Aggregate supply and demand – A positive second quarter, but risks building ahead

September 20, 2021

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- **Aggregate supply and demand (2Q21): 23.3% y/y (nsa); Banorte: 25.8%; consensus: 24.8% (range: 24.4% to 25.8%); previous: -2.9%**
- **All components grew sizably in annual terms, recalling the deep distortions from lockdowns in the same period last year, as well as other calendar effects related to the timing of the *Easter* holiday**
- **In sequential terms, aggregate supply and demand rose 1.2% q/q. Inside, we highlight growth in consumption (1.9%) and exports (2.9%), the latter despite supply chain issues. Imports (0.2%) and investment (0.5%) were more modest, likely related to some uncertainty due to the pandemic**
- **We maintain our 6.2% GDP forecast for 2021, albeit with some downside risks due to signals of potential weakness in the recovery of domestic demand and persistent issues in industry**

Aggregate supply and demand surges in annual terms in 2Q21. These grew 23.3% y/y, lower than our forecast (25.8%) and consensus (24.8%). As mentioned in other occasions, annual figures are distorted by several factors, including: (1) One more working day in the annual comparison due to the leap year in 2020 as well as the timing of the Easter holiday; and (2) strict lockdowns, especially in April and May 2020. Despite of the former, growth with seasonally adjusted figures came in at the same 23.3% y/y level (Chart 1). Back to nsa figures and focusing on supply, GDP expanded 19.6% y/y, as already published. Imports were weaker than our expectations, up 35.1%, with goods (34.5%) lower than services (51.9%) due to base effects, as seen in Table 1. On demand, exports advanced 41.9% (Chart 4), accelerating at the margin and in our view aided by the recovery in external demand. Meanwhile, consumption stood at 22.6%, slightly lower than the monthly indicator. We believe this component was helped by a better environment regarding COVID-19, also reflected in the improvement of mobility levels during most of the quarter. Goods were up 28.4% and services by 20.0%. Moreover, investment advanced 34.1% (Chart 3). Performance was rather lackluster, with ups and downs in construction and some prevailing weakness in machinery and equipment. Lastly, government spending was quite strong at 3.9%, despite current spending by the Federal government falling 8.9% y/y in real terms, as well as social payment programs being brought forward to 1Q21 due to electoral season rules and higher health spending in the same period last year due to COVID-19.

Sequential dynamics show that the recovery continued, albeit mixed among components. Aggregate supply and demand grew 1.2% q/q, moderating vs. the +2.0% of 1Q21 (Table 2). This is likely related to a more challenging base as the recovery matures, even despite more favorable epidemiological conditions throughout the period. Even so, this seems to have had a different impact across categories, with some having a more relevant outperformance than others.

In this context, within demand, consumption expanded 1.9%, likely benefited by a wider reopening. While the imported component was still stronger at 3.1%, performance in the domestic sector was also favorable at 2.6% (Chart 5). In our view, the spread across both sectors continues to narrow after widening strongly across 2020 due to the distortions triggered by the pandemic. We also believe that stronger fundamentals have been a key support.

Investment was relatively muted at 0.5%. Looking at the breakdown there were some surprises, with the public component outperforming at 2.3% and the private sector rising only 0.2% (Chart 6). While this is likely influenced by past prints, we believe there were other factors at play, such as: (1) Supply chain disruptions impacting some of the investment in machinery and equipment; (2) added uncertainty, including some related to the pandemic but others also of a more idiosyncratic nature; and (3) and acceleration in public works ahead of the June 6th election, especially at the state and municipal levels. Also boosted by this last point, government spending expanded 2.9%, its largest increase since 1Q20 (see Chart 7). According to recent data from INEGI, most of the value added into this category seems to come from local governments, which we believe was key to explain performance in the quarter.

Going to supply, imports were somewhat muted at 0.2%, likely skewed by the considerable expansion in the previous quarter (Chart 8). In our view, some weakness might be due to supply restrictions (*e.g.* semiconductors and other key raw materials), while productive processes continue to adjust to life after the pandemic. In this context, and briefly turning back to demand, inventories declined sharply (-28.1%), suggesting that companies turned to existing stock instead of importing additional goods. Lastly, and as already been reported, GDP rose 1.5%, with services leading higher.

More cautious about 3Q21. We think today's results were mostly favorable despite being below our expectations, with a better overall backdrop –both globally and locally– that aided the continuation of the recovery from the COVID-19 slump. In our view, the most relevant drivers included: (1) High stimulus in the US, both fiscal and monetary; (2) the decline in virus cases as the winter receded and 'delta' was still not so prevalent; and (3) fewer temporary shocks, such as the lack of gas during several days in February. Nevertheless, we have had some signals about a more protracted slowdown, especially in domestic demand. In this respect, we will look closely to upcoming hard data, such as retail sales for July on Friday, as well as non-oil consumption and capital goods imports in the trade balance and the unemployment rate for August next week.

In this regard, we think the most important short-term risk for consumption has to do with still high inflation, with the headline likely climbing further at least for the rest of the year. In turn, this may at least dampen recent employment gains. On the virus, a local peak in daily cases was reached near the end of August, a situation that may help confidence at the margin late in the quarter.

Overall, fundamentals remain favorable, so we believe the slowdown could be relatively modest and driven mainly by increased cautiousness among consumers. We believe another meaningful insight about the effective state of the reopening is likely to be seen in the sequential performance of services, especially as the latest mobility data remains resilient. Going into 2022, we highlight the possibility of additional sizable growth in remittances, as well as the government's proposal to increase direct transfers to vulnerable groups (*e.g.* to the elderly and students) as part of its social policies, as potential tailwinds.

On investment, we continue seeing this component as a relative laggard. Uncertainty about USMCA has increased, while goods producers keep facing several challenges related to supply chain restrictions. To the best of our knowledge, several of them look likely to continue for the rest of the year and into 2022. Although demand from abroad remains vigorous, limitations on raw materials may also affect capital spending. We will also keep monitoring the government's plans on this, including the approval of resources to key projects in the *2022 Budget* proposal. In this sense, the MoF's Chief Economist, Iván Cajeme Villareal, stated in the conference call that they plan to accelerate expenditures in the *Santa Lucía Airport* and *Mayan Train* next year. Moreover, we are waiting for the release of the third package of public-private partnerships. Although favorable, news so far suggests a limited amount near 0.3% of GDP.

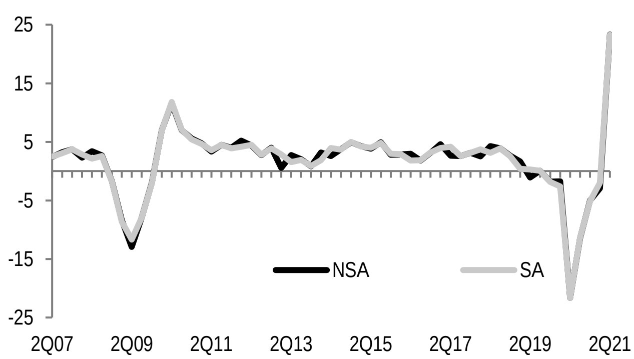
We maintain our 6.2% GDP forecast for 2021 and at 3.0% next year. Nevertheless, we see some downside risks in both due to the factors mentioned above. Specifically, we may well have an added impact in store because of the new wave of COVID-19 (including in trade dynamics) and less stimulus measures in the US, at least in the short term. In this sense, we see potential weakness ahead in the recovery of domestic demand and persistent issues in industry which may dampen growth.

Table 1: Aggregate demand
% y/y nsa, % y/y sa

	% y/y nsa						% y/y sa	
	2Q21	1Q21	2Q20	1Q20	Jan-**Jun'21**	Jan-**Jun'20**	2Q21	2Q20
Aggregate supply	23.3	-2.9	-21.7	-1.8	8.8	-11.8	23.3	-21.7
GDP	19.6	-3.6	-18.7	-1.3	6.9	-10.1	19.5	-18.8
Imports	35.1	-1.1	-29.7	-3.1	14.4	-16.6	35.3	-29.5
Goods	34.5	0.2	-28.8	-2.7	15.0	-16.0	--	--
Services	51.9	-25.7	-46.8	-10.8	1.0	-27.6	--	--
Aggregate demand	23.3	-2.9	-21.7	-1.8	8.8	-11.8	23.3	-21.7
Private consumption	22.6	-4.3	-21.0	-0.7	7.7	-10.9	22.3	-21.1
Domestic	21.5	-6.7	-21.3	-0.8	5.8	-11.1	21.1	-21.5
Goods	23.3	-1.1	-19.6	-0.1	9.8	-9.8	22.9	-19.7
Services	19.6	-11.9	-23.0	-1.5	2.0	-12.3	19.6	-23.0
Imported	55.2	7.6	-31.1	-1.9	27.3	-16.6	55.3	-31.1
Goods	53.9	8.9	-30.0	-1.5	27.7	-15.8	--	--
Services	163.6	-36.0	-70.1	-14.7	9.2	-39.9	--	--
Government spending	3.9	-0.7	2.1	3.2	1.6	2.6	3.7	2.0
Investment	34.1	-5.0	-33.7	-8.8	11.1	-21.0	34.2	-33.8
Private	39.5	-4.8	-36.6	-9.0	13.0	-22.6	39.6	-36.7
Public	5.3	-6.1	-12.0	-7.2	-0.9	-9.4	5.2	-11.8
Exports	41.9	-4.1	-30.5	1.7	15.5	-15.1	41.8	-30.7
Goods	37.7	-1.3	-27.4	2.6	15.8	-13.2	--	--
Services	207.2	-41.1	-73.6	-9.0	10.0	-39.5	--	--
Inventories	7.8	56.3	-24.8	-14.9	37.4	-19.1	9.5	-22.6
Statistical discrepancy	-137.2	-134.6	-790.7	-326.7	-138.4	--	--	--

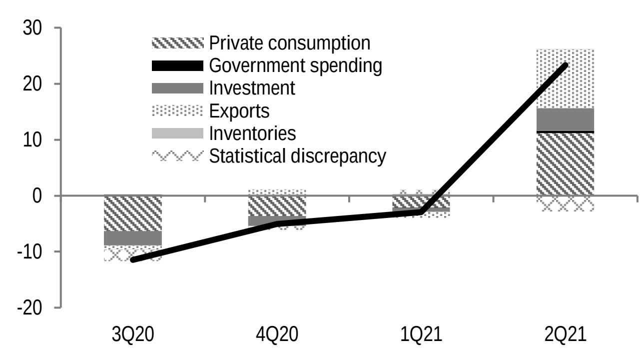
Source: INEGI

Chart 1: Aggregate demand
% y/y nsa, % y/y sa



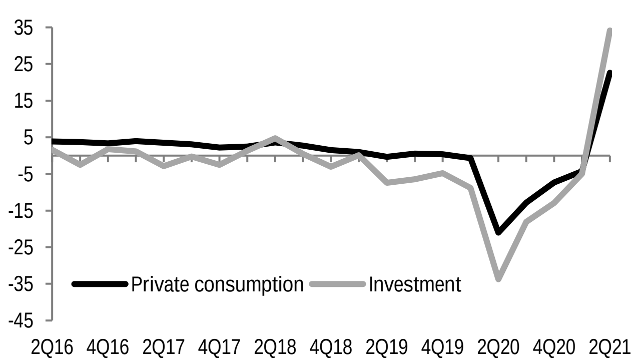
Source: INEGI

Chart 2: Aggregate demand
% y/y, contribution to the annual change, nsa



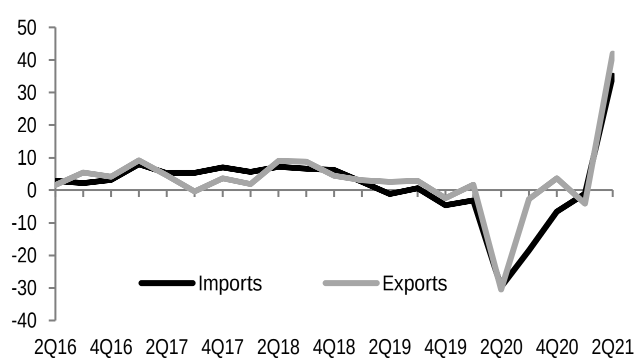
Source: INEGI

Chart 3: Private consumption and investment
% y/y nsa



Source: INEGI

Chart 4: Exports and imports
% y/y nsa



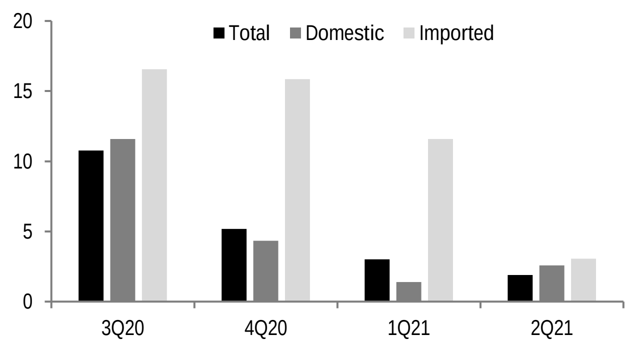
Source: INEGI

Table 2: Aggregate supply and demand
% q/q sa, % q/q saar

	% q/q sa				% q/q saar	
	2Q21	1Q21	4Q20	3Q20	2Q21	1Q21
Aggregate supply	1.2	2.0	5.2	13.5	4.9	8.4
GDP	1.5	1.1	3.3	12.7	6.0	4.5
Imports	0.2	5.5	9.5	16.8	0.8	24.0
Aggregate demand	1.2	2.0	5.2	13.5	4.9	8.4
Private consumption	1.9	3.0	5.2	10.8	7.8	12.6
Domestic	2.6	1.4	4.3	11.6	10.8	5.7
Goods	0.6	1.0	3.9	16.5	2.3	4.1
Services	5.2	2.3	4.6	6.2	22.5	9.6
Imported	3.1	11.6	15.9	16.6	12.8	55.0
Government spending	2.6	0.8	-0.1	0.3	10.6	3.4
Investment	0.5	4.8	3.8	22.7	2.0	20.7
Private	0.2	6.0	4.0	26.3	0.9	26.3
Public	2.3	0.0	2.3	0.5	9.5	0.0
Exports	2.9	-2.8	1.2	39.9	12.3	-10.7
Inventories	-28.1	39.1	-16.9	31.8	-73.3	274.4

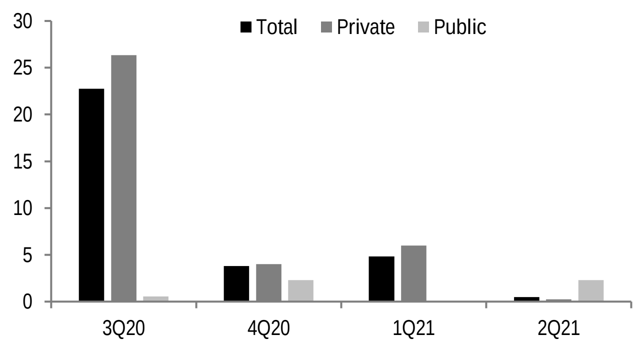
Source: INEGI

Chart 5: Private consumption
% q/q sa



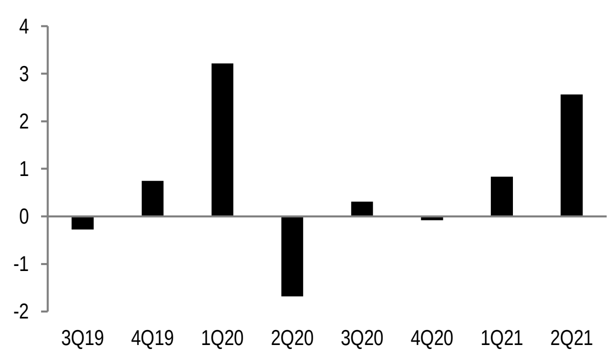
Source: INEGI

Chart 6: Investment
% q/q sa



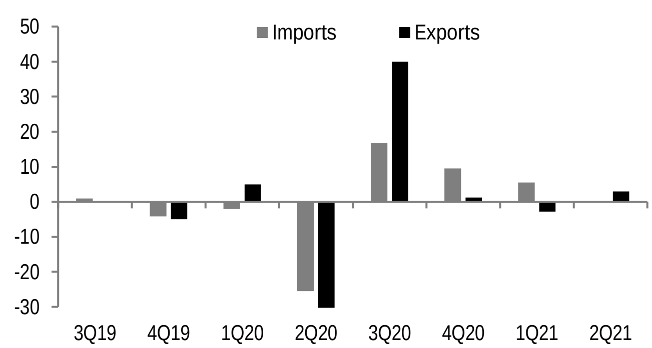
Source: INEGI

Chart 7: Government spending
% q/q sa



Source: INEGI

Chart 8: Exports and imports
% q/q sa



Source: INEGI

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