Domestic demand advanced further in May, but remains below pre-pandemic levels

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- **Gross fixed investment (May): 46.5% y/y (nsa); Banorte: 46.6%; consensus: 45.4% (range: 37.1% to 52.3%); previous: 43.0%**
- **Private consumption (May): 28.8% y/y (nsa); previous: 25.5%**
- **As in the previous month, annual rates remain distorted by a very favorable base effect, resulting in abnormally large prints**
- **In sequential terms, investment rebounded 0.7%, reversing some of the previous month's loss (-0.9%). The move was driven by construction (+2.1%), higher after some recent weakness. Machinery and equipment was weak (-1.3%), dragged by the imported component (-0.6%)**
- **Consumption rose 0.9% m/m, stringing three months to the upside. In our view, this is highly related to better virus conditions that allowed a broader reopening. In this sense, we highlight the +1.6% in services, albeit also with a very strong rebound in imported goods (+6.9%)**
- **We expect domestic demand to continue recovering, albeit at a slower pace. We do not rule out some setbacks given higher COVID-19 cases and persistent price pressures, among others**

GFI posts a mild rebound in May. Investment stood at 46.5% y/y (see Chart 1), virtually in line with our 46.6% forecast. By sectors, both construction (38.7%), and machinery and equipment (58.0%) remained high (Chart 2). As in the previous month, annual rates are highly distorted by 2020's lockdown, with April and May being the lowest points of activity. As a result, the analysis of sequential data becomes much more informative. In this context, using sa figures, investment rebounded 0.7% m/m (previous: -0.9%), partially compensating for recent losses (Chart 3). This is consistent with our view that April's contraction was more a blip than a change in trend. Inside, construction expanded by 2.1%, with absolute levels of activity at their highest since the pandemic started. Strength centered in the residential sector (3.2%), with non-residential still lagging (1.6%). Nevertheless, the latter has had a better-than-expected performance since the start of the year, in our view likely benefitted by government spending ahead of the June election. We believe this has happened despite federal spending in physical investment plunging 29.9% y/y in real terms in the period. In this respect, we warn that the print is skewed down as some emergency COVID-19 support measures were accounted in this line last year. In contrast, machinery and equipment was weak at -1.3% m/m, mainly dragged by the imported component at -0.6% (Table 2). This is quite different from the 2.2% m/m increase in capital goods imports. In this respect, we have seen that the correlation between them has been declining at the margin recently. Meanwhile, the domestic component fell for a second consecutive month, at -0.2%. This was centered in the 'other' category (-6.6%), with a sizable rebound in transportation equipment (6.2%) which remains in a challenging environment. This was flagged already by the sector's weakness in the IP report. Overall, activity stands 15.7% below July 2018's all-time high and -2.0% vs. February 2020 (Chart 4).

Consumption keeps going higher, in our view helped by better fundamentals. This component stood at 28.8% y/y (Chart 5). As in GFI, the pandemic is distorting annual rates, resulting in large annual expansions. Consumption of imported goods surged 69.3%, with domestic goods up 28.9% (Table 3). In the former, we highlight durables (147.0%), while in the latter the leader was semi durables (292.2%). Moreover, services strengthened 21.5% (Chart 6).

With seasonally adjusted figures, consumption grew 0.9% m/m (Chart 7), stringing three months to the upside. Broadly speaking, we think several factors help explain its relative resilience. Among them, we note: (1) Very high remittances growth; (2) the recovery in employment; (3) higher consumer confidence levels; and (4) the gradual increase in mobility, which by May reached a new high since the pandemic broke. Within, we saw a more mixed performance. Growth was led by imported goods (6.9%), while in the domestic component the best performance was in services (+1.6%). In our view, these are consistent with the drivers mentioned above. On the contrary, domestic goods fell 1.0%, albeit only after advancing 1.8% in April. With these, consumption is 3.2% below its all-time high (July 2019) and -1.7% to February 2020 (Chart 8).

We expect domestic demand to maintain a positive trend, albeit with mounting short-term risks. Overall, we see today's data as favorable. Nevertheless, it happened in a backdrop of a widespread global improvement in terms of the evolution of the virus. Right now, the situation has become more challenging because of the rise in the 'delta' variant. For example, new daily cases yesterday stood at 21,569, just 3.4% below its record high during the 'second' wave at the beginning of this year. Fortunately, this has not been matched by higher deaths. In this environment, we see three key factors that might dampen some of the economic impact: (1) Progress in vaccinations, especially in groups most at risk, such as the elderly; (2) the population's adaptation to sanitary measures and natural fatigue; and (3) the government's unwillingness to impose strict restrictions to business operations. In this context, we have observed that mobility levels have remained relatively resilient. Our take is that the main driver of possible weakness ahead in both investment and consumption would likely be related to greater cautiousness from both companies and consumers given renewed uncertainty about activity ahead. In this sense, we will look to available confidence measures, trying to gauge if this is indeed affecting behavior. In this sense, business confidence up in July advanced for three out of the four main sectors –with the exception of services excluding commerce–; meanwhile, consumer confidence stagnated following an upward trend since the reopening started.

Apart from the virus, we flag other risks. For consumption, two stand out, in our view: (1) Persistently high inflation, with recent prints surprising mostly at the core level and in key goods for the population, such as corn tortillas; and (2) the expiration of additional unemployment benefits in the US in early September, which may impact migrants' available resources to be sent back to their families. Regarding this component of aggregate demand, non-oil consumption goods imports moderated to 0.3% m/m in June. Meanwhile, July's non-manufacturing PMI showed a relevant decline, particularly in the production component.

On investment, we also flag some short-term headwinds. First, Mexican legislators will return in early September, with one of their most immediate tasks being the approval of the *2022 Budget.* In this sense, we have had some news about more enforcement measures to avoid tax evasion, with some proposals of eliminating incentives to the auto industry, among others. Second, the outsourcing reform has been delayed also to September as doubts about the registration process abounds. In this sense, we do not rule out also some impact to the labor market. Third, trade tensions have been rising lately between the US on one side, and Mexico/Canada on the other. Although this are likely to be resolved within the dispute settlement mechanisms within USMCA, uncertainty about the final resolution of this issues may affect investment. Lastly, the fact that raw material scarcity is still limiting growth is also likely to be reflected in relatively low appetite for factory investment. Despite high demand levels (particularly from the US), companies may not want to increase total capacity as they can't produce as much as they wanted.

Overall, we maintain our view that the recovery of GDP will continue in the second half of the year, but at a more modest pace. We still think that the external sector will lead relative to consumption, followed lastly by investment. Specifically, we maintain our 6.2% y/y growth estimate, in our view with balanced risks so far.

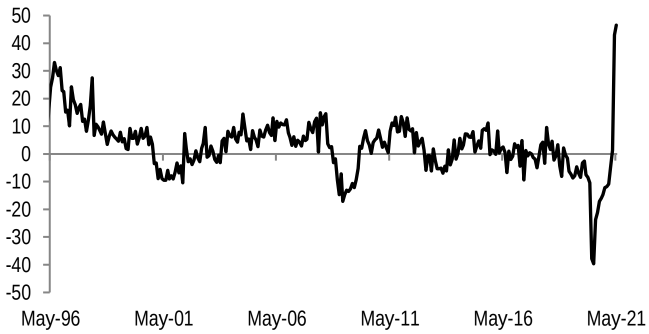
Gross Fixed Investment

Table 1: Gross fixed investment
% y/y nsa

	nsa				sa	
	May-21	May-20	Jan-May**'21**	Jan-May**'20**	May-21	May-20
Total	46.5	-39.7	10.0	-20.5	47.2	-38.3
Construction	38.7	-34.0	5.2	-17.8	38.9	-33.9
Residential	60.3	-39.4	12.1	-20.2	60.0	39.6
Non-residential	19.1	-28.3	-1.5	-15.4	19.7	-27.6
Machinery and equipment	58.0	-46.3	17.2	-24.1	57.6	-43.3
Domestic	88.2	-55.5	19.0	-27.0	86.7	-53.8
Transportation Equipment	91.5	-59.7	16.2	-32.7	88.8	-58.1
Other machinery and equipment	82.9	-47.1	22.9	-17.6	83.1	-44.6
Imported	42.3	-39.9	16.2	-22.3	43.5	-35.8
Transportation Equipment	138.4	-69.8	8.5	-34.6	138.4	-69.9
Other machinery and equipment	34.4	-34.6	17.3	-20.2	35.6	-29.2

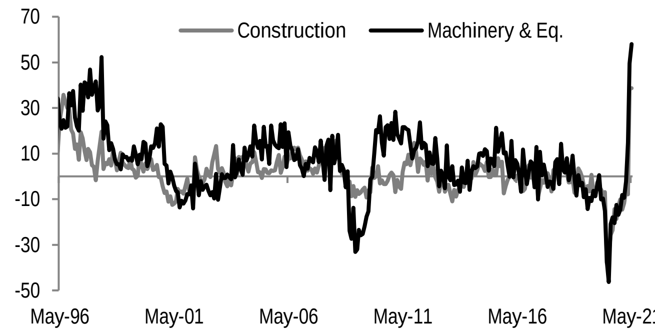
Source: INEGI

Chart 1: Gross fixed investment
% y/y



Source: INEGI

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



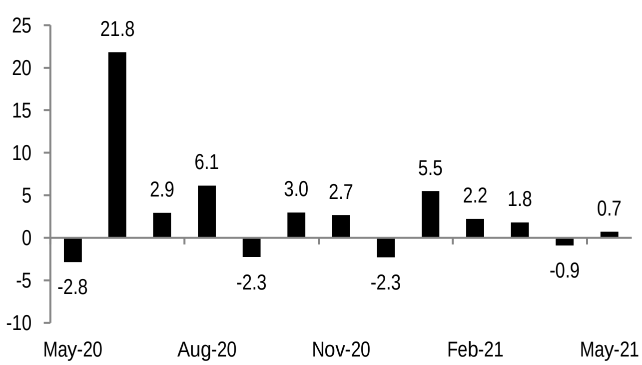
Source: INEGI

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

	% m/m			% 3m/3m	
	May-21	Apr-21	Mar-21	Mar-May**'21**	Feb-Apr**'21**
Total	0.7	-0.9	1.8	4.7	6.0
Construction	2.1	-1.2	-0.4	2.6	3.9
Residential	3.2	-2.4	-2.2	-1.0	-1.5
Non-residential	1.6	0.0	1.9	6.4	7.6
Machinery and equipment	-1.3	-0.9	3.5	5.2	6.7
Domestic	-0.2	-2.4	6.9	5.5	4.7
Transportation Equipment	6.3	-8.2	7.3	5.3	6.5
Other machinery and equipment	-6.6	5.3	8.8	8.6	5.7
Imported	-0.6	0.8	2.4	5.7	7.2
Transportation Equipment	1.3	-9.5	14.0	13.0	14.0
Other machinery and equipment	-1.5	1.8	1.5	5.0	7.2

Source: INEGI

Chart 3: Gross fixed investment
% m/m sa



Source: INEGI

Chart 4: Gross fixed investment
Index sa

Source: INEGI

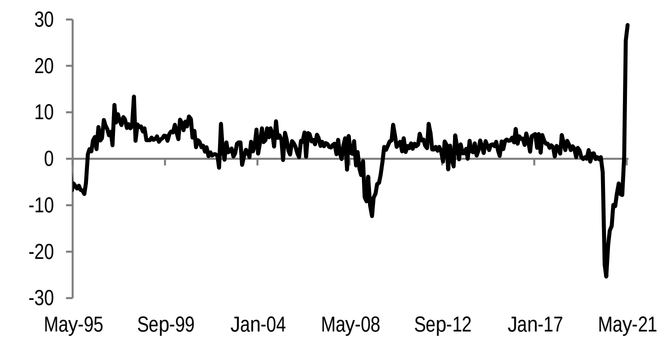
Private consumption

Table 3: Private consumption
% y/y nsa

	nsa				sa	
	May-21	May-20	Jan-**May'21**	Jan-**May'20**	May-21	May-20
Total	28.8	-25.4	5.8	-10.2	29.0	-24.3
Domestic	25.1	-23.9	3.9	-9.6	25.1	-23.2
Goods	28.9	-24.1	9.1	-9.0	29.3	-22.7
Durables	88.9	-48.0	21.5	-17.6	--	--
Semi-durables	292.2	-79.8	36.9	-37.2	--	--
Non-durables	12.4	-9.7	4.4	-2.5	--	--
Services	21.5	-23.7	-1.0	-10.2	21.4	-23.7
Imported goods	69.3	-38.0	24.1	-15.2	70.7	-33.7
Durables	147.0	-59.3	37.3	-27.5	--	--
Semi-durables	27.4	-24.8	12.3	-15.2	--	--
Non-durables	53.2	-25.8	20.8	-4.3	--	--

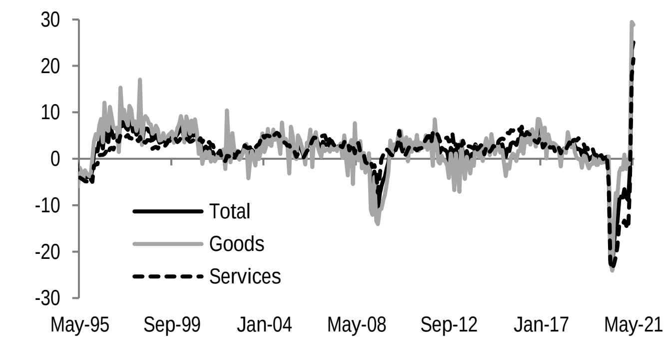
Source: INEGI

Chart 5: Private consumption
% y/y



Source: INEGI

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



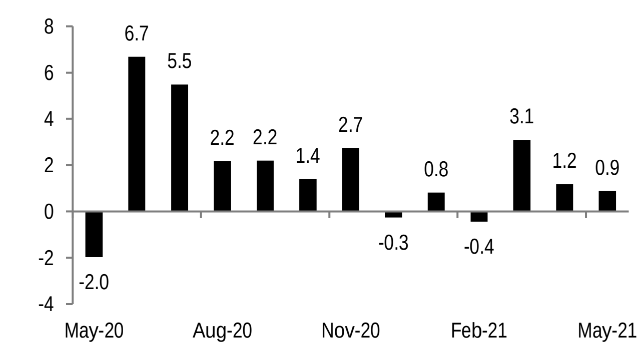
Source: INEGI

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

	% m/m			% 3m/3m	
	May-21	Apr-21	Mar-21	Mar-May**'21**	Feb-Apr**'21**
Total	0.9	1.2	3.1	4.2	2.5
Domestic	0.0	2.2	2.5	3.8	2.3
Goods	-1.0	1.8	0.6	1.8	1.6
Services	1.6	2.2	2.9	5.3	3.5
Imported goods	6.9	-3.0	6.0	6.8	4.4

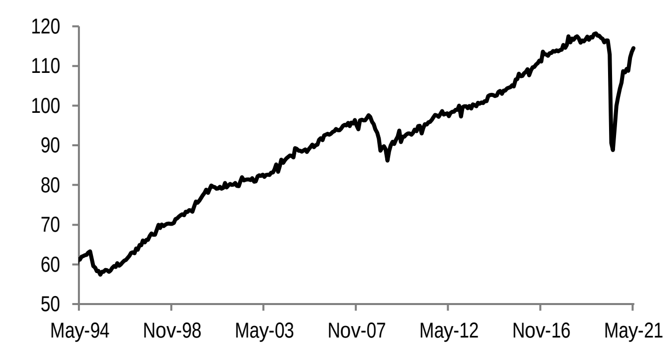
Source: INEGI

Chart 7: Private consumption
% m/m sa



Source: INEGI

Chart 8: Private consumption
Index sa



Source: INEGI

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