Domestic demand recovers in October

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- **Gross fixed investment (October): -14.7% y/y (nsa); Banorte: -13.5%; consensus: -13.7% (range: -15.2% to -11.4%); previous: -16.0%**
- **Private consumption (October): -10.3% y/y (nsa); previous: -9.8%**
- **The period had a negative calendar effect, with annual rates impacted relative to the previous month. Year-to-date, investment and consumption have declined 19.5% and 11.9% y/y, in the same order**
- **In sequential terms, investment rose 2.8% m/m, reversing September's 2.6% decline. Inside, both construction (4.7%) and machinery and equipment (+0.1%) were stronger, with the first rebounding significantly after losses in the previous month**
- **Consumption grew 1.1% m/m, adding five months to the upside. Performance was led by goods, both domestic (1.5%) and imported (2.5%). Meanwhile, services backtracked 0.6%, albeit only after a very strong print in September**
- **We believe that risks for domestic demand have continued to rise, especially in the short-term. In addition, the medium-term outlook remains challenging, with the pandemic and other idiosyncratic factors at play**

GFI recovers in October after a slight setback. This came in at -14.7% y/y (see Chart 1), lower than consensus (-13.7%), which practically matched our -13.5%. This was positive taking into account a negative calendar effect, as October had one less working day in the annual comparison (vs. +1 in September). Construction improved significantly to -12.7% (Chart 2), largely driven by a rebound in the residential sector, standing at -5.5%. However, the non-residential sector remains as a laggard, at -19.6%, still with a limited boost from projects within the public-private infrastructure plan. Meanwhile, machinery and equipment weakened at the margin to -17.0%, even after a more positive base effect. Inside, transportation was slightly, both domestic (-21.1%) and imported (-28.1%), boosted by GM's strike last year which pushed 2019 figures down. On the contrary, other M&Eq. was more negative, with similar declines in both subsectors (Table 1).

Using seasonally adjusted data, investment gathered pace at 2.8% m/m, reversing last month's 2.6% decline (Chart 3). We highlight that construction rebounded 4.7% m/m after falling 6.4% in September. Looking at the details, the residential sector grew 5.1% and non-residential 1.4%. Despite of this, we believe that activity remains depressed, feeling the brunt of weak domestic demand. In this respect, we see risks still lingering around, not only in the short-term but also on a more structural fashion (*e.g.* more widespread use of home office schemes even if the pandemic is eventually conquered, which could affect commercial real estate). Machinery and equipment barely grew 0.1%. Most components were modest, although this was compensated by the 4.0% in other domestic (Table 2). In absolute terms, this category is 12.4% below February's level, stressing the great challenges that remain in place for a total recovery (Chart 4).

Private consumption keeps trending up. The figure stood at -10.3% y/y, below the -9.8% of the previous month (Chart 5). Nevertheless, this was mainly driven by the abovementioned calendar effect. Correcting for this, (using seasonally adjusted data), it inched to -9.8% from -11.3% previously. We should recall that epidemiological conditions worsened until the end of the month, so mobility kept supporting the gradual recovery. On the other hand, we highlight that durable goods were lower, to -9.8% domestically and -39.2% in the imported component. In this respect, some distortions are likely to have played out given that consumers may have delayed some purchases ahead of *El Buen Fin* (Mexico's Black Friday), waiting for bargains (Table 3). Services were also lower at the margin, at -14.5% (Chart 6).

With seasonally adjusted figures, consumption rose 1.1%, extending the move higher for a fifth consecutive month (Chart 7). With this, the absolute level of consumption stands 9.0% below February (Chart 8). Although performance is better than in the case of investment, it still shows an important lag relative to external demand (except for tourism services, as these have also been impacted due to mobility restrictions). Specifically, only services backtracked (-0.6%). On a more positive note, imported goods surged 2.5%, which may be related to the build-up of inventories ahead of the discount period.

Heightened risks for domestic demand going forward. In our view, today's report reaffirms that domestic dynamics remains somewhat subdued relative to the performance of external-facing sectors. We believe the lack of fiscal stimulus partly explains this divergence, which in turn could result in a prolonged recovery of the overall economy. In addition, short-term risks are mounting, with a deterioration in epidemiological conditions since the end of October. This has resulted in several states going back to 'red' in the traffic light indicator, most notably Mexico City and the State of Mexico in mid-December.

Despite the rebound, we believe the outlook for investment remains challenging. Although progress on the vaccination process and the overall expectation of the economic recovery could be a positive factor, it is our take that some idiosyncratic factors will continue weighing on this component. Among them, we highlight (1) lack of enough demand growth to support increased capacity levels, along sanitary restrictions; (2) lingering concerns about the country's credit rating which could impact financing costs, with pressures stemming from Pemex's financial position; (3) low productivity growth and persistently high informality levels; and (4) concerns about the rule of law and inconsistency about some government policies, especially amid the upcoming electoral cycle.

In addition, and possibly most important, the current position of many businesses remains fragile, compromising their ability to deploy ambitious CAPEX plans. However, we do recognize some favorable factors, including reduced trade uncertainty with the US after Joe Biden's win and the USMCA framework, coupled with the higher likelihood of some businesses adopting *nearshoring* –looking to diversify to avoid concentration risks, such as those experienced at the start of the pandemic–. Moreover, the public-private partnership on infrastructure might start to pay-off somewhat soon, with signals of another package brought forward in coming months.

On a shorter-term basis, capital goods imports for November were slightly better at -12.9% y/y (+2.3% m/m), while construction within IP surprised to the upside at -7.8% y/y (+2.2% m/m). In this context, the latter sector retains some advantage as it is still considered essential, allowing operations to continue even with the traffic light indicator in 'red'. This might limit the overall impact from deteriorating conditions, at least on ongoing projects.

Consumption may be among the most vulnerable to new flares of the virus, such as the one we are experiencing right now. Specifically, services and durable goods remain the most exposed. However, the impact could be more moderate when compared to April-May, as businesses have learned from experience and have taken measures to become more profitable. Another factor to watch carefully is the new impact of the virus on employment conditions, especially in the informal sector. In this sense, employment took a slight dip in the eleventh month of 2020, losing 34.5 thousand positions, albeit with the unemployment rate improving 33bps to 4.37%. So far, the impact has been mixed, with IMEF's non-manufacturing indicator for December declining 1.0pts to 48.1pts, with all subcomponents lower. Nevertheless, consumer confidence was better, climbing 1.2pts to 38.1pts, highest since the pandemic began. In our view, this may be related to positive news about the development and deployment of the vaccine. Meanwhile, ANTAD's same-store sales fell 0.7% y/y in real terms in November, with departmental stores benefited by *El Buen Fin*, up 3.9%. However, we think that some sales that normally occur in December may have been brought forward. Coupled with restrictions to non-essential activities, we see a meaningful slowdown in the last month of 2020. Regarding fundamentals, remittances remained strong with a 15.6% y/y expansion in November. On the contrary, consumer credit kept declining, still showing a complex situation for purchases of durable and semi-durable goods, and likely also exhibiting the effect of more cautiousness due to high uncertainty.

All in all, we maintain our view that domestic demand is facing stronger headwinds relative to the external sector, with relevant challenges both from the pandemic and other idiosyncratic factors. In this context, we maintain our estimates of a 4.1% y/y recovery of GDP in 2021, which despite being high in absolute terms it would be quite modest factoring-in and expected plunge of 9.0% last year.

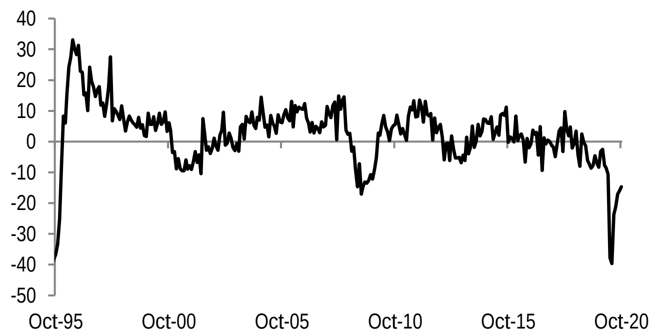
Gross Fixed Investment

Table 1: Gross fixed investment
% y/y nsa

	nsa				sa	
	Oct-20	Oct-19	Jan-Oct **'20**	Jan-Oct **'19**	Oct-20	Oct-19
Total	-14.7	-8.4	-19.5	-4.9	-13.7	-8.8
Construction	-12.7	-8.1	-18.4	-3.2	-12.4	-8.0
Residential	-5.5	-6.5	-16.9	-1.2	-5.4	-7.0
Non-residential	-19.6	-9.6	-19.9	-5.1	-19.5	-9.6
Machinery and equipment	-17.0	-8.6	-21.0	-7.2	-14.9	-8.9
Domestic	-18.3	-4.2	-25.3	-4.6	-16.7	-4.5
Transportation Equipment	-21.1	-11.1	-30.0	-5.5	-18.7	-12.0
Other machinery and equipment	-14.6	7.3	-18.0	-3.1	-14.5	7.5
Imported	-16.1	-11.4	-18.1	-8.8	-13.1	-11.3
Transportation Equipment	-28.1	-24.1	-36.4	-5.0	-28.3	-24.1
Other machinery and equipment	-14.2	-8.9	-14.9	-9.5	-10.8	-8.7

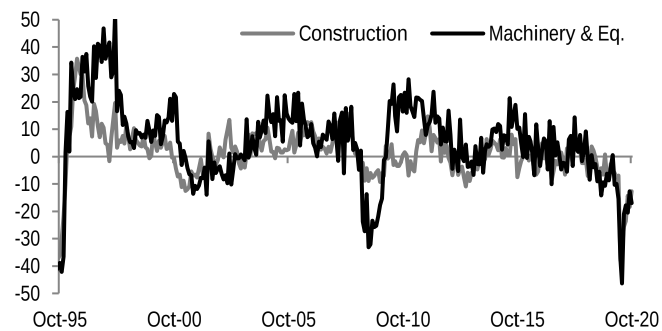
Source: INEGI

Chart 1: Gross fixed investment
% y/y



Source: INEGI

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



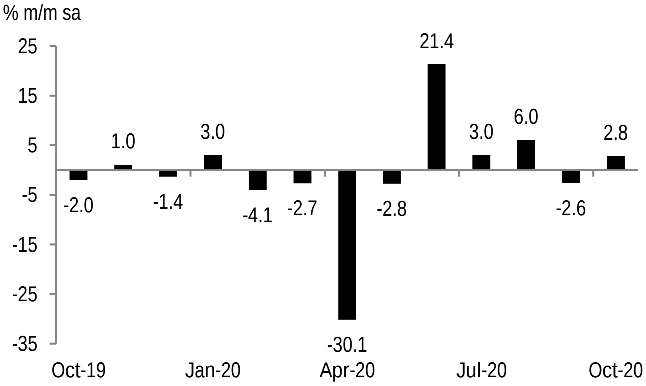
Source: INEGI

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

	% m/m			% 3m/3m	
	Oct-20	Sep-20	Aug-20	Aug-Oct**'20**	Jul-**Sep'20**
Total	2.8	-2.6	6.0	13.8	19.2
Construction	4.7	-6.4	10.9	13.6	17.3
Residential	5.1	-8.4	19.1	22.5	29.0
Non-residential	1.4	-2.5	4.6	4.9	5.0
Machinery and equipment	0.1	1.4	0.4	15.8	25.4
Domestic	0.3	2.2	-0.1	25.4	47.8
Transportation Equipment	0.5	-2.7	-0.9	20.7	54.4
Other machinery and equipment	-4.0	10.8	3.5	32.2	40.1
Imported	0.7	1.0	0.7	10.1	13.6
Transportation Equipment	0.1	16.1	-11.9	29.6	45.4
Other machinery and equipment	1.5	-0.6	3.1	8.8	10.4

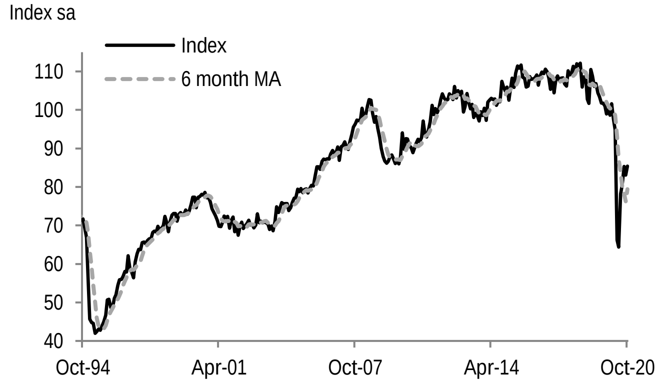
Source: INEGI

Chart 3: Gross fixed investment
% m/m sa



Source: INEGI

Chart 4: Gross fixed investment
Index sa



Source: INEGI

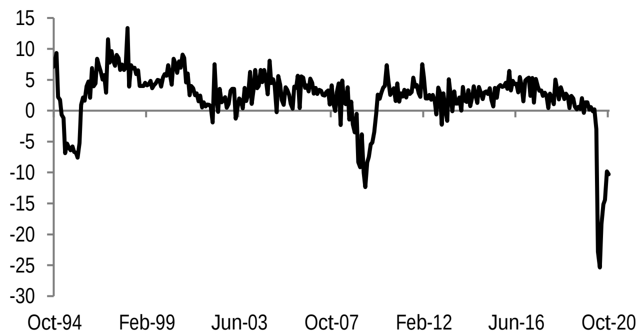
Private consumption

Table 3: Private consumption
% y/y nsa

	nsa				sa	
	Oct-20	Oct-19	Jan-Oct **'20**	Jan-Oct **'19**	Oct-20	Oct-19
Total	-10.3	1.4	-11.9	1.1	-9.8	1.2
Domestic	-8.3	0.5	-11.2	0.8	-8.0	0.4
Goods	-1.9	0.5	-7.9	0.0	-1.3	0.2
Durables	-9.8	4.0	-16.3	-5.4	--	--
Semi-durables	-7.8	-5.6	-29.7	1.5	--	--
Non-durables	0.5	1.3	-2.4	0.4	--	--
Services	-14.5	0.6	-14.2	1.6	-14.8	0.2
Imported goods	-24.2	7.4	-18.6	3.0	-21.4	7.7
Durables	-39.2	18.0	-32.9	2.2	--	--
Semi-durables	-19.6	-1.3	-18.4	5.7	--	--
Non-durables	-10.5	2.6	-5.8	2.4	--	--

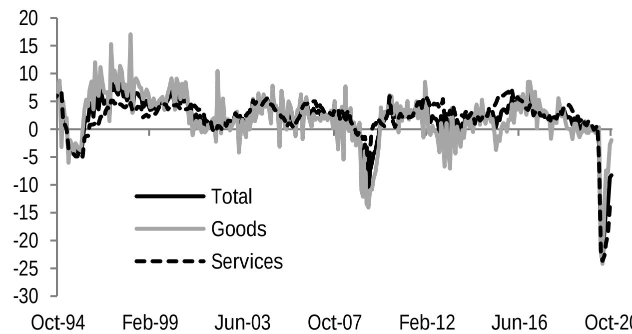
Source: INEGI

Chart 5: Private consumption
% y/y



Source: INEGI

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



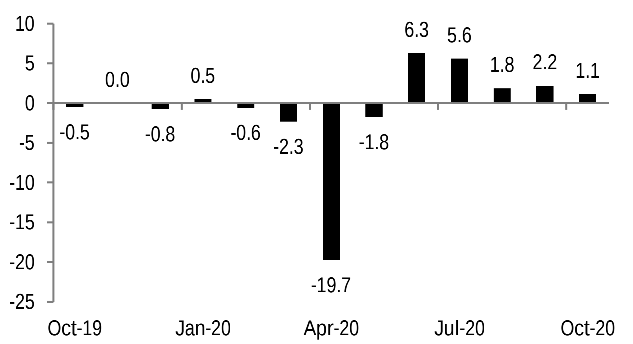
Source: INEGI

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

	% m/m			% 3m/3m	
	Oct-20	Sep-20	Aug-20	Aug-Oct**'20**	Jul-**Sep'20**
Total	1.1	2.2	1.8	9.6	11.4
Domestic	0.9	2.2	1.7	9.3	11.2
Goods	1.5	0.6	0.8	11.2	16.6
Services	-0.6	4.8	1.7	7.0	5.9
Imported goods	2.5	-1.6	2.9	10.0	12.2

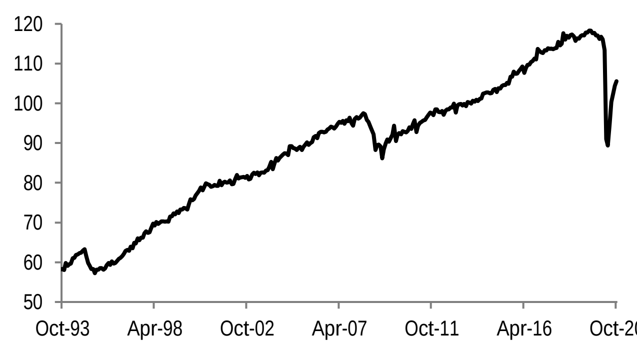
Source: INEGI

Chart 7: Private consumption
% m/m sa



Source: INEGI

Chart 8: Private consumption
Index sa



Source: INEGI

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