2Q21 GDP – Acceleration fueled by the reopening

- **Gross Domestic Product (2Q21 P, nsa): 19.7% y/y; Banorte: 19.8%; consensus: 19.8% (range: 15.5% to 20.9%); previous: -3.6%**
- **Gross Domestic Product (2Q21 P, sa): 1.5% q/q; Banorte: 1.6%; consensus: 1.8% (range: 0.8% to 2.1%); previous: 0.8%**
- **The annual rate reached a new historical high, recalling the very positive base effect due to strong contractions in April-May 2020 on strict lockdowns, as well as a hesitant recovery in June as part of the reopening**
- **All sectors grew sequentially, highlighting the 2.1% q/q pickup in services. Industry decelerated at the margin to 0.4%, albeit relatively positive considering supply issues. Primary activities went up 0.6% despite very difficult weather conditions most of the period**
- **According to our calculations, today's print implies activity at around 12.3% y/y in June (-1.6% m/m), with the new global wave of COVID-19 cases and the stage of the recovery suggesting a slower pace and increasing challenges into 3Q21**
- **Nevertheless, the recovery so far remains consistent with our call of full-year GDP at 6.2%. In addition, we reiterate our forecast for 2022 at 3.0%**
- **Revised figures will be published on August 25th**

GDP close to expectations at 19.7% y/y in 2Q21. Consensus was 19.8%, which matched our forecast. This happened even after May's IGAE beat expectations earlier this week. The annual rate reached a new historical high, recalling the very positive base effect due to strong contractions in April-May 2020 on strict lockdowns, as well as a hesitant recovery in June as part of the reopening (Chart 1). There was also a marginal boost from a calendar effect related to the *Easter* holiday, given that in this year it was felt in both March and April. Hence, with seasonally adjusted figures, the economy grew 19.6% y/y (Table 1). Broadly speaking, we believe support came from several factors, the most important being a wider reopening on the back of improved epidemiological conditions in the first half of the period, with new cases reaching a new low and the 'traffic light' indicator also at its best levels around the end of May. Moreover, we recall that US fiscal stimulus was boosted again at the end of March, likely benefiting both exports and remittances. In turn, confidence levels –both consumers and businesses– improved meaningfully during the period. Returning to original data, primary activities grew 6.7%, industry rebounded 28.2% and services by 17.1%. as shown in Chart 2.

Sequential acceleration in 2Q21, hand-in-hand with higher mobility. With seasonally adjusted figures, GDP grew 1.5% q/q (Banorte: 1.6%, consensus: 1.8%). This is above the 0.8% of the first quarter, which was affected by virus conditions and other shocks, primarily at the start of the period. It also translates to a 6.3% q/q annualized rate (Table 2), slightly lower than the 6.5% for the same period in the US.

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Apart from the drivers mentioned above, the acceleration was coupled with higher mobility, recovering gradually despite staying slightly below pre-pandemic levels. As the historical series is not revised in preliminary data, this would mean four consecutive quarters of the recovery (Chart 3).

In our view, the better environment was clearly reflected in services, which gathered pace significantly, at 2.1% (Chart 4). Although subsector data will be known until revised figures are released, social-intensive activities such as lodging and transportation were likely among the most benefited, This has already been hinted by IGAE for April and May. Other positive surprises so far include retail sales, consistent with higher confidence and a more widespread reopening of physical stores. In contrast, recreational services have lagged so far despite the more benign backdrop. Government has also advanced, not ruling out some boost ahead of the mid-term elections.

Industry was also favorable at 0.4% q/q. Although this was below services, it should be recalled that the rebound since the reopening (in 3Q20) has been much stronger. Moreover, we see it as positive considering a plethora of supply issues and constraints affecting the sector, especially manufacturing. In contrast, construction and mining surprised positively at the margin. An additional headwind has been the increase in goods' prices (with a year-to-date advance of 3.5% according to inflation data, as opposed to 2.1% for services within the core), which may very well dampen demand growth. In our view, the sector is still facing a difficult backdrop, so we remain cautious about the short-term outlook. Lastly, we were positively surprised by the primary sector (0.6%), which managed to stay above water despite severe droughts in the country virtually during the whole period.

Based on these preliminary figures, the economy in 2Q21 was 2.4% below the level of activity in 4Q19 –before the pandemic– and 3.6% lower than its historical high reached on 3Q18.

GDP implies that COVID-19 impacted again in June. Considering that the monthly GDP-proxy (IGAE) averaged 23.8% y/y in April-May, today's estimate implies that June was close to 12.3% y/y (with original figures). According to our calculations, with seasonally adjusted data it would translate to -1.6% m/m. The latter would be much worse than the +0.3% estimate by INEGI's *Timely Indicator of Economic Activity*. In our view, this would mostly be because of the more difficult backdrop because of the 'delta' variant. The latter, despite a population less willing to modify their behavior because of this, probably owing to fatigue. In this sense, we believe the economic impact may be less severe than in previous instances. On the other hand, recent data for the period is consistent with a slowdown, such as IMEF's PMIs and the trade balance, among the most relevant.

We maintain our 6.2% forecast for full-year 2021, with mixed factors for the rest of the year. The report was very close to our expectations, so we maintain our call of a slowdown in activity in 2H21 and full-year growth estimate of 6.2% (see Table 3 and Table 4). This is not only because of a "natural" moderation given accumulated gains since the reopening, but also on a series of mixed factors ahead that could lead to higher uncertainty.

As mentioned repeatedly above, the most important remains the evolution of the virus, its effect on economic agents' behavior and possible responses in terms of restrictions. On the first, our base case is that the economic effects will be less severe than in the first two waves, with: (1) People less willing and capable to resist strict lockdowns again; and (2) ongoing vaccinations. On the second, we see a more lenient approach. Nevertheless, we have had news recently about more restrictions on access to some highly visited public beaches (*e.g.* in La Paz, Baja California Sur, and Acapulco, Guerrero), threatening touristic services and transportation. In Mexico City, the local government suspended some administrative procedures at least until August-end on higher hospitalization rates. In contrast, the Federal government has insisted that kids will return to school in August despite the pandemic, albeit with some states saying they will go ahead while others have shown more hesitancy. In our view and at the very least, consumers and businesses may show greater caution because of this.

On a more positive note, we highlight plans for additional fiscal stimulus in the US, with negotiations moving forward in the last few days. Although this is directed mainly to physical infrastructure, the boost to the US economy could keep spilling over to Mexico. In our view, this has helped our country's through trade and remittances channels, among others. In addition, more spending is still left from earlier rounds, which should keep helping consumption. Locally, the government is likely to unveil a new infrastructure package soon for about $70 billion (0.3% of nominal GDP in the year up to 1Q21, or US$3.5 billion). According to the *Transportation and Communications Ministry*, it will include 10 to 15 projects on highways, railroads and airports, among others. This comes on top of the first and second packages announced in 2020. Despite of its limited size, this could help construction as business organizations (such as CMIC) have insisted on the need to reestablish alliances with the government because the Army has displaced them. Lastly, there are early signs that the scarcity of semiconductors is starting to lessen at the margin.

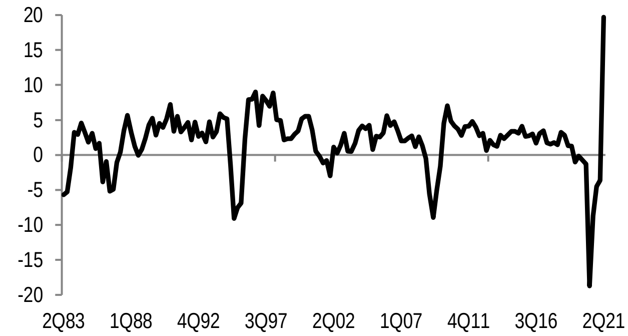
On the contrary, we also see some headwinds. Among them, we could have more uncertainty on the fiscal front ahead of negotiations for the *2022 Budget*. Although the President said that no new taxes will be proposed, enforcement measures will continue to be tightened. For example, the head of Mexico's IRS (*Sistema de Administración Tributaria*) stated recently that they could eliminate tax benefits to the auto industry. This comes on top of increasing tensions because of USMCA rules in this sector as well as on labor, agriculture, and even energy. Although competitive advantages relative to China are still high, uncertainty because of these issues may at least slowdown investment plans until a resolution. Lastly, there are still doubts about the implementation and possible effects in the labor market of the upcoming start of the outsourcing reform.

Table 1: GDP
% y/y nsa, % y/y sa

	nsa						sa					
	2Q21	1Q21	2Q20	1Q20	Jan-**Jun'21**	Jan-**Jun'20**	2Q21	1Q21	2Q20	1Q20	Jan-**Jun'21**	Jan-**Jun'20**
Total	19.7	-3.6	-18.7	-1.3	7.0	-10.1	19.6	-2.8	-18.7	-2.1	7.4	-10.4
Agricultural	6.7	2.8	-3.9	-2.6	4.8	-3.2	6.8	2.6	-3.4	-3.0	4.7	-3.2
Industrial production	28.2	-2.7	-25.4	-2.3	10.6	-13.8	28.2	-2.0	-25.4	-3.1	11.1	-14.2
Services	17.1	-4.0	-16.3	-0.6	5.8	-8.5	17.0	-3.4	-16.3	-1.2	6.0	-8.7

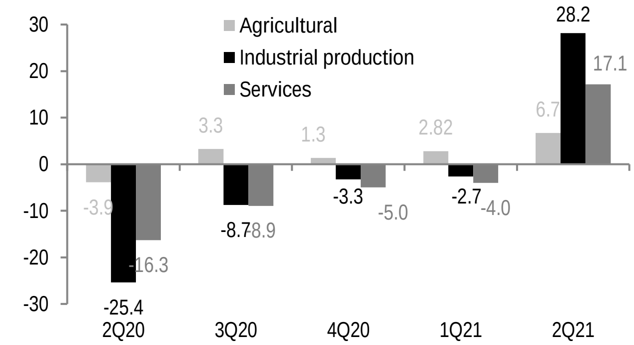
Source: INEGI

Chart 1: GDP
% y/y nsa



Source: INEGI

Chart 2: GDP by sectors
% y/y nsa



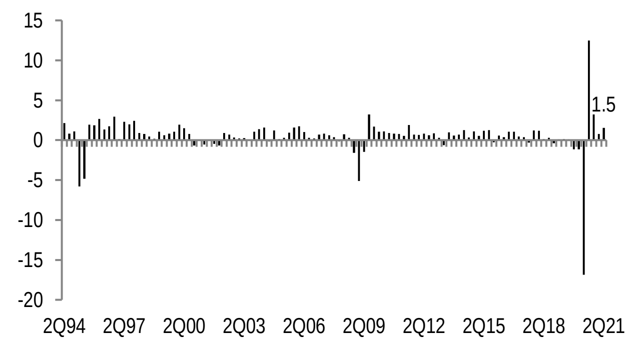
Source: INEGI

Table 2: GDP
% q/q sa, % q/q saar

	% q/q				% q/q saar			
	2Q21	1Q21	4Q20	3Q20	2Q21	1Q21	4Q20	3Q20
Total	1.5	0.8	3.2	12.5	6.3	3.1	13.5	60.0
Agricultural	0.6	0.7	-2.1	6.1	2.4	2.7	-8.1	26.9
Industrial Production	0.4	0.5	3.6	22.5	1.7	1.9	15.4	125.3
Services	2.1	0.9	3.2	9.0	8.5	3.6	13.6	41.3

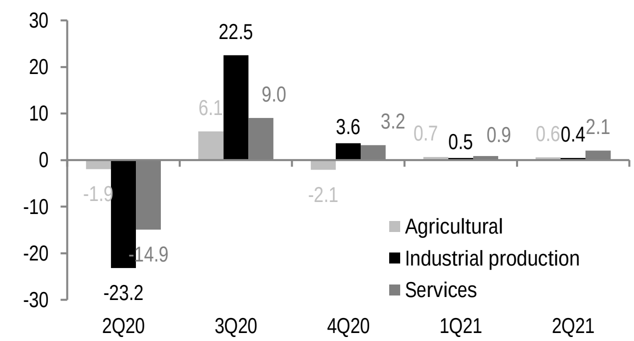
Source: INEGI

Chart 3: GDP
% q/q sa



Source: INEGI

Chart 4: GDP by sectors
% q/q sa



Source: INEGI

Table 3: GDP 2021: Supply
% y/y nsa; % q/q sa

% y/y	1Q21	2Q21	3Q21	4Q21	2021
GDP	-3.6	19.7	7.1	3.8	6.2
Agricultural	2.8	6.7	-0.4	1.0	2.5
Industrial production	-2.7	28.2	7.1	3.2	7.8
Services	-4.0	17.1	7.4	4.2	5.8
% q/q					
GDP	0.8	1.5	0.7	0.4	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

Table 4: GDP 2021: Demand
% y/y nsa; % q/q sa

% y/y	1Q21	2Q21	3Q21	4Q21	2021
GDP	-3.6	19.7	7.1	3.8	6.2
Private consumption	-4.2	21.4	11.2	7.2	8.2
Investment	-4.9	23.4	12.4	4.6	7.6
Government spending	-0.7	-1.3	-2.2	2.3	-0.5
Exports	-4.3	63.2	9.9	6.7	15.7
Imports	-1.0	49.0	22.3	11.7	18.5
% q/q					
GDP	0.8	1.5	0.7	0.4	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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