Industrial production – Notable rebound in July amid a challenging backdrop

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- **Industrial production (July): 7.3% y/y nsa; Banorte: 6.4%; consensus: 7.2% (range: 6.1% to 11.3%); previous: 13.5%**
- **The positive base effect continues to unwind as the reopening gathered steam in 2020. In addition, there is a slightly negative calendar effect, resulting in an 8.0% y/y expansion with seasonally adjusted figures**
- **In sequential terms, industry rebounded 1.1% m/m, with relevant gains in manufacturing (1.4%) and construction (0.6%) after declining in June. On the contrary, mining fell for a second month in a row at -0.3%. With this, activity stands 2.5% below February 2020, before the pandemic started**
- **In our view, industry remains in a challenging spot, with higher uncertainty due to the deterioration in virus conditions, prevailing supply chain issues –which will likely extend into 2022– and other idiosyncratic factors**
- **While we expect IP to end stronger in the second half of the year, risks remain tilted to the downside, especially as the pandemic and distortions related to it continue**

Industry keeps moderating in annual terms. The indicator reached 7.3% y/y (see Chart 1), higher than both consensus (7.2%) and further from our 6.4%. The base effect keeps becoming less favorable at the margin as the reopening gathered additional steam in the same period of 2020. By this point, most activities had resumed, with even those 'non-essential' restarting to some extent. Sectors most benefited the most by this remained construction and manufacturing, at 15.0% and 6.2%, respectively (see Chart 2). In turn, mining (3.2%) and utilities (4.1%) expanded more modestly, reflecting less impact last year. Calendar effects skewed figures to the downside as there was one fewer working day vs. July 2020. In this sense, growth was at 8.0% y/y with seasonally adjusted figures, better than *INEGI's Timely Indicator of Economic Activity*. For further details, please refer to Table 1.

Despite a sequential pickup, challenges remain. Industry rose 1.1% m/m, quite high albeit only recovering the accumulated loss of the past two months (Chart 3). On top of supply issues, performance was likely limited by worsening pandemic conditions (*e.g.* affecting global trade flows due to higher restrictions, such as in China and Japan) along some idiosyncratic factors. With today's result, activity stands 2.5% below February 2020, just before the pandemic struck (Chart 4). Inside, and consistent with the rebound, three out of the four categories were higher. The only one lower was mining at -0.3%, dragged by the oil sector at -0.4%. This is consistent with timely data from Pemex, signaling a modest decline. We should recall that there was an accident on an underwater gas pipeline in the *Ku-Maloob-Zaap* field, which likely impacted figures at the margin. On the contrary, both non-oil (+1.0%) and services related (+2.2%) bounced back after June's losses, still likely supported by high commodities prices.

Construction rose 0.6%, quite modest considering the -2.0% seen in the previous month. Civil engineering was the outperformer at 5.5%, surprising higher considering that the electoral season had already ended. Specifically, in previous years we used to see a relevant acceleration in this category in the lead up the elections, situation which did not occur in 2021. Edification expanded only 1.3%, while works related to the sector plummeted 3.9%.

Lastly, manufacturing posted the best performance at 1.4%, breaking with two months to the downside. Nevertheless, it still does not constitute a meaningful acceleration, matching activity levels similar to the ones seen in April. In our opinion, this suggests that the scarcity of raw materials keeps taking a toll on output. In this context, 19 out of 21 sectors posted a better performance, albeit with most of them corresponding to a rebound from losses in June (Table 2). The sectors with the largest increases were textiles ex. clothing (6.9%), electrical equipment (5.9%) and oil and carbon related products (5.7%). On the contrary, the two with a contraction were clothing (-0.04%) and printing (-2.4%). In a relevant note, transportation equipment rose by 0.6%, with autos still limited by the short supply of semiconductors as activity levels have a long way to go to recover to even post-pandemic highs.

Difficulties for industry will remain in place. We believe that today's expansion is not very surprising when incorporating the series of problems that goods producers are facing, both locally and globally. To the latter we must add once again problems associated with COVID-19, with available information up to August still pointing to a very challenging environment. On data already released, IMEF's manufacturing indicator fell despite a slight uptick in the 'production' component, with a relevant decline in 'deliveries' and 'new orders'. *Markit's* PMI manufacturing suggests an even deeper contraction, highlighting comments about low demand –in contrast with recent news– and export orders from the US. Purchases of goods have been affected by the scarcity of containers and raw materials, among other logistics issues. In the US, the same indicator also declined, although it has been five consecutive months above 60pts, indicating a strong expansion.

Apart from these issues, reports continue about problems due to railway blockades, as well as uncertainty because of USMCA after the Mexican government requested formally at the end of the month a consultation with the US about rules of origin in the auto sector. About the latter and the scarcity of semiconductors, the president of AMIA, Fausto Cuevas, stated that they now expect this year's production to be closer to 3 million units (as in 2020, in the middle of the pandemic), with factories operating only at 50% capacity. He also said that this could extend to the second half of 2022. In August, production reached 237,040 units, translating to a 21.4% y/y contraction. We have also had reports of additional issues in logistics due to recent hurricanes impacting the Gulf of Mexico, mainly on transportation in eastern US.

In mining there are also other factors suggesting difficulties. Among them, we recall the explosion of an oil platform and gas distribution center at the *Ku-Maloob-Zaap* complex in the coast of Campeche, on August 22nd.

According to Pemex's CEO, Octavio Romero, production was affected at 125 wells. Although the effect was temporary as the company said that all production was reestablished by August 30th, a total of 1.6 million barrels were not obtained. Also, in this sector, the company *Talos Energy* is currently on a dispute with the Mexican government over the control of the Zama oilfield, sending a dispute notice on September 3rd. Given this uncertain environment and financial challenges at the company, risks remain skewed to the downside.

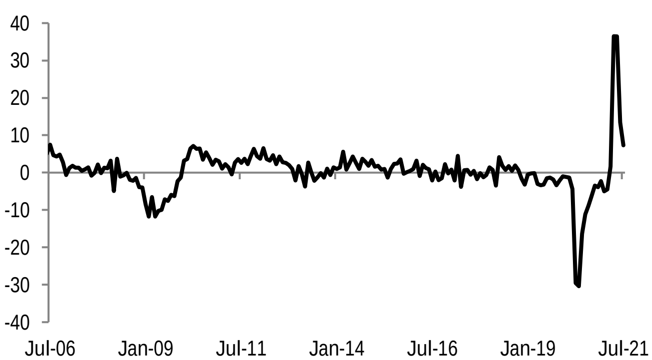
Lastly, there are also cautionary signs in construction. Gonzalo Méndez, president of the *National Chamber for Housing Development and Promotion*, CANADEVI, warned that Mexico's housing production could fall between 10% to 20% because a significant number of subcontractors have not regularized their status due to the outsourcing reform. The latter came into force this month. On the other hand, the president of the *Mexican Chamber of the Construction Industry*, Francisco Solares, argued that the reform is positive but there are several grey areas, so they are looking into the possibility of a special treatment for this industry. In terms of the public sector, the *2022 Budget* does incorporate a sizeable expansion in physical investment, mainly related to a key push on some of the priority projects, such as the Santa Lucía Airport, the Dos Bocas Refinery and the Mayan Train.

Table 1: Industrial production
% y/y nsa, % y/y sa

	nsa				sa	
	Jul-21	Jul-20	Jan-Jul'**21**	Jan-Jul'**20**	Jul-21	Jul-20
Industrial Production	7.3	-11.2	10.0	-13.4	8.0	-11.1
Mining	3.2	-3.2	1.8	-0.1	3.4	-2.9
Oil and gas	2.9	-3.3	-0.1	1.5	3.2	-3.0
Non-oil mining	2.0	-4.1	13.0	-10.2	2.2	-3.8
Services related to mining	9.8	0.6	-4.5	9.9	10.4	2.0
Utilities	4.1	-7.9	-0.2	-5.3	4.1	-7.9
Electricity	4.5	-8.9	-0.9	-5.9	4.5	-8.9
Water and gas distribution	2.7	-3.7	2.4	-3.3	2.7	-3.7
Construction	15.0	-23.6	10.2	-21.0	16.6	-22.8
Edification	15.1	-24.9	10.4	-22.2	16.7	-24.3
Civil engineering	11.4	-21.8	0.5	-19.0	11.5	-21.9
Specialized works for construction	18.1	-18.7	19.4	-17.1	20.7	-17.3
Manufacturing	6.2	-8.7	13.8	-14.8	7.0	-9.1
Food industry	4.7	-1.0	2.0	-0.3	4.7	-1.5
Beverages and tobacco	1.5	-1.1	16.0	-15.0	1.3	-0.5
Textiles - Raw materials	45.3	-37.9	44.7	-40.2	47.8	-37.7
Textiles - Finished products ex clothing	14.4	-11.1	22.8	-21.3	13.9	-10.3
Textiles - Clothing	39.6	-44.4	28.2	-39.6	41.3	-43.5
Leather and substitutes	22.3	-37.4	31.2	-41.4	24.5	-37.0
Woodworking	28.3	-18.4	19.8	-20.2	28.4	-18.1
Paper	12.7	-7.7	9.8	-7.8	13.4	-7.6
Printing and related products	29.1	-28.8	19.3	-19.7	31.6	-28.7
Oil- and carbon-related products	37.3	-32.4	18.1	-10.4	37.3	-32.6
Chemicals	2.9	-8.6	-1.0	-5.3	3.6	-8.2
Plastics and rubber	19.3	-11.4	25.0	-16.7	21.0	-11.3
Non-metallic mineral goods production	10.2	-9.4	17.9	-13.3	10.3	-9.6
Basic metal industries	22.3	-18.8	14.6	-12.7	22.6	-18.5
Metal-based goods production	12.0	-7.8	24.3	-17.4	13.5	-7.5
Machinery and equipment	20.7	-23.5	22.6	-23.9	24.1	-24.4
Computer, communications, electronic, and other hardware	2.2	-1.1	13.6	-10.9	1.0	-1.6
Electric hardware	20.3	-1.5	24.8	-6.7	20.8	-1.7
Transportation equipment	-8.2	-8.3	26.7	-31.2	-6.4	-10.0
Furniture, mattresses and blinds	21.6	-11.5	34.7	-25.4	23.3	-11.0
Other manufacturing industries	13.6	-12.3	12.9	-14.3	15.1	-12.5

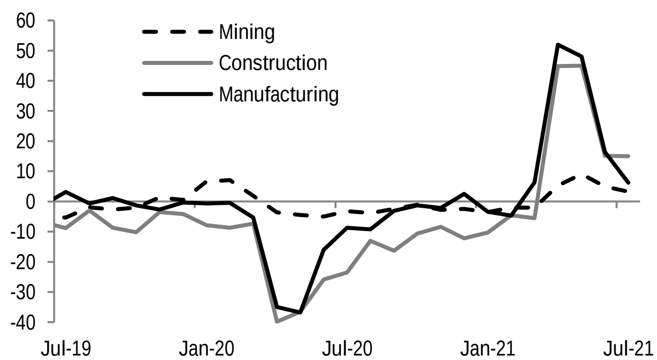
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



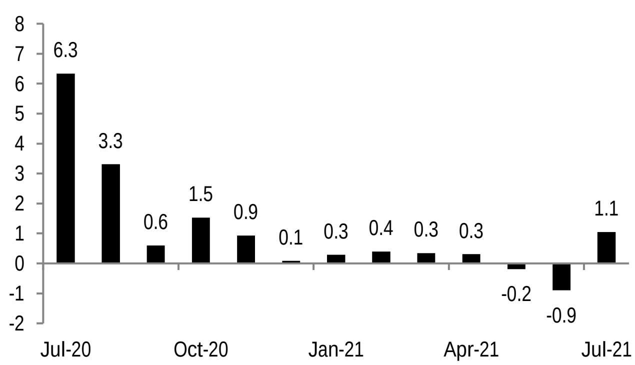
Source: INEGI

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

	% m/m			% 3m/3m	
	Jul-21	Jun-21	May-21	May-Jul'21	Apr-Jun'21
Industrial Production	1.1	-0.9	-0.2	-0.1	0.2
Mining	-0.3	-0.9	0.7	-0.7	-0.4
Oil and gas	-0.4	-0.7	0.2	-0.8	0.0
Non-oil mining	1.0	-1.1	1.2	-2.5	-4.4
Services related to mining	2.2	-2.4	3.3	5.0	6.5
Utilities	1.4	-0.6	1.3	2.5	1.7
Electricity	2.2	-0.7	1.8	3.1	1.7
Water and gas distribution	-1.2	-0.2	-0.2	0.3	1.7
Construction	0.6	-2.0	1.5	0.1	0.8
Edification	1.3	-3.7	3.0	-0.1	0.2
Civil engineering	5.5	-2.5	-0.3	-1.2	-1.1
Specialized works for construction	-3.9	3.0	-1.5	1.2	3.1
Manufacturing	1.4	-0.1	-1.3	0.3	0.7
Food industry	0.2	1.3	0.4	2.0	1.8
Beverages and tobacco	4.1	-1.8	0.0	0.0	-1.8
Textiles - Raw materials	1.4	1.3	-1.2	3.6	5.1
Textiles - Finished products ex clothing	6.9	-1.3	7.7	0.5	-5.9
Textiles - Clothing	0.0	-0.6	3.8	6.8	9.0
Leather and substitutes	1.0	1.4	1.0	1.1	-1.0
Woodworking	2.3	5.8	1.5	4.8	4.1
Paper	1.5	-1.8	-2.5	3.4	8.3
Printing and related products	-2.4	1.1	21.6	6.6	-2.5
Oil- and carbon-related products	5.7	-6.4	6.5	-9.3	-14.8
Chemicals	2.1	1.1	-1.3	0.9	-0.2
Plastics and rubber	2.4	-0.3	1.9	4.1	3.4
Non-metallic mineral goods production	0.4	-0.2	-1.2	-1.2	-0.6
Basic metal industries	1.4	-2.2	0.4	0.8	1.1
Metal-based goods production	3.3	1.9	-1.0	0.4	-0.3
Machinery and equipment	0.2	3.1	0.3	0.9	0.1
Computer, communications, electronic, and other hardware	0.1	0.6	-2.6	-2.1	-1.7
Electric hardware	5.9	-5.4	-2.3	-0.4	2.8
Transportation equipment	0.6	-0.9	-5.6	-2.2	0.0
Furniture, mattresses and blinds	1.1	-0.1	18.1	8.6	-0.3
Other manufacturing industries	1.4	-4.8	8.7	5.5	4.8

Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa

Source: INEGI

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