katia 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 Zaldívar	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	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.ceballos@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
Osvaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.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.roldan.ferrer@banorte.com	(55) 5004 - 1454