Gradual recovery of domestic demand continued in July

- **Gross fixed investment (July): -21.2% y/y (nsa); Banorte: -22.2%; consensus: -22.4% (range: -23.3% to -15.9%); previous: -24.1%**
- **Private consumption (July): -15.1% y/y (nsa); previous: -18.2%**
- **Investment and consumption kept improving gradually as more activities reopened. Nevertheless, on a year-to-date basis they have contracted by 21.4% and 11.8%, respectively**
- **In sequential terms, investment climbed 4.4% m/m, led by machinery and equipment (11.1%), although construction was also higher (1.1%). The main boost within the former was in the domestic component, standing at 21.8%**
- **Meanwhile, consumption increased 5.2% m/m on top of the 5.6% observed in the previous month. Inside, domestic (8.2%) and imported goods (6.4%) were stronger than services (3.0%)**
- **We think domestic demand could recover further in August, albeit at a slower pace as reopening efforts and mobility indicators already show some normalization. Moreover, fundamentals remain affected, signaling a long road for a full recovery**

GFI improved at the margin in July. This came in at -21.2% y/y (see Chart 1), above consensus (-22.4%), which was virtually equal to our forecast. Similar to other figures for the month, we believe additional efforts to resume activities yielded benefits to this component of aggregate demand. Nevertheless, it keeps falling at a double-digit pace as uncertainty about the outlook for activity remained very high due to the pandemic. Construction was again the weakest, at -23.7% (Chart 2), while machinery and equipment (M&Eq.) stood at -18.0%. Within the former, the residential sector observed a stronger relative recovery (-21.7%), in our view signaling an extension of a higher benefit from a resumption of activity in the private sector. Meanwhile, the non-residential branch fell at a more significant pace, at -25.8%. Going to machinery and equipment, we highlight a stronger rebound in transportation equipment in comparison to others, despite remaining quite low, both in those catalogued as domestic and imported (Table 1). It is our take that this is directly related to the faster recovery in the auto sector, which in turn has been positively influenced by the sector's strength in the US.

With seasonally adjusted data, investment increased 4.4% m/m after the historical rebound of 20.1% observed in June (Chart 3). Nevertheless, and as expected, absolute levels remain depressed, with the index 17.9% lower than in February (Chart 4). We highlight that machinery and equipment (11.1%) has rebounded more strongly than construction (1.1%) since the reopening of activities began. Within the former, the domestic component maintains high dynamism, standing at 21.8% after popping 35.5% in the previous month (Table 2). We think this may be partially related to a substitution effect from imports, in turn influenced by the accumulated depreciation of the Mexican peso.

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Nevertheless, it should be mentioned that the latter did not fall as much in the first two months of the lockdown (April and May), resulting in a more challenging base effect. As such, the imported component picked up only 2.8%.

On the other hand, construction slowed down meaningfully in both the residential (1.4%) and non-residential sectors (1.2%). The former was likely influenced by a more difficult base effect. Nevertheless, the magnitude of the moderation suggests that demand for this type of goods has been hit meaningfully, with most new projects delayed. In the latter, the pace of the recovery has been below 2%-pts in the last three months after plunging 23.0% in April. This happened despite seeing an acceleration in the federal government's physical investment spending, with the possibility of different classifications between the Ministry of Finance and INEGI.

Private consumption also better in the month. The figure stood at -15.1% y/y, above the -18.2% of the previous month (Chart 5). We believe some of this uptick is related to the reopening of shopping malls in big metropolitan areas in Mexico City and the State of Mexico, among others. In this respect, the retail sales report published earlier also flagged this situation, with non-essential categories benefitting the most. Reflecting the latter, sales of durable and semi-durable goods –especially domestically produced– rebounded more strongly despite remaining quite affected (Table 3), with non-durables more stable at the margin. In turn, services are still contracting south of 20%-pts, which as mentioned previously, will probably recover at a much more gradual pace given persistent challenges to capacity utilization on the need to comply with distancing guidelines. This is consistent with GDP data from the supply-side, in which services have also improved, although with a lagged recovery in sectors that we believe depend more on social interactions.

With seasonally adjusted figures, consumption grew 5.2% m/m, extending the 5.6% increase observed in June (Chart 7). Nevertheless, activity levels remain depressed, 14.3% below those seen in February (Chart 8). By category, the gap in domestic goods is the narrowest at -7.2%, followed by services (-20.2%) and lastly, imported goods (-20.6%). We highlight that the latter is very weak despite the high degree of openness for the economy, a situation that has also been flagged by trade balance data which have shown again historically wide surpluses in recent data.

A mixed recovery is likely to continue in coming months. Overall, we believe the report was positive, driven largely by: (1) The reopening of more activities; and (2) economic agents' efforts to adjust to the 'new normality'. In the short term, it is likely the former keeps adding some support, although at a slower pace. In this respect, we think the most positive and sizable effects from reopening have been seen already. This is consistent with dynamics in timelier data, such as IMEF indicators, which have advanced at a more modest pace since August. On the other hand, the latter may have more room to improve, considering fatigue among consumers due to the pandemic and still room for activities hit the most in lockdown periods to continue seeing gains in terms of capacity utilization.

In our view, this may have a more positive effect in some services, such as those related to tourism (such as lodging) and entertainment (*e.g.* mass events going virtual or reopening with some distancing restrictions).

Going to specifics, we think results in consumption were favorable, maintaining a relatively fast sequential recovery for a second consecutive month. Specifically, we highlight the relative improvement in durable goods categories. Nevertheless, we do not rule out these figures may be distorted by a one-off effect driven by needs accumulated during the strictest lockdown months. In turn, this could be due to the wider availability of physical stores since July, with internet sales still with low penetration. Therefore, we will focus on performance in coming months to judge whether this rebound is sustainable or not. On the other hand, some risks remain. Among them, consumer credit has extended its decline and is deeply negative, which we think is a significant headwind for purchases of big-ticket items. On a more positive note, employment has strengthened since May, led by the informal sector, which may be of some help for families' incomes despite evidence of lower wages. Consumer confidence has picked up in tandem with reopening efforts, although this has been mostly because of expectations components as opposed to current conditions or purchasing power.

We remain more concerned about investment, especially in construction as the recovery is lagging relative to the broader economy. We do not see significant catalysts in the short-term for a trend reversal, so it is our take that it will remain among the most impacted by underlying domestic weakness. We also note that business confidence has not seen a clear rebound up until September. In our view, this has been dampened by prevailing uncertainty and weak growth expectations, among other factors. This should prevail at least until a vaccine and/or effective treatment is announced, although other headwinds will remain. Machinery and equipment is likely to stay stronger, supported by external demand. In this backdrop, it is key to follow closely the advance in infrastructure projects announced yesterday, especially as these seek a big participation of the private sector. It will be equally important if more projects are added and executed, which would be beneficial for growth in the short- and medium-term.

Overall, we maintain our view that domestic-facing sectors will recover at a slower pace than those more closely oriented to external demand, as signaled by trade balance figures which show a modest performance in imports relative to exports. Mobility and gasoline sales data have shown less gains –or even some stagnation– since August, signaling that people remain cautious. Anecdotal evidence also suggests that the adaptation to the 'new normality' has advanced meaningfully despite still having some room to improve. In this backdrop, we reaffirm our forecasts for 2020 of a contraction of 10.4% y/y in consumption and -20.4% in investment, although with some upside risks given the latest released data.

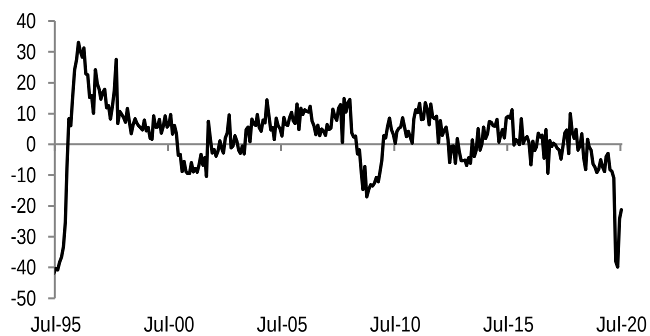
Gross Fixed Investment

Table 1: Gross fixed investment
% y/y nsa

	nsa				sa	
	Jul-20	Jul-19	Jan-Jul **'20**	Jan-Jul **'19**	Jul-20	Jul-19
Total	-21.2	-8.1	-21.4	-4.7	-21.2	-9.6
Construction	-23.7	-6.6	-20.1	-3.1	-23.7	-6.8
Residential	-21.7	-7.2	-20.4	-2.5	-21.6	-7.2
Non-residential	-25.8	-6.0	-19.8	-3.7	-26.1	-6.6
Machinery and equipment	-18.0	-9.9	-23.2	-6.7	-17.6	-13.3
Domestic	-23.1	-2.9	-28.5	-4.8	-23.4	-5.5
Transportation Equipment	-24.5	0.5	-33.0	2.0	-25.4	-3.0
Other machinery and equipment	-20.5	-8.4	-20.3	-15.4	-20.5	-10.5
Imported	-14.6	-14.1	-19.6	-8.0	-17.4	-13.6
Transportation Equipment	-35.3	0.2	-36.9	-0.2	-36.7	-2.0
Other machinery and equipment	-10.8	-16.3	-16.5	-9.3	-9.6	-20.2

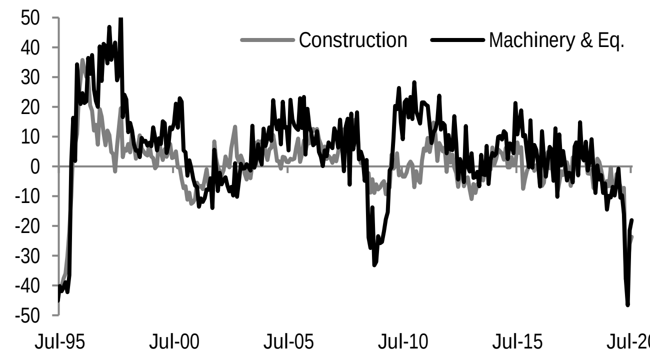
Source: INEGI

Chart 1: Gross fixed investment
% y/y



Source: INEGI

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



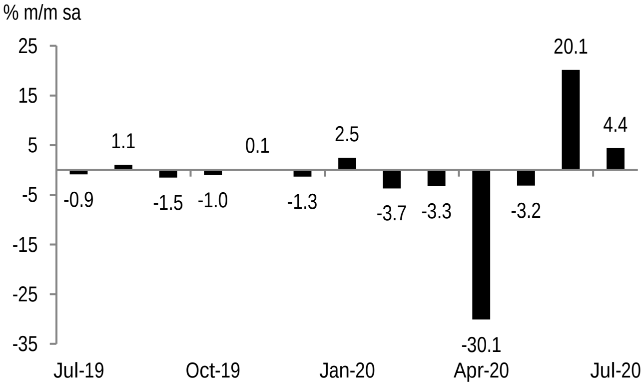
Source: INEGI

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

	% m/m			% 3m/3m	
	Jul-20	Jun-20	May-20	May-Jul**'20**	Apr-Jun**'20**
Total	4.4	20.1	-3.2	-14.4	-29.6
Construction	1.1	14.0	1.8	-16.5	-30.4
Residential	1.4	21.4	7.1	-16.0	-34.1
Non-residential	1.2	1.6	0.3	-15.9	-24.6
Machinery and equipment	11.1	26.0	-9.3	-11.7	-28.0
Domestic	21.8	35.5	-1.3	-17.5	-42.5
Transportation Equipment	22.0	38.2	18.0	-15.8	-46.6
Other machinery and equipment	18.5	27.3	-17.8	-21.5	-36.3
Imported	2.8	19.2	-9.5	-8.2	-18.4
Transportation Equipment	31.9	53.9	-32.9	-37.8	-52.9
Other machinery and equipment	0.4	14.7	-7.1	-4.6	-13.5

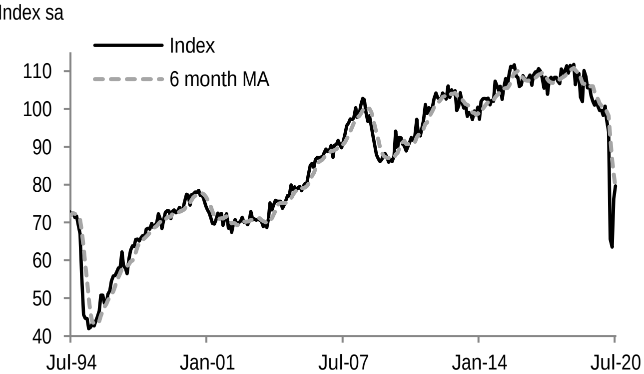
Source: INEGI

Chart 3: Gross fixed investment
% m/m sa



Source: INEGI

Chart 4: Gross fixed investment
Index sa



Source: INEGI

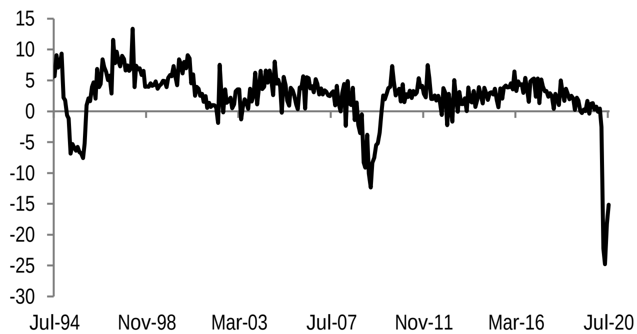
Private consumption

Table 3: Private consumption
% y/y nsa

	nsa				sa	
	Jul-20	Jul-19	Jan-Jul **'20**	Jan-Jul **'19**	Jul-20	Jul-19
Total	-15.1	1.7	-11.8	0.8	-15.3	0.5
Domestic	-14.2	0.8	-11.3	0.7	-14.3	-0.2
Goods	-7.6	1.6	-8.9	0.3	-7.7	-0.1
Durables	-19.5	-8.0	-21.2	-11.3	--	--
Semi-durables	-25.3	-0.9	-35.7	2.4	--	--
Non-durables	-2.9	3.4	-2.1	1.4	--	--
Services	-20.3	0.0	-13.5	1.0	-20.3	-0.1
Imported goods	-23.2	9.8	-16.9	2.2	-22.7	5.0
Durables	-36.6	9.0	-30.3	-2.7	--	--
Semi-durables	-25.9	7.4	-17.8	6.7	--	--
Non-durables	-11.4	11.7	-5.2	4.4	--	--

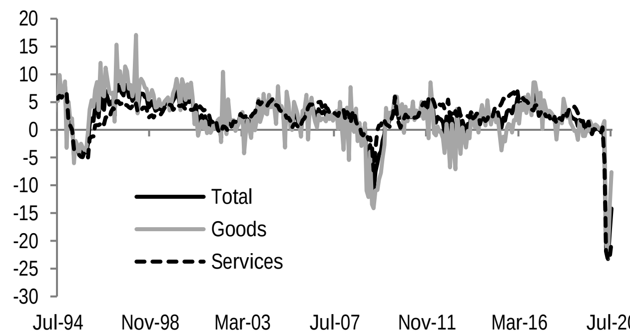
Source: INEGI

Chart 5: Private consumption
% y/y



Source: INEGI

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



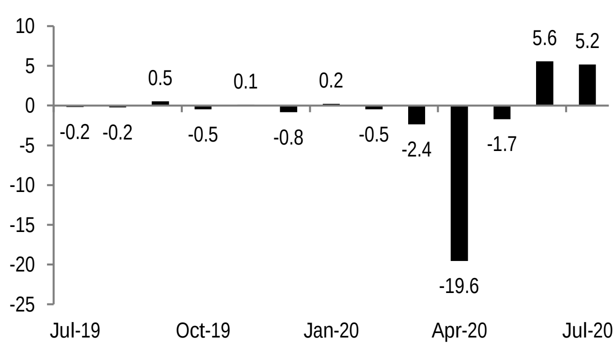
Source: INEGI

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

	% m/m			% 3m/3m	
	Jul-20	Jun-20	May-20	May-Jul**'20**	Apr-Jun**'20**
Total	5.2	5.6	-1.7	-11.5	-20.4
Domestic	5.4	4.6	-1.5	-11.1	-19.6
Goods	8.2	8.5	-1.4	-8.2	-18.5
Services	3.0	1.0	-1.4	-14.0	-21.1
Imported goods	6.4	10.9	-6.4	-15.9	-28.0

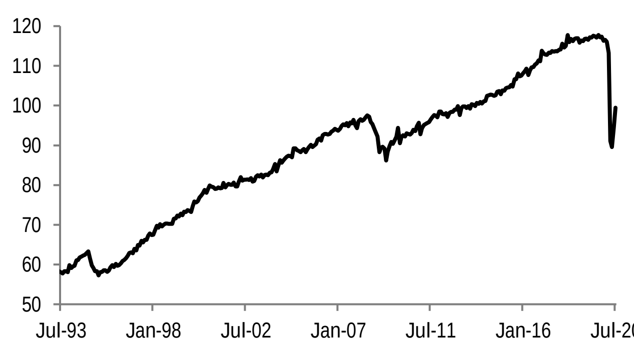
Source: INEGI

Chart 7: Private consumption
% m/m sa



Source: INEGI

Chart 8: Private consumption
Index sa



Source: INEGI

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