Industrial production – Recovery started in June with the economic reopening

August 11, 2020

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- **Industrial production (June): -16.7% y/y nsa; Banorte: -17.4%; consensus: -17.9% (range: -26.4% to -11.1%); previous: -30.6%**
- **This figure was better than the -17.9% y/y implied in the 2Q20 GDP report. As a result, industry plunged 14.1% in the first half of the year**
- **In monthly terms, activity rebounded 17.9%, above our expectations. In our view, this was driven by the gradual reopening of the economy and the inclusion of new sectors as essential, among other factors**
- **Mining grew by 1.6% m/m, relatively impacted by lower output in the oil sector (-1.6%), while non-oil was significantly stronger (23.1%)**
- **Construction was also higher, coming in at 17.5%. Although civil engineering improved (3.3%), the pickup was mostly driven by edification (20.7%), in our view benefited by higher activity in the private sector**
- **Manufacturing led gains, surging 26.7%. We highlight the 250.1% rebound in transportation, as several auto plants returned to work. Other positive sectors included textiles raw materials (100.5%), clothing (67.9%) and machinery and equipment (36.6%)**
- **We expect industry to post additional gains in July, led by support from external demand, mainly from the US, which is likely to be more positive for manufacturing**
- **We maintain our full-year forecast for industry at -12.3% y/y with risks broadly balanced after today's report**

Industry moderates its pace of decline in June. The fall came in at -16.7% y/y (see Chart 1), above consensus (-17.9%), which was close to our -17.4%. This result was higher than the -17.9% implied by the 2Q20 GDP report for this month, with mixed revisions in the previous two. As a result, industrial activity for the quarter was revised upwards, to -25.7% from -26.0% originally. Thus, the sector plunged 14.1% in the first half of the year (Table 1). We should mention that the month also benefitted from two additional working days in the annual comparison. Nevertheless, it is our take that most of the support came from the gradual reopening of the economy and the inclusion of new sectors as essential during the period. Mining added three consecutive months in contraction, at -5.2%, with the improvement in non-oil faded by the weaker performance in the oil sector. Meanwhile, construction was stronger across the board at -26.1% despite all subsectors still declining at a double-digit pace, with edification picking up the most relative to May at -26.2%. Lastly, the rebound in manufacturing was the most positive surprise, standing at -16.5% (Chart 2). Although all sectors remain in negative territory, all of them were higher in the annual comparison except for oil- and carbon-related products, likely influenced to some extent by its relative stability during the confinement months due to the pandemic and Pemex's status as an essential activity.

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A significant rebound in monthly terms. Industry rebounded 17.9% m/m (Chart 3), in our view driven by the gradual reopening of the economy and the inclusion of new sectors as essential, among other factors. Nevertheless, it should be mentioned that, given recent hefty declines, the index stands around 16.4% below the level observed in February. In our view, this is going to be harder to reverse in coming months as limitations on activity –as a result of both sanitary measures at work, but also more depressed demand– will represent a relevant headwind. Moreover, the level of activity is hovering around those last seen in early 1998 (Chart 4). On a more positive note and in line with our expectations, all sectors grew, with the strongest rebound in manufacturing (+26.7% m/m). We highlight the 250.1% expansion in transportation, as several auto plants returned to work following their designation as an essential activity (Table 2). Other positive sectors included textiles raw materials (100.5%) and clothing (67.9%), likely related to *maquiladoras* which are labor-intensive, along machinery and equipment (36.6%). In contrast, only three sectors declined, including oil- and carbon- related and the food industry, although we note both had a more challenging base effect as they were not impacted as heavily as others in recent months.

Construction was also better, at +17.5%. The main driver was the recovery of 20.7% in edification. It should be remembered that private construction was also categorized as essential, back in business more decisively in this period. Nevertheless, the rebound in civil engineering was more modest (3.3%) despite federal data that keeps showing elevated growth in physical investment spending. We think that challenges to this sector remain very elevated, given that flexibility in public finances remains limited while businesses and consumers stay cautious given high levels of uncertainty, which has hit durable-goods the most.

We expect industry to post additional gains in July. Specifically, we think this will be led by support from external demand, mainly from the US, which is likely to be more positive for manufacturing. In this sense, the IMEF manufacturing index climbed to 48.1pts from 43.1pts in May, with a favorable signal going forward from the increase in the 'new orders' component. We also consider that business confidence in this sector built up on recent gains despite remaining at relatively low levels. Autos is likely to remain the bright spot, with production already reversing recent losses as it grew by 0.7% y/y in July. An additional boost could be in store from the start of USMCA, particularly as tensions between China and the US have exacerbated and will likely stay high given the electoral process in the latter country. Overall, we believe extraordinary fiscal measures to support families' incomes in the US will be an important backstop to partially counter the effects of the pandemic. In this sense, businesses that are export-oriented are poised to benefit more from this backdrop.

In construction, INEGI's surveys –confidence and aggregate trend indicators– were also better in July. Although these also anticipate a sequential recovery, we believe the path going forward will be more challenging. First, we expect uncertainty to keep weighing on investment decisions, with companies safeguarding financial health and households maintaining their preference for the purchase of non-durables goods and precautionary savings.

In addition, government support has been limited, much more focused on granting loans than direct transfers apart from those already contemplated in social programs. We believe this may be one of the reasons behind the deceleration in mortgage credit, which could extend further despite accumulated rate cuts by the central bank since the easing cycle began one year ago. Broadly speaking, we think the recovery of domestic demand will take more time to materialize, impacting this sector for a more extended period despite the follow through with flagship projects by the Federal Government. In mining, the outlook is likely better for coming months, considering that Mexico's participation in the OPEC+ output cut ended in June. Nevertheless, the overall situation of the oil industry remains challenging, and specifically in the case of Pemex, which given its high relevance may prove to continue as an important limitation. The non-oil sector could keep benefiting from stronger global demand, with raw materials necessary for the reactivation of key industries in the short-term.

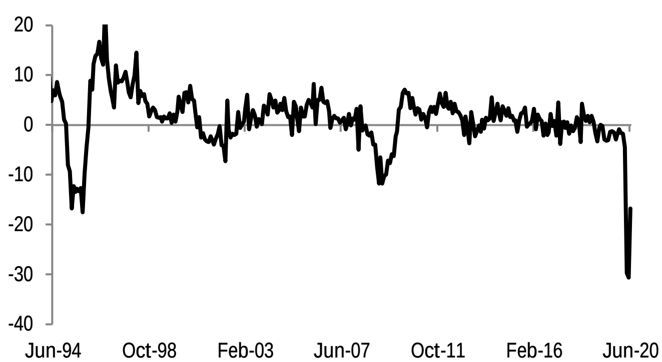
We maintain our full-year forecast for industry at -12.3% y/y. Given the sizable drop already observed in the first half, activity would have to contract around 10.5% y/y in the second semester for our estimate to materialize. In our view, risks are broadly balanced. These would be the case if the relative strength of manufacturing remains in place, which so far seems reasonable to assume given extraordinary measures to support the economy, especially in the US. Nevertheless, risks still abound, given that: (1) Uncertainty about the pandemic has not waned, without ruling out that the evolution of new cases in our main trading partner derails reopening plans and some states impose more severe lockdowns again; and (2) room to continue providing direct stimulus to companies and families diminishes given their effect on the fiscal outlook and as we get closer to the election on November 3rd. On the other hand, construction is likely to stay muted given domestic conditions, modest support, and still low confidence levels, with the sector already weak even before the pandemic hit.

Table 1: Industrial production
% y/y nsa

	Jun-20	Jun-19	Jan-Jun '20	Jan-Jun '19
Industrial Production	-16.7	-3.0	-14.1	-1.6
Mining	-5.2	-5.5	0.1	-7.8
Oil and gas	-2.9	-8.1	2.5	-9.8
Non-oil mining	-12.4	-0.4	-11.2	-3.2
Services related to mining	-5.9	4.8	7.2	-1.6
Utilities	-13.3	2.7	-5.1	1.1
Electricity	-15.6	2.8	-5.9	1.0
Water and gas distribution	-4.3	2.3	-2.3	1.1
Construction	-26.1	-7.0	-20.9	-3.6
Edification	-26.2	-5.6	-20.5	-1.7
Civil engineering	-29.2	-6.2	-24.3	-5.9
Specialized works for construction	-21.7	-15.0	-18.2	-10.2
Manufacturing	-16.5	-1.1	-16.2	0.9
Food industry	-0.6	0.3	1.1	0.9
Beverages and tobacco	-15.2	3.2	-16.2	1.7
Textiles - Raw materials	-51.2	-1.9	-41.4	-1.4
Textiles - Finished products ex clothing	-28.4	-8.9	-24.4	0.0
Textiles - Clothing	-57.4	-9.2	-39.3	-4.8
Leather and substitutes	-55.8	-6.2	-44.1	-2.0
Woodworking	-25.8	1.6	-21.1	0.0
Paper	-14.7	-2.9	-9.0	0.5
Printing and related products	-30.5	-24.5	-19.7	-13.8
Oil- and carbon-related products	-9.7	0.4	-5.0	-9.0
Chemicals	-8.2	-2.8	-5.2	-3.4
Plastics and rubber	-19.1	-2.4	-18.1	-2.5
Non-metallic mineral goods production	-16.7	-2.4	-14.5	-3.6
Basic metal industries	-19.0	-11.5	-12.6	-4.5
Metal-based goods production	-24.3	-11.3	-21.2	-5.9
Machinery and equipment	-21.2	-8.9	-24.2	-0.1
Computer, communications, electronic, and other hardware	-12.4	6.0	-13.3	7.0
Electric hardware	-16.9	-0.7	-7.4	-0.6
Transportation equipment	-27.4	3.3	-36.0	6.2
Furniture, mattresses and blinds	-23.3	-10.5	-28.5	-3.7
Other manufacturing industries	-17.6	-1.2	-14.0	2.9

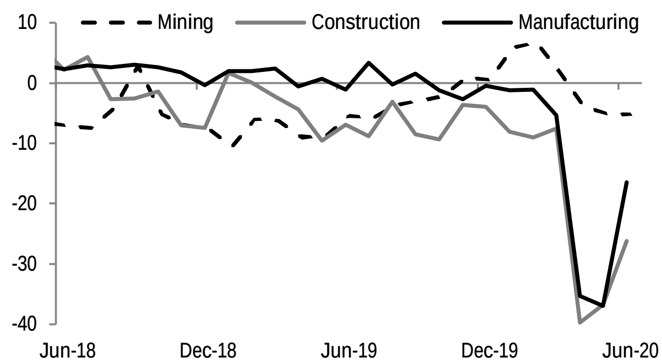
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



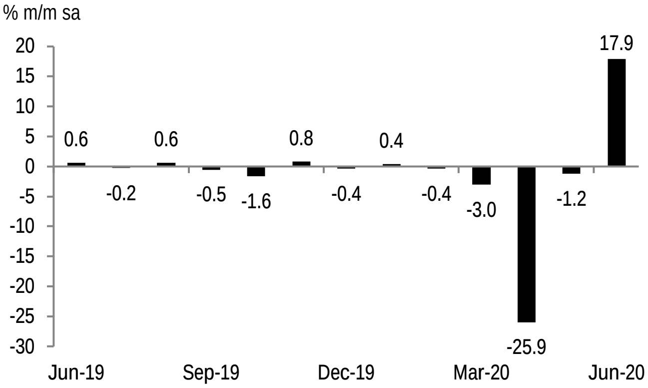
Source: INEGI

Table 2: Industrial production
% m/m sa; % 3m/3m sa

	% m/m			% 3m/3m	
	Jun-20	May-20	Apr-20	Apr-Jun'20	Mar-May'20
Industrial Production	17.9	-1.2	-25.9	-23.9	-20.2
Mining	1.6	-2.2	-5.9	-7.7	-5.6
Oil and gas	-1.6	-4.8	-0.6	-4.2	-1.6
Non-oil mining	23.1	3.3	-26.9	-23.8	-23.1
Services related to mining	-6.5	2.6	2.5	-1.6	3.6
Utilities	0.7	-10.0	-0.9	-8.0	-6.1
Electricity	0.4	-12.2	-0.6	-9.1	-6.7
Water and gas distribution	1.5	-0.9	-2.2	-3.9	-4.3
Construction	17.5	0.9	-34.7	-31.5	-24.6
Edification	20.7	5.2	-40.7	-34.9	-27.1
Civil engineering	3.3	-2.8	-16.6	-19.2	-15.8
Specialized works for construction	16.4	-6.1	-25.5	-26.3	-21.2
Manufacturing	26.7	-0.3	-31.1	-27.3	-24.1
Food industry	-0.1	-1.4	-1.2	-1.4	0.2
Beverages and tobacco	35.7	-2.1	-35.6	-29.7	-25.5
Textiles - Raw materials	100.5	4.8	-73.6	-64.2	-50.5
Textiles - Finished products ex clothing	36.7	58.0	-67.7	-50.0	-40.2
Textiles - Clothing	67.9	5.8	-73.9	-68.7	-53.2
Leather and substitutes	214.2	3.7	-85.0	-74.4	-59.3
Woodworking	27.1	-8.9	-27.0	-30.8	-30.4
Paper	5.1	-8.9	-11.8	-14.9	-9.3
Printing and related products	-1.5	33.3	-48.3	-38.7	-28.2
Oil- and carbon-related products	-0.6	2.6	-1.3	3.3	0.1
Chemicals	3.8	-6.4	-7.5	-9.4	-6.0
Plastics and rubber	38.1	-11.1	-31.7	-31.0	-28.2
Non-metallic mineral goods production	24.6	8.9	-38.2	-29.7	-24.8
Basic metal industries	-2.8	2.1	-19.5	-22.1	-16.7
Metal-based goods production	31.6	-9.0	-35.5	-33.8	-27.2
Machinery and equipment	36.6	-5.2	-34.9	-33.2	-29.7
Computer, communications, electronic, and other hardware	21.0	0.2	-21.5	-16.4	-15.5
Electric hardware	5.3	-13.4	-11.3	-17.6	-10.9
Transportation equipment	250.1	42.4	-82.3	-62.0	-60.4
Furniture, mattresses and blinds	99.6	2.5	-60.2	-49.3	-45.3
Other manufacturing industries	9.6	6.1	-30.3	-24.3	-17.9

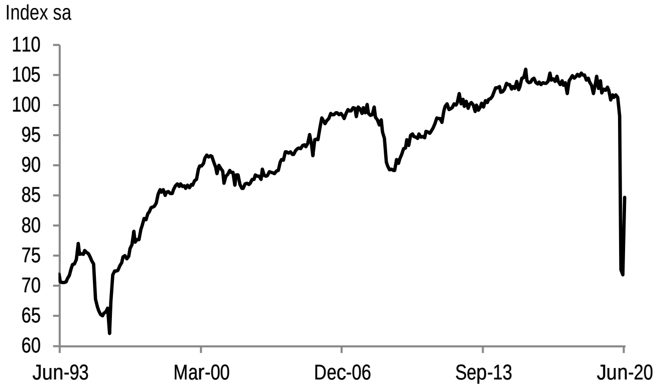
Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa



Source: INEGI

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