Industrial production – Marginal uptick in May as challenges remain for manufacturing

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- **Industrial production (May): 36.4% y/y nsa; Banorte: 37.4%; consensus: 36.7% (range: 31.8% to 39.1%); previous: 36.5%**
- **The annual comparison remains skewed to the upside due to a very favorable base effect, recalling the lockdown extended to this month in 2020. With seasonally adjusted data, activity grew 36.6% y/y**
- **In sequential terms, industry rebounded 0.1% m/m, not enough to make up for April's losses. This was a result of mostly broad gains which were partially offset by the 0.7% decline in manufacturing. With this, activity stands 2.6% below February 2020, closer to pre-pandemic levels**
- **In our view, industry remains in a tough position, with supply-chain issues persistently impacting output in the manufacturing sector despite elevated demand. As such, this remains as one of the key hurdles in the path to recovery**
- **We maintain our forecast of a 32.2% y/y expansion of industry in 2Q21 with balanced risks, which is part of our recent upward revision to annual GDP, now seen at 6.2% (previous: 5.9%)**

Industry remains high on a positive base effect during May. The indicator reached 36.4% y/y (see Chart 1), below both our forecast (37.4%) and closer to consensus (36.7%). While not a historical high –just an inch below April's figure– data remains highly skewed on effects from the pandemic, just as the lockdowns extended and many activities remained shut in the same period last year. A key factor, just like in April, was that private construction and some industries within manufacturing (*e.g.* autos) were still not considered essential. As such, these maintained the largest expansions, with the total from each at 45.0% and 48.0%, respectively (see Chart 2). However, comparisons also turned more favorable for mining (8.9%) and utilities (8.7%). The former reflects some of the oil cuts the country made as part of the OPEC+ agreement, while the latter started to reflect reduced demand on lower activity. Calendar effects are modest, with just the skew from one additional working day. Correcting for this with seasonally adjusted data, activity grew 36.6% y/y, slightly stronger than the 36.4% from INEGI's *Timely Indicator of Economic Activity*. For more details, please refer to Table 1.

Sequential gains in most sectors, albeit with manufacturing lower. Industry managed a 0.1% m/m expansion, somewhat low considering the -0.3% seen in April (Chart 3). With this, activity stands 2.6% lower than in February 2020, before the pandemic (Chart 4). In our view, performance was broadly influenced by several factors, including additional gains on the virus front –with cases still trending down and vaccinations gathering pace–, an improvement on employment conditions and signs of a reviving demand. However, a large negative factor also came into play, with supply-chain issues denting dynamism in manufacturing at -0.7%, now adding two consecutive months of declines. This situation had not happened since April-May 2020, just at the height of the lockdowns.

The shock seems clearer when looking at the breakdown, as some of the more complex categories in terms of supply processes were lower, including transportation (-2.9%) –with an accumulated loss of 5.9% in the past two months, electronic (-2.6%) and electrical equipment (-1.9%), along chemicals (-1.6%) and textile raw materials (-1.6%). By contrast, some relatively isolated categories such as the food industry (0.1%) were more modest. Moreover, there are around five other categories with relevant increases, albeit most of them rebounding after a sharp decline in April, as seen in Table 2.

Construction accelerated substantially at 2.0%, more than making up for a lackluster performance in March and April. Gains were centered in edification (+3.7%), with losses in both civil engineering (-0.5%) and specialized works (-1.7%). Data contrasted with our view of an acceleration in public works ahead of the elections, which is typical as it aims to boost opinion of incumbent parties and candidates. Nevertheless, results are quite positive, suggesting that despite some volatility in the sector, the recovery seems to remain on track.

Lastly, mining posted another 1.0% increase. Inside, data from the oil sector was somewhat mixed, with a slight decline in crude seemingly offset by larger gas extraction, resulting in a 0.4% expansion as a whole. Non-oil mining gathered additional dynamism (1.0%), consistent with some support from persistently high prices. However, for a second month in a row the outperformance comes from services, now at 3.5%.

Risks continue to mount, clouding the outlook. We believe that today's report was somewhat lackluster, as it reveals that relevant hurdles remain on the path for the recovery. Specifically, these seem to be concentrated in manufacturing, as supply chain issues remain and are exacerbating for some sectors. This is slightly concerning when looking at some of the most recent data, including June's manufacturing indicator from IMEF. While the headline figure was unchanged at 52.4pts, performance inside was more telling as 'new orders', 'production' and 'employment' were lower, while 'deliveries' and 'inventories' were higher, albeit in our view due to the wrong reasons. This deterioration is on par with some loss of dynamism in the US, as portrayed June's ISM manufacturing index. The latter report suggests that problems continue in raw materials –including availability and prices– and shipping logistics, despite strong demand. Considering this, we believe constraints to higher output will continue to dampen the recovery of the sector despite prospects remaining positive, especially from abroad.

In this context, one of the worst hit sectors continues to be autos. VW has reported intermittent stoppages since early in the year, but have exacerbated in the last couple of months, especially in June and July due to the scarcity of chips. This has had a spillover effect on key suppliers, which have also had to halt production. Some of them, including *Fujikura* and *Seglo* have reported that during this period, workers will only earn 50% of their wages, while also discounting vacation time. A similar situation is happening for Nissan, which has also started July on renewed stoppages in most of their lines in Aguascalientes. However, representatives from the workers union have stated that these might have a limited effect as the yearly retooling will begin in the month.

Moreover, after a brief restart, GM once again announced that their Ramos Arizpe plant closed in late June and early July to accommodate for shortages impacting other parts of the production process. On the contrary, reports suggest that only a very few automakers have avoided significant setbacks, including Toyota, Mazda and Kia. On top of the latter, other industries remain under pressures as commodities remain on an upward trend, pressuring margins and in some cases, making production of some goods impossible.

On regulatory issues, the US Trade Representative, Katherine Tai, recently visited Mexico as part of the celebration of the one-year anniversary of the USMCA. While she touted some progress, concerns remain on the labor sector, especially amid a dispute regarding the violation of workers rights' in GM's union. While a resolution has been achieved –with additional focus on an upcoming vote to approve their collective bargaining agreement–, it suggests this might remain a hot topic between the two nations. This represents a risk, although we believe Mexico's overall position remains relatively strong, particularly as tensions between the US and China are still benefiting our country.

On mining, Pemex stopped operation of its *Yúum K'ak' Náab* Floating Production Storage and Offloading facility (FPSO) –which is the only terminal able to load supertankers– for the first half of June. While this could have a limited impact on production, it will most likely hit exports. Moreover, on July 2nd there was a fire due to an underwater gas leak near the *Ku Maloob Zaap* complex which lasted around five hours. While the overall impact was modest, and may not be reflected in output data, it is a glimpse of the plethora of challenges around the operations of the state-owned company. In contrast, the outlook for the non-oil sector remains more positive, with favorable price dynamics extending to more recent days.

Turning to construction, most advanced data from business confidence and the aggregate trend indicator suggest added strength, as they have done for nearly a year. Nevertheless, considering this period's outperformance and high volatility, it is likely that we could see a moderation in June. On other news, Francisco Solares, head of the *Mexican Construction Industry Chamber* (CMIC, in Spanish) has maintained its criticism about the role taken by the Army as the developer of many public infrastructure projects, advocating for the return of private companies. He also mentioned that around 2,000 businesses remain impacted by the lack of work due to prevailing uncertainty. On a more favorable note, Mexico City's government announced the go-ahead for 17 large-scale projects in *Paseo de la Reforma* –one of the country's most emblematic streets–.

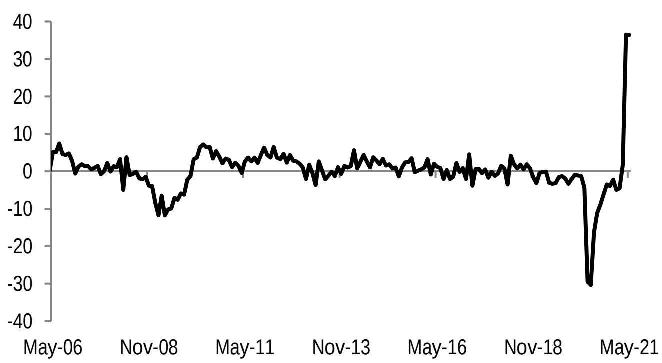
Considering this, we maintain our forecast for industry in 2Q21 at 32.2% y/y, which is part of our recent 2021 GDP estimate revision, now seen at 6.2%. This implies a deceleration in annual terms for activity in June, consistent with a less favorable base effect than in the previous two months.

Table 1: Industrial production
% y/y nsa

	May-21	May-20	Jan-May**'21**	Jan-May**'20**
Industrial Production	36.4	-30.4	9.9	-13.3
Mining	8.9	-4.5	0.9	1.5
Oil and gas	2.8	-0.9	-1.4	3.4
Non-oil mining	42.0	-27.3	15.4	-11.2
Services related to mining	2.3	22.6	-7.4	14.3
Utilities	8.7	-12.3	-2.5	-3.1
Electricity	9.3	-14.0	-3.8	-3.1
Water and gas distribution	6.6	-5.9	1.8	-3.0
Construction	45.0	-36.6	8.5	-19.6
Edification	55.9	-40.0	8.9	-20.7
Civil engineering	2.9	-23.1	-1.6	-17.9
Specialized works for construction	51.3	-34.8	16.7	-16.0
Manufacturing	48.0	-36.8	15.0	-15.8
Food industry	3.2	-5.0	0.8	-0.1
Beverages and tobacco	62.7	-40.4	20.3	-18.0
Textiles - Raw materials	248.0	-75.3	38.7	-38.4
Textiles - Finished products ex clothing	79.0	-48.2	23.4	-22.6
Textiles - Clothing	242.8	-76.5	17.1	-35.1
Leather and substitutes	434.9	-86.6	27.2	-40.1
Woodworking	61.3	-44.7	14.3	-19.5
Paper	33.5	-20.7	7.5	-6.7
Printing and related products	50.4	-31.2	11.1	-15.1
Oil- and carbon-related products	7.6	-4.6	18.7	-5.2
Chemicals	5.1	-14.5	-2.6	-4.0
Plastics and rubber	81.1	-42.9	25.5	-17.6
Non-metallic mineral goods production	49.7	-32.5	19.0	-13.5
Basic metal industries	26.8	-20.6	10.9	-10.3
Metal-based goods production	78.1	-46.3	24.4	-17.9
Machinery and equipment	66.3	-47.4	22.1	-24.5
Computer, communications, electronic, and other hardware	31.2	-26.6	17.2	-12.8
Electric hardware	53.3	-22.7	24.2	-5.5
Transportation equipment	322.0	-81.0	39.2	-36.8
Furniture, mattresses and blinds	190.9	-63.6	35.7	-28.5
Other manufacturing industries	44.0	-25.7	10.6	-14.0

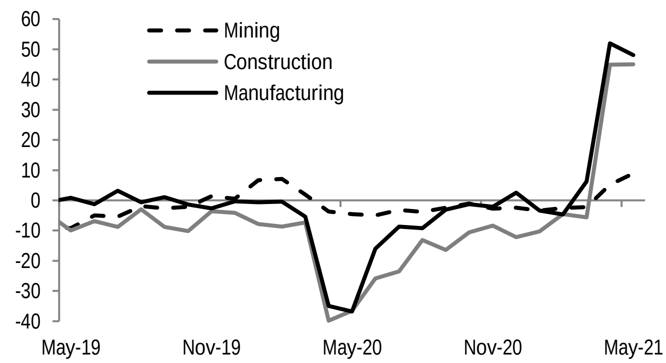
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



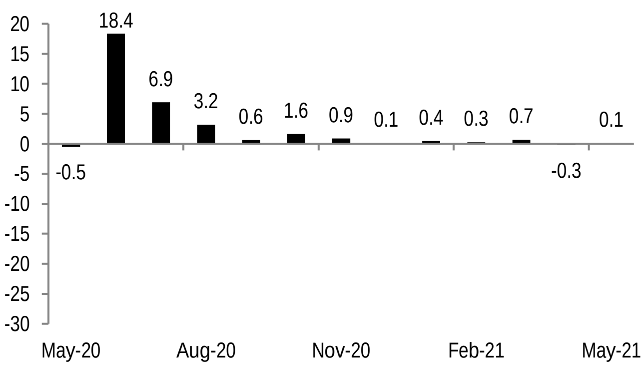
Source: INEGI

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

	% m/m			% 3m/3m	
	May-21	Apr-21	Mar-21	Mar-May'21	Feb-Apr'21
Industrial Production	0.1	-0.3	0.7	0.9	1.0
Mining	1.0	1.0	-3.0	0.2	1.8
Oil and gas	0.4	0.4	-1.9	0.5	2.1
Non-oil mining	1.0	0.3	-7.1	-5.2	-2.2
Services related to mining	3.5	6.4	-4.2	7.5	8.1
Utilities	1.3	-0.8	5.1	1.4	-1.8
Electricity	1.8	-1.6	6.4	1.3	-2.6
Water and gas distribution	0.0	1.6	0.6	1.7	0.8
Construction	2.0	-0.1	0.2	3.4	3.9
Edification	3.7	-0.4	-1.4	2.7	2.3
Civil engineering	-0.5	-4.6	5.9	5.9	7.2
Specialized works for construction	-1.7	2.7	0.6	1.8	2.9
Manufacturing	-0.7	-0.8	3.2	0.6	-0.5
Food industry	0.1	0.5	0.6	0.9	0.6
Beverages and tobacco	0.0	0.2	-0.9	0.0	-0.8
Textiles - Raw materials	-1.6	1.3	5.5	3.4	3.1
Textiles - Finished products ex clothing	7.4	-13.0	3.1	-1.8	1.4
Textiles - Clothing	3.6	0.5	8.8	10.3	4.3
Leather and substitutes	0.7	-3.5	2.9	0.1	0.2
Woodworking	-0.3	-2.0	-1.8	0.3	0.6
Paper	-1.7	9.5	0.8	6.2	2.9
Printing and related products	20.5	-17.7	0.5	-2.2	1.0
Oil- and carbon-related products	6.9	-23.3	14.5	-1.1	7.4
Chemicals	-1.6	1.2	0.0	-1.8	-2.9
Plastics and rubber	1.6	-0.1	4.2	1.9	1.0
Non-metallic mineral goods production	-1.1	-1.6	3.8	1.1	0.7
Basic metal industries	0.4	0.7	3.0	2.3	0.8
Metal-based goods production	-0.5	-4.1	4.6	1.8	2.4
Machinery and equipment	0.0	-6.5	8.8	3.4	3.0
Computer, communications, electronic, and other hardware	-2.6	0.6	-1.0	-1.5	0.4
Electric hardware	-1.9	3.4	4.6	7.8	6.6
Transportation equipment	-2.9	-3.1	10.8	-0.9	-5.9
Furniture, mattresses and blinds	18.9	-11.8	-0.9	0.0	1.1
Other manufacturing industries	8.3	0.8	-1.2	3.7	1.2

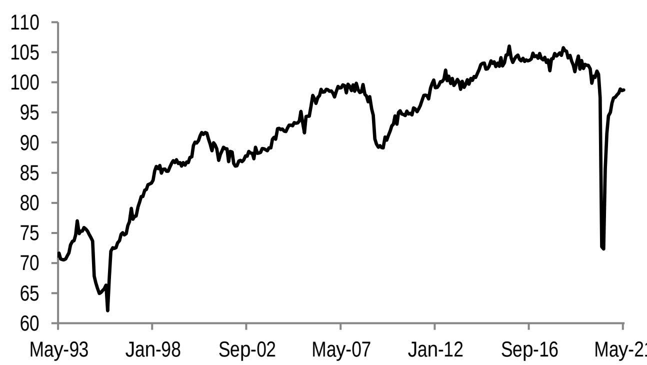
Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa



Source: INEGI

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