Industrial production – The recovery continued, with a positive surprise in construction

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- **Industrial production (August): -9.0% y/y nsa; Banorte: -10.6%; consensus: -10.3% (range: -13.0% to -8.1%); previous: -11.4%**
- **This figure was higher for a third consecutive month, consistent with the steps taken to reopen the economy. In this context, year-to-date, industry has declined by 13.1% y/y**
- **In monthly terms, activity rose 3.3%, better than our expectations, but still decelerating relative to previous months. Despite of the latter, this figure is positive and is partly due to a more difficult base effect, as industry has led the rebound in activity**
- **Mining advanced 0.8%, with a relatively balanced mixed between non-oil (+1.1%) and oil (+1.6%), with the latter benefiting from better weather conditions**
- **Construction surprised to the upside at +11.2%. Inside, the acceleration was mainly driven by edification (+15.1%), signal which we consider to be especially favorable considering last month's stagnation. Meanwhile, civil engineering was more moderate but also positive (+2.0%)**
- **Manufacturing decelerated significantly to +0.8% (previous: +11.3%), with a decline in food (-1.0%), transportation (-2.2%) and electronical (-3.7%) equipment compensating for increases in all other components**
- **We maintain our view that externally dependent sectors, such as manufacturing, will continue to drive the recovery, albeit with more uncertainty about a possibly speedier recovery in domestic demand**

Industrial activity continues to improve in August. The headline figure came in at -9.0% y/y (see Chart 1), above both consensus (-10.3%) and our estimate (-10.6%). This was also better than the -11.4% from the previous month. It should be noted that there was a negative calendar effect, given that August had one less working day in the annual comparison. Correcting for the latter (using seasonally adjusted figures), activity declined 8.4% y/y. While the performance continues to be highly influenced by mounting efforts to reopen the economy, there were some surprising dynamics. On the positive side, and using non-seasonally adjusted data, construction came in at -14.0% y/y (Chart 2), which represents a 9.1%-pts increase relative to July, with a significant improvement in edification. Meanwhile, both mining and manufacturing were lower than the previous month at -3.5% and -9.2% (Table 1), albeit driven by the calendar effect previously mentioned. Within the former, while oil and non-oil activity rose –with better climate conditions benefiting the first–, services related to the sector fell strongly, also hit by a more challenging base effect. Within the latter, all but two sectors remain in negative territory, once again with relevant recovery in textiles, but also in oil and carbon related manufacturing, possibly also aided by better weather. Meanwhile, and in line with timelier data, transportation decelerated, impacted by distortions in production timing due to the effect of the pandemic. In this context, year-to-date activity for the sector stands at -13.1% y/y.

Sequential gains persist across all sectors. Industry grew 3.3% m/m (Chart 3), which is still positive as it now adds three consecutive months to the upside. Nevertheless, it does represent a deceleration, which might be driven by: (1) A lower number of businesses reopening, given that they have done so in previous months; and (2) a more marginal impact of said reopening, as aggregate demand remains limited. In this sense, in absolute terms activity now stands at levels similar to those of 2010, just in the aftermath of the Great Financial Crisis (Chart 4). Considering this, industrial production remains 7.1% below the level seen in February before the impact from the pandemic started to unravel, suggesting that there is still a long way to go in order to fully recover.

Unlike previous months, the main boost came from construction at +11.2%, which in our view was highly surprising, considering that business confidence for the sector in August had actually declined, while other forward-looking data was more modest. Inside, the increase was driven by edification at +15.1% (Table 2). We believe this is very favorable, as it suggests a larger pick-up in investment –and thus domestic demand– than we expected. Nevertheless, we will need to look into its performance going forward to see signs of a more sustained gain. Civil engineering was more muted, but still positive at +2.0%. Going into mining, both oil (+1.6%) and non-oil (+1.1%) were better, driving the whole sector up 0.8%. While the latter had been exhibiting a better performance in the last few months, the former had been impacted by a combination of adverse weather as well as a challenging position within Pemex, factor which might have limited a larger rebound. Finally, manufacturing slowed down considerably, standing at +0.8% from +11.3% in the previous month. While there were only three sectors in negative territory, these were some of the most important, being food (-1.0%), transportation (-2.2%), and electronic equipment (-3.7%).

Better signals for September. In our view, the main highlight of today's report is that we might be starting to see stronger signals for domestic demand, as it was better than we anticipated. This includes both construction, as well as IMEF's non-manufacturing PMI for September, which rose 2.6pts to 49.3pts. Despite of this, considering the broad impact to the economy and relatively low stimulus at the domestic level, we remain cautious going forward, expecting more of a positive effect from the external sector, as we saw in June and July.

By sectors, manufacturing might be poised for a better performance, with a slight improvement in IMEF's manufacturing PMI to 49.3pts. Auto production in said month was also better, at -5.5% y/y from -13.2% in August. Another relevant factor might be continued strength in the US, despite the expiration of some fiscal stimulus measures. Particularly, the ISM manufacturing stood at 55.4pts, only 0.6pts below August's figure and still firmly in expansion. In contrast, reports of additional disruptions to railways in both September and October across several states, including Michoacán and Chihuahua, might result in headwinds for the sector. Despite of this, we expect this sector to remain as the driving force behind the recovery, considering the relative upside it has due to the dependence from foreign demand, without discarding also relevant competitive gains from the depreciation of the Mexican peso so far in the year and uncertainty over the relationship between the US and China.

On mining, the non-oil sector could remain somewhat strong, with an important boost also from the external sector, which has also resulted in a recovery in prices relative to the months in which lockdown measures were the harshest. In oil, overall weather conditions were also favorable during September, possibly aiding an additional uptick. In contrast, we do not rule out some disruptions in October from hurricane Delta. Despite of this, and as previously mentioned, headwinds prevail, with the situation regarding Pemex's financial position still a drag for a more sustained recovery.

We remain somewhat more cautious about construction, considering comments from industry leaders as well as data which had been muted, contrasting with today's figures. The recent announcement between the Federal Government and the private sector in infrastructure investment for $297.3 billion is a good first step to reactivate the sector. Nevertheless, more is needed to combat the decline in civil engineering, which has maintained a downward trend since last year. This is especially relevant given latest figures of physical investment spending from the Federal Government, declining at a double-digit pace in August (-17.4% y/y in real terms). Meanwhile, soft indicators such as the aggregate trend indicator and business confidence improved in September, suggesting an additional increase. Nevertheless, and possibly a drag going forward, the 'adequate moment to invest' component within the latter remains below pre-pandemic levels. Considering these factors, the environment seems to remain highly uncertain about this sector's performance.

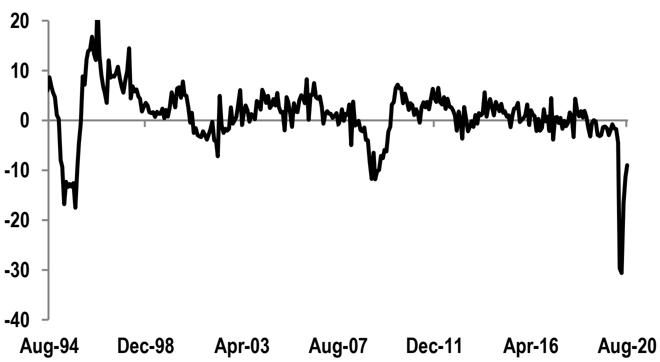
All in all, we maintain our view that the recovery in the second half of the year will probably be driven by industry, mainly manufacturing due to its very relevant ties to external demand. We will stay on the look for possible additional improvements on domestic-facing sectors, given that if additional pieces fall into place –such as increased certainty– renewed optimism from consumers and a greater impact of government policies, they might hold the key for a speedier rebound and insert upside risks to our full-year GDP forecast of -9.8% y/y.

Table 1: Industrial production
% y/y nsa

	Aug-20	Aug-19	Jan-Aug '20	Jan-Aug '19
Industrial Production	**-9.0**	**-1.2**	**-13.1**	**-1.5**
Mining	**-3.5**	**-3.6**	**-0.8**	**-7.0**
Oil and gas	-2.3	-5.7	1.1	-9.0
Non-oil mining	-1.1	-2.5	-9.0	-2.9
Services related to mining	-16.4	10.2	3.3	0.3
Utilities	**-4.5**	**4.0**	**-5.6**	**1.3**
Electricity	-4.9	4.8	-6.3	1.4
Water and gas distribution	-3.1	1.0	-2.7	1.1
Construction	**-13.7**	**-3.1**	**-20.3**	**-4.2**
Edification	-10.6	0.3	-19.7	-2.2
Civil engineering	-27.4	-2.3	-25.4	-5.3
Specialized works for construction	-11.4	-18.8	-17.3	-12.7
Manufacturing	**-9.2**	**-0.3**	**-14.3**	**1.0**
Food industry	-3.5	1.1	0.3	1.3
Beverages and tobacco	1.5	1.1	-11.6	2.0
Textiles - Raw materials	-25.4	-8.0	-39.0	-2.2
Textiles - Finished products ex clothing	-10.8	-5.2	-20.7	-1.5
Textiles - Clothing	-34.8	-6.1	-39.3	-4.4
Leather and substitutes	-33.2	-4.4	-42.1	-2.2
Woodworking	-12.9	-2.0	-19.5	-0.2
Paper	-5.6	-1.7	-8.5	-0.1
Printing and related products	-21.9	0.0	-21.1	-11.1
Oil- and carbon-related products	-22.2	-0.8	-10.9	-6.3
Chemicals	-5.5	-1.4	-5.6	-2.5
Plastics and rubber	-5.1	-2.3	-15.5	-1.8
Non-metallic mineral goods production	-4.2	-1.7	-12.4	-2.7
Basic metal industries	-16.5	1.1	-14.0	-3.5
Metal-based goods production	-3.3	-6.3	-17.4	-5.7
Machinery and equipment	-17.0	-1.6	-23.2	1.3
Computer, communications, electronic, and other hardware	-4.8	6.5	-10.7	7.0
Electric hardware	2.1	-4.5	-5.5	-1.0
Transportation equipment	-15.5	-0.8	-30.1	5.2
Furniture, mattresses and blinds	-11.1	-2.3	-24.2	-4.4
Other manufacturing industries	-10.7	-0.3	-13.4	1.9

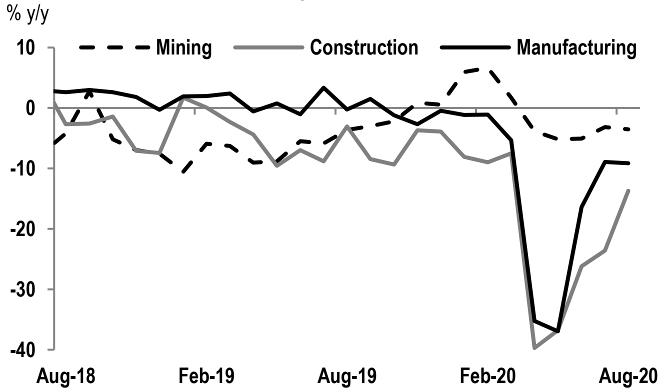
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



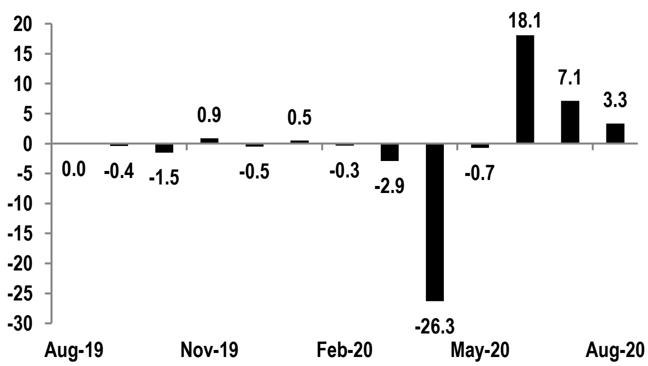
Source: INEGI

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

	% m/m			% 3m/3m	
	Aug-20	Jul-20	Jun-20	Jun-Aug'20	May-Jul'20
Industrial Production	**3.3**	**7.1**	**18.1**	**11.2**	**-8.9**
Mining	**0.8**	**1.0**	**1.6**	**-0.8**	**-4.8**
Oil and gas	1.6	-0.2	-1.6	-4.2	-5.6
Non-oil mining	1.1	8.6	24.1	20.2	-4.0
Services related to mining	-4.4	1.9	-7.0	-4.7	-1.9
Utilities	**5.7**	**5.5**	**0.4**	**-1.0**	**-8.5**
Electricity	6.8	7.2	0.1	-1.4	-10.2
Water and gas distribution	0.9	0.2	1.6	0.4	-2.4
Construction	**11.2**	**1.3**	**16.7**	**5.8**	**-15.3**
Edification	15.1	1.1	20.7	8.8	-16.2
Civil engineering	2.0	-0.3	1.5	-5.5	-13.0
Specialized works for construction	4.1	2.2	18.6	5.0	-13.7
Manufacturing	**0.8**	**11.3**	**26.9**	**18.7**	**-7.3**
Food industry	-1.0	0.7	-0.1	-1.3	-1.6
Beverages and tobacco	1.3	21.1	35.6	29.4	-4.6
Textiles - Raw materials	13.8	27.9	101.2	35.7	-32.2
Textiles - Finished products ex clothing	1.0	34.7	34.4	38.9	-8.8
Textiles - Clothing	14.6	38.2	71.2	21.8	-40.6
Leather and substitutes	10.7	42.0	214.5	49.8	-38.9
Woodworking	5.6	13.7	29.3	19.5	-12.0
Paper	4.2	8.6	5.4	1.4	-10.3
Printing and related products	12.4	15.0	-1.3	6.2	-15.3
Oil- and carbon-related products	10.6	-20.5	0.0	-9.1	-0.5
Chemicals	2.8	4.3	4.0	0.7	-6.7
Plastics and rubber	7.2	12.9	39.5	23.8	-11.2
Non-metallic mineral goods production	6.1	11.1	24.7	20.5	-7.2
Basic metal industries	4.7	4.0	-1.8	-3.9	-12.6
Metal-based goods production	2.7	28.7	31.5	24.8	-11.3
Machinery and equipment	8.7	1.6	42.8	21.3	-13.1
Computer, communications, electronic, and other hardware	-3.7	10.1	20.7	16.4	-0.7
Electric hardware	1.7	20.9	5.3	4.8	-10.9
Transportation equipment	-2.2	25.4	252.4	117.8	-5.8
Furniture, mattresses and blinds	3.4	19.8	100.2	56.1	-10.6
Other manufacturing industries	6.4	8.3	10.3	8.2	-9.1

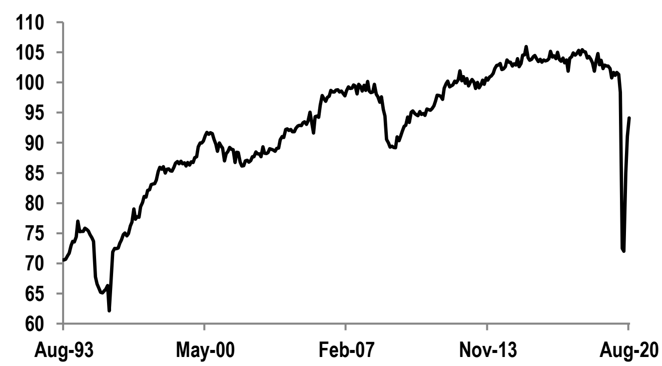
Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa



Source: INEGI

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