Mixed domestic demand in July, influenced by virus conditions

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- **Gross fixed investment (July): 15.7% y/y (nsa); Banorte: 14.9%; consensus: 15.1% (range: 10.3% to 20.5%); previous: 16.9%**
- **Private consumption (July): 11.9% y/y (nsa); previous: 19.1%**
- **Investment rose 2.1% m/m, more than enough to reverse the -1.8% seen in June. All components were higher, noting a strong performance in machinery and equipment (+4.5%), with construction more modest at the margin (+2.1%)**
- **Consumption expanded just 0.1% m/m, not offsetting the -0.7% from the previous month. In our view, this suggests that worsening virus conditions did influence activity. All subcomponents were negative except for domestic goods (+1.8%)**
- **We believe activity will maintain a positive trend through the remainder of the year. Nevertheless, the 'third wave' of COVID-19 likely hindered performance throughout 3Q21**

GFI rebounded in July. Investment came in at 15.7% y/y (see Chart 1), above both our forecast and consensus. As in other indicators, annual figures continue showing a downward trend, consistent with a broader recovery in 2020. In this sense, both construction (14.2%) and machinery and equipment (17.5%) maintained large expansions (Chart 2). To isolate for these distortions, we turn to sequential data, which is much more useful to measure the degree and state of the recovery.

In this sense, using seasonally adjusted figures, investment expanded 2.1% m/m (Chart 3), more than compensating from the previous month loss (-1.8%). While positive, it is still not enough to signal a complete recovery, in our view still affected by: (1) Uncertainty surrounding progress of COVID-19 and its impact; (2) prevailing supply restrictions, limiting potential investments; and (3) idiosyncratic factors. In our view, these are having a different effect across sectors. Overall, activity stands 16.0% below its all-time high in July 2018 and -2.0% vs. February 2020 (Chart 4). By sectors, construction rose 2.1%, boosted by the non-residential sector (3.0%), which seems correlated with the strong performance in civil engineering in the IP report. As mentioned in other releases, this seems unusual considering the electoral calendar. The residential sector was more modest at 1.3%, still better in terms of the accumulated recovery. Machinery and equipment were stronger at 4.5%, more than compensating for losses in the previous three months. Performance was favorable across sectors, albeit stronger in the imported component at 7.5% (Table 2), broadly in line with capital goods imports in the trade balance. Inside, 'other' was relatively stronger at 14.0%, with transportation lower at -8.0%, likely impacted by semiconductor shortages which have plagued auto production. Meanwhile, the domestic component expanded 1.0%, still relatively lagged. The breakdown shows a similar story but with more modest adjustments, with 'others' (3.6%) outperforming transportation (-2.5%).

Consumption barely grew, suggesting weakness. Consumption came in at 11.9% y/y (Chart 5). As in GFI, annual figures continue losing steam, trend that will extend in coming months. Inside, the base effect was still stronger in imported goods at 31.3%, with domestic ones up 5.8% (Chart 6). In either case, both durable and semi-durable categories remain strong, as seen in Table 3. In a similar manner, domestic services stood at 14.3%.

With seasonally adjusted figures, consumption barely grew 0.1% m/m (Chart 7), which is low considering the -0.7% of the previous month. In our view, this is mainly a result of the deterioration in COVID-19 dynamics, increasing cautiousness among consumer about the possible impact of the latest wave. Moreover, by the end of the month the 'traffic light' indicator worsened, which could have had an additional impact. We also believe there was an adverse effect from price pressures. In this backdrop, all categories backtracked except domestic goods (+1.8%), as seen in Table 4. On the contrary, weakness was concentrated in domestic services (-1.2%) and imported goods (-1.8%), consistent with the abovementioned narrative. With these results, consumption is 4.5% below its all-time high (June 2019) and -2.7% to February 2020 (Chart 8).

We expect a recovery through the end of the year, albeit with some weakness. We believe today's report suggests the 'third wave' of COVID-19 impacted activity. However, it seems to have been more modest relative to previous spikes, at least until July. In this sense, more timely data suggests a further slowdown in August, with mixed signals for September. This coincides with a substantial worsening in epidemiological conditions, with cases reaching an all-time high through the middle of August and slowing down afterwards. However, and possibly helping to explain the more modest impact, mobility has remained resilient, with levels hovering below pre-pandemic levels.

In this context, there were employment losses in the primary and industrial sectors in August, with modest gains in services. Available trade balance data suggests an impact to both consumption and investment. Non-oil consumption goods imports fell 5.7% m/m after the -0.9% seen in July. Meanwhile, capital goods imports plunged 2.5%, following up a 5.0% expansion. While this signals that investment might be in a better position, we remain cautious about this.

Specifically, we believe consumption might be poised for a faster rebound as epidemiological conditions improve. This is partly based on timely data, such as IMEF's PMIs –with non-manufacturing an inch above contraction– and still strong fundamentals, especially remittances. In addition, pent-up demand for services –including tourism– could come back relatively quickly as cases fall. This is especially relevant as the winter holiday season approaches, possibly drawing foreign visitors. As such, the main challenge continues to be price pressures, with the positive effects from the recently enacted price ceiling to LP gas fading quickly and increases in relevant categories across both the core and non-core components. This could result in lower disposable income for consumers, having to reroute more resources for basic needs, which tend to have less value added.

For investment, the outlook continues to be challenging. For starters, manufacturing is still under pressure due to the lack of raw materials, which continues hindering investment in some areas (*e.g.* transportation). In addition, high costs (*e.g.* iron ore prices and several industrial commodities, along shipping rates) could also be affecting others. This comes on top of other idiosyncratic factors that could continue weighing on investors, including ongoing disputes on USMCA and railway blockades. On a positive note, the *2022 Budget* incorporates the largest amount of public spending since 2009. However, this comes after a long period of underperformance, with public investment's latest peak in 1Q09. As such, the boost may be relatively modest, especially if a slowdown is seen in 2023, which is likely considering spending plans in some key infrastructure projects.

All in all, we expect the recovery trend to continue towards the end of the year. Nevertheless, considering the recent slowdown and other headwinds to activity, we believe risks to our 6.2% GDP forecasts for 2021 are tilted to the downside.

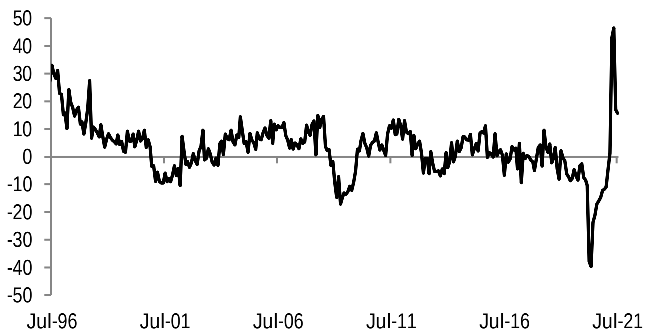
Gross Fixed Investment

Table 1: Gross fixed investment
% y/y nsa

	nsa				sa	
	Jul-21	Jul-20	Jan-Jul'**21**	Jan-Jul'**20**	Jul-21	Jul-20
Total	15.7	-21.2	11.7	-21.0	17.0	-21.0
Construction	14.2	-23.7	7.2	-19.8	14.6	-23.2
Residential	16.3	-23.3	12.8	-21.3	16.5	-23.1
Non-residential	11.9	-24.0	1.6	-18.1	12.2	-23.8
Machinery and equipment	17.5	-17.9	18.2	-22.8	20.2	-17.5
Domestic	9.9	-22.8	19.4	-27.6	11.5	-23.2
Transportation Equipment	0.6	-23.6	15.7	-32.4	1.4	-24.1
Other machinery and equipment	23.5	-21.5	24.7	-19.7	25.3	-21.0
Imported	22.2	-14.6	17.5	-19.5	26.7	-13.3
Transportation Equipment	10.5	-35.2	14.6	-37.2	9.2	-35.9
Other machinery and equipment	23.7	-10.9	17.9	-16.4	29.1	-9.3

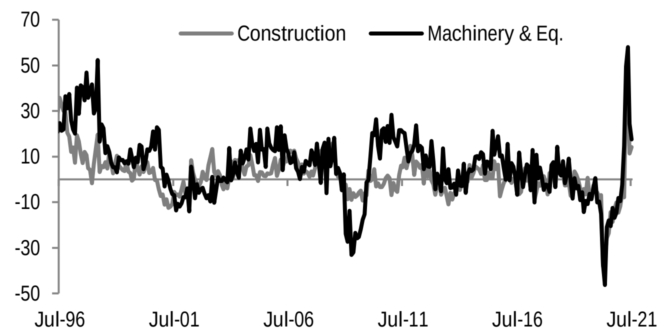
Source: INEGI

Chart 1: Gross fixed investment
% y/y



Source: INEGI

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



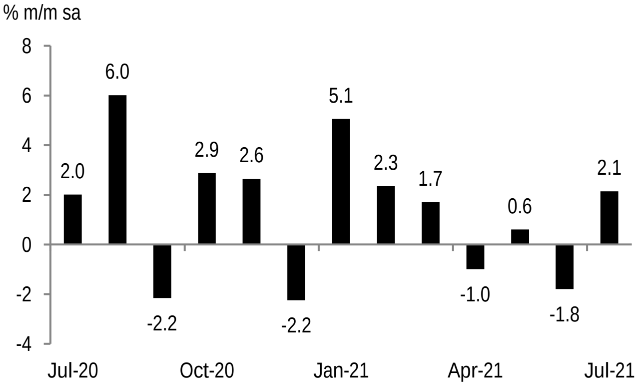
Source: INEGI

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

	% m/m			% 3m/3m	
	Jul-21	Jun-21	May-21	May-Jul'**21**	Apr-Jun'**21**
Total	2.1	-1.8	0.6	0.0	0.7
Construction	2.1	-2.6	1.5	-0.8	-0.9
Residential	1.3	-4.4	2.6	-2.4	-3.1
Non-residential	3.0	-4.4	1.0	-0.7	0.6
Machinery and equipment	4.5	-0.7	-0.1	1.1	1.5
Domestic	1.0	-1.5	-0.7	0.2	1.8
Transportation Equipment	-2.5	-3.2	5.9	-1.0	-2.1
Other machinery and equipment	3.6	-0.6	-6.1	0.7	5.8
Imported	7.5	0.0	0.8	3.4	2.2
Transportation Equipment	-8.0	3.5	0.8	-2.6	1.2
Other machinery and equipment	14.0	-2.9	-0.3	2.8	0.6

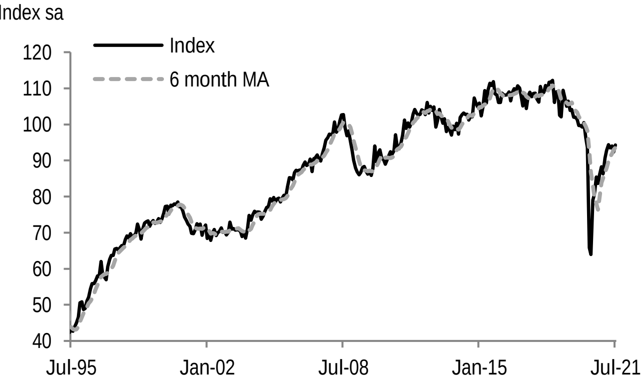
Source: INEGI

Chart 3: Gross fixed investment
% m/m sa



Source: INEGI

Chart 4: Gross fixed investment
Index sa



Source: INEGI

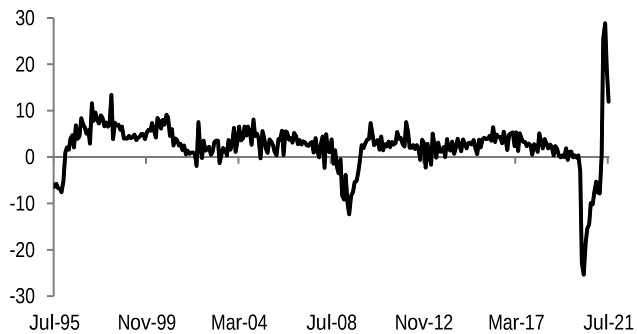
Private consumption

Table 3: Private consumption
% y/y nsa

	nsa				sa	
	Jul-21	Jul-20	Jan-**Jul'21**	Jan-**Jul'20**	Jul-21	Jul-20
Total	11.9	19.1	-15.5	8.4	12.8	-15.4
Domestic	9.9	16.1	-14.5	6.4	10.4	-14.4
Goods	5.8	13.0	-7.4	9.2	6.3	-7.5
Durables	18.1	40.2	-18.6	23.5	--	--
Semi-durables	13.7	47.5	-24.4	34.5	--	--
Non-durables	3.3	6.1	-2.7	4.4	--	--
Services	14.3	19.4	-21.1	3.6	14.5	-21.0
Imported goods	31.3	48.3	-23.3	28.2	36.4	-22.1
Durables	40.5	95.0	-36.8	44.3	--	--
Semi-durables	28.3	35.3	-25.4	17.5	--	--
Non-durables	27.3	29.5	-11.2	23.0	--	--

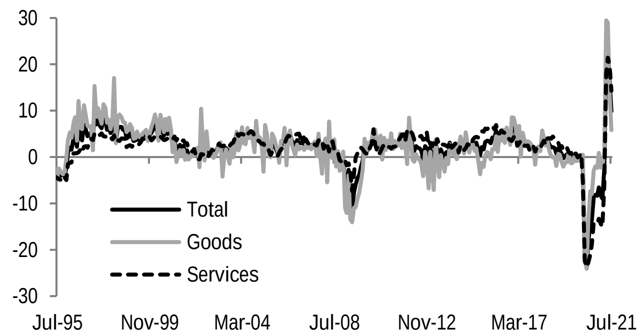
Source: INEGI

Chart 5: Private consumption
% y/y



Source: INEGI

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



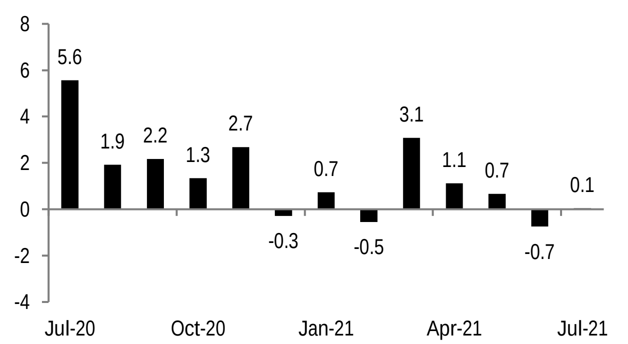
Source: INEGI

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

	% m/m			% 3m/3m	
	Jul-21	Jun-21	May-21	May-Jul**'21**	Apr-Jun**'21**
Total	0.1	-0.7	0.7	1.9	3.2
Domestic	0.1	-0.6	-0.3	1.6	3.3
Goods	1.8	-2.0	-1.3	-0.7	0.6
Services	-1.2	0.3	1.1	3.2	4.9
Imported goods	-1.8	-1.0	6.0	5.3	5.0

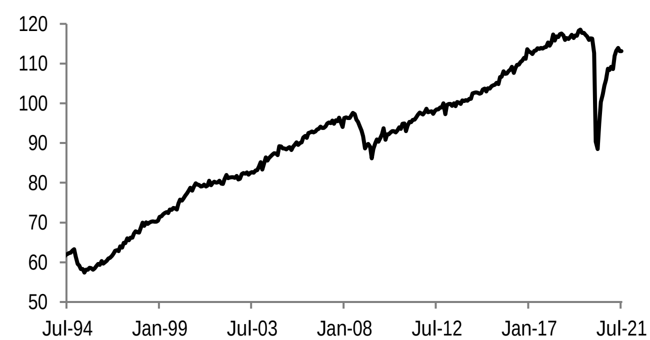
Source: INEGI

Chart 7: Private consumption
% m/m sa



Source: INEGI

Chart 8: Private consumption
Index sa



Source: INEGI

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