Industrial production – Pause in September after the recent rebound

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- **Industrial production (September): -6.2% y/y nsa; Banorte: -5.9%; consensus: -6.2% (range: -7.3% to -5.8%); previous: -9.0%**
- **This figure was higher for a fourth consecutive month. Performance was slightly below our forecast, which in turn was stronger than the implied figure within the 3Q20 preliminary report. On a year-to-date basis, industry has declined by 12.2% y/y**
- **In monthly terms, industry was unchanged at 0.0%, with construction lagging after surging in August. With this, total activity is around 7.1% lower than in February, before the pandemic hit**
- **Mining stood at 0.2%, with oil inching higher by the same magnitude and non-oil up 0.4%. This slowdown was observed even with reports suggesting no major impacts from storms during the period**
- **Construction backtracked 5.6% after the 11.9% shown in the previous month. This was a result of a 9.0% dip in edification, more closely related to the private sector. Civil engineering was also negative, at -0.7%**
- **Manufacturing surprised higher, accelerating to +2.4% (previous: +0.8%). By industry, we highlight transportation (5.1%) and clothing (6.1%) to the upside. Meanwhile, machinery and equipment declined 1.9% and beverages fell 2.2%**
- **In our view, risks to the recovery in 4Q20 have increased as external demand may be impacted by the evolution of COVID-19 and the lack of additional fiscal stimulus in the US**

Industrial activity improved further in September. The headline figure came in at -6.2% y/y (see Chart 1), in line with consensus (-6.2%) but below our -5.9%. Although there were mixed revisions to the previous months, the result was virtually equal to the implied figure for the period in the 3Q20 preliminary GDP report. Moreover, it was stronger for a fourth consecutive month in the annual comparison, although it should be recalled that it had a positive calendar effect due to one more working day. Correcting for the latter (using seasonally adjusted figures), activity fell 7.5% y/y (previous: -8.2%). Going back to original data, we highlight that construction weakened again after a strong upward surprise in the previous month, standing at -16.1% y/y (Chart 2), with a correction lower of 7.0%-pts in edification. In contrast, manufacturing was quite positive, at -3.1%, with a better performance across the board as all sectors were higher than in August. Meanwhile, mining –which has been more stable since the pandemic broke– reached -2.8% (Table 1). Within the latter, oil was unchanged at the margin (-2.3%) despite a somewhat more difficult base effect. Non-oil and services related to the sector picked up modestly, at +1.8% and -15.6%, in the same order. With these figures, industrial activity accumulates a -12.2% y/y decline in the first three quarters of the year.

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A pause in the sequential recovery, with a mixed performance across sectors. Industry was flat at 0.0% m/m (Chart 3), pausing after three consecutive months of strong gains following the reopening of the economy. Although the slowdown was to be expected given more difficult base effects, it was more sizable than we expected –marginally negative at two decimal places–. In this sense, in absolute terms activity remains at levels similar to those seen in 2010, just in the aftermath of the Great Financial Crisis (Chart 4). Moreover, total activity is around 7.1% lower than in February, before the pandemic hit.

This was mainly due to a strong reversal lower in construction, at -5.6% after surging 11.9% in August. Specifically, edification backtracked 9.0%, while civil engineering was more stable, at -0.7% (Table 2). We believe this suggests that headwinds for domestic demand remain elevated, with this sector likely limiting a stronger recovery. Despite high volatility in recent months, it is still around 16.5% lower than before the pandemic, which increases our cautiousness about the likelihood of more sustained gains. Going into mining, oil was more modest (0.2%) was also more modest, even despite not showing great distortions in the period due to climate conditions. This points that both global and local conditions remain difficult for this component, which is very sensible to the outlook for economic growth. The non-oil sector was higher (0.4%), in our view also limited by the latter factor. On a more positive note, manufacturing kept showing very high resiliency, accelerating to 2.4% from 0.8% in August. By industry, we highlight transportation (5.1%) and clothing (6.1%) to the upside. Meanwhile, machinery and equipment declined 1.9% and beverages fell 2.2%, with only two more sectors out of 21 in negative territory.

Cautious about the recovery on risks building up in 4Q20. Despite today's more modest outcome, industry has been stronger than expected in recent months. In this backdrop, we also highlight that the IMEF manufacturing in October picked up to 50.1pts, above the threshold for expansion or contraction for the first time since May 2019, led by the 'new orders' and 'production' subcomponents. This suggests that the relative strength in manufacturing could extend. Other indicators in the US, such as the ISM manufacturing –at highs in little over two years– and vehicle sales, also reinforce this notion. Specifically, the auto sector could continue moving higher despite the accumulated gains since reopening activities. On the contrary, the IMEF non-manufacturing –where construction is accounted for– fell to 47.7pts, consistent with some stagnation in mobility levels and practically in persistent contraction since May 2019.

We expect the recovery to continue, albeit at a more modest pace and with several risks in the short-term. Broadly speaking, we highlight two: (1) The recent evolution of COVID-19 cases, which could lead to new supply-chain disruptions, more so as winter approaches; and (2) the lack of fiscal stimulus in the US, which could impact demand from that country. With Biden winning the presidential election but a high likelihood that the Senate will remain with the Republicans, an approval this year looks very hard. Moreover, idiosyncratic factors could also limit performance.

In manufacturing, auto production rebounded strongly in October according to AMIA, up 11.8% y/y from -5.5% in the previous month. Although this is favorable, reports warn of some problems due to COVID-19. For example, the auto parts industry in Chihuahua could have been affected by epidemiological conditions returning to 'red' in the traffic-light indicator (since October 26th). Industry participants have said there is no "Plan B" in place to cope with this. Durango also returned to this color at the beginning of November. Meanwhile, Nuevo León has also seen an acceleration in cases, although companies in the state have ruled out closures as they already comply with sanitary and distancing measures. Even if we do not anticipate closures as stringent as before, the possibility of disruptions is present. In the idiosyncratic front, railway blockades continue in Michoacán since the beginning of October, impacting the transportation of goods by several industries nationwide.

In mining, we anticipate an adverse effect at least in October from bad weather. Specifically, we note the possible impact from hurricanes Delta –which entered the Yucatán Peninsula as Category 4 on October 6th– and Zeta –by the end of the month–. In this backdrop, news state that: (1) Pemex stopped sending personnel to offshore locations in Ciudad del Carmen, Campeche, since the beginning of the period; and (2) according to *Bloomberg*, Mexican exports of crude oil reached a minimum of at least two years in October, as Pemex's main oil terminals were shut for about a third of the month due to bad weather. Although temporary, these represent additional headwinds a rebound of oil production, which is important given its high relative weight in the sector.

Lastly, available data in construction has remained relatively positive, although dynamics have been very volatile and suggest that challenges remain high. Among the former: (1) Business confidence kept climbing in October, reaching a seven-month high, including in the 'adequate moment to invest' component; (2) the aggregate trend indicator has shown similar dynamics, improving for both contractors and subcontractors; and (3) housing credit has been much more positive relative to other sectors. About today's result, we note that one more working day for the sector was allowed in Mexico City in September, which nonetheless did not boost the result significantly. Moreover, the state's governor, Claudia Sheinbaum, warned recently that new restrictions could be imposed given higher virus cases. Lastly, president López-Obrador stated that the government will soon announce a new package of public-private investments, which could also be favorable at the margin, albeit likely materializing until next year.

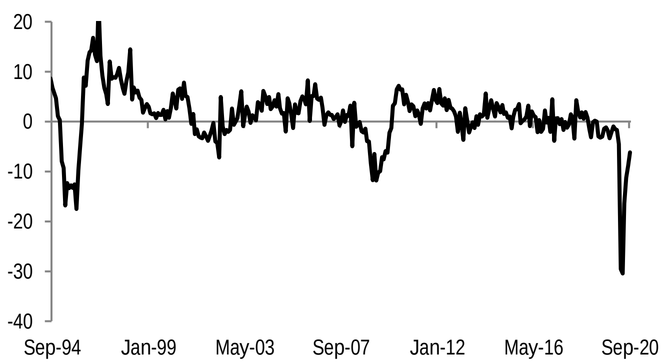
All in all, we believe that risks for the recovery have increased for 4Q20. In this backdrop, we maintain our view of a higher annual rate in industrial activity for the quarter, at -7.0% y/y from -8.8% in 3Q20. In this environment, we should also say that the incremental effect of the additional reopening of activities will likely be more modest given the rebound already accumulated in the last months.

Table 1: Industrial production
% y/y nsa

	Sep-20	Sep-19	Jan-Sep'**20**	Jan-Sep'**19**
Industrial Production	-6.2	-1.7	-12.2	-1.5
Mining	-2.8	-2.4	-0.8	-5.8
Oil and gas	-2.3	-5.5	0.7	-9.0
Non-oil mining	1.8	-3.3	-7.7	-3.4
Services related to mining	-15.6	30.9	3.2	16.9
Utilities	-7.2	0.9	-5.3	-1.4
Electricity	-8.5	2.0	-5.9	-0.9
Water and gas distribution	-1.5	-3.5	-3.1	-3.1
Construction	-16.1	-8.9	-19.6	-4.8
Edification	-16.5	-8.9	-19.1	-2.7
Civil engineering	-25.8	-7.8	-26.4	-8.8
Specialized works for construction	-1.3	-10.5	-14.0	-10.5
Manufacturing	-3.1	1.4	-13.1	1.3
Food industry	1.1	1.9	-0.5	2.2
Beverages and tobacco	1.3	5.2	-11.1	3.4
Textiles - Raw materials	-21.3	-5.3	-36.5	-3.1
Textiles - Finished products ex clothing	0.2	-12.1	-17.8	-2.2
Textiles - Clothing	-28.6	1.8	-37.8	-2.4
Leather and substitutes	-25.2	-3.4	-38.6	-2.2
Woodworking	-9.3	-1.9	-18.2	-0.1
Paper	0.0	-1.4	-6.6	0.4
Printing and related products	-14.8	-2.3	-19.5	-9.2
Oil- and carbon-related products	0.8	0.7	-9.3	-5.7
Chemicals	-4.3	-1.8	-5.2	-3.1
Plastics and rubber	0.0	-1.3	-13.8	-2.3
Non-metallic mineral goods production	-0.6	-0.6	-10.9	-0.5
Basic metal industries	-3.7	1.6	-12.0	-2.7
Metal-based goods production	-2.0	7.2	-14.3	3.1
Machinery and equipment	-12.9	1.5	-21.8	0.9
Computer, communications, electronic, and other hardware	1.3	3.4	-9.0	5.7
Electric hardware	9.0	-0.7	-3.8	-1.5
Transportation equipment	-6.0	2.4	-27.5	4.4
Furniture, mattresses and blinds	-5.5	-6.1	-21.6	-4.3
Other manufacturing industries	-6.6	-0.7	-12.7	-3.4

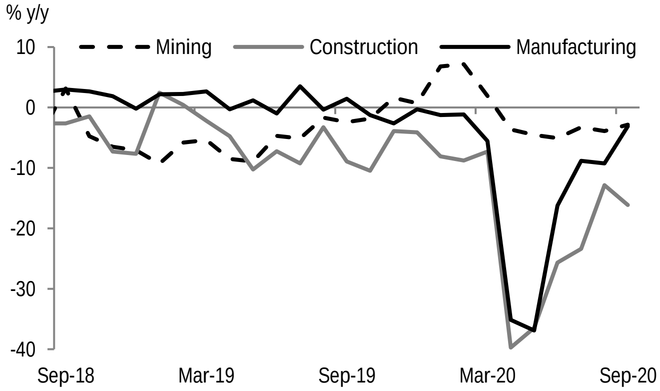
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



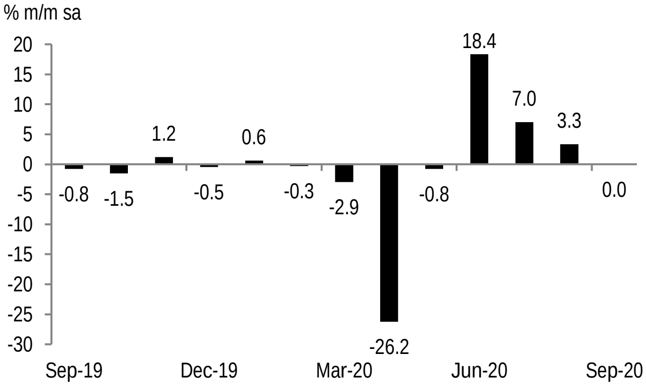
Source: INEGI

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

	% m/m			% 3m/3m	
	Sep-20	Aug-20	Jul-20	Jul-Sep'**20**	Jun-Aug'**20**
Industrial Production	0.0	3.3	7.0	21.7	11.4
Mining	0.2	1.4	1.1	2.4	-0.6
Oil and gas	0.2	1.8	-0.3	-1.5	-4.2
Non-oil mining	0.4	2.0	10.3	30.3	21.6
Services related to mining	-1.0	-4.2	1.8	-5.2	-4.9
Utilities	-3.1	5.5	5.6	5.2	-0.8
Electricity	-3.9	6.7	7.2	6.2	-1.3
Water and gas distribution	0.6	1.1	0.2	1.9	0.6
Construction	-5.6	11.9	0.7	19.4	6.3
Edification	-9.0	16.4	0.5	24.9	9.5
Civil engineering	-0.7	2.8	-0.4	1.5	-5.6
Specialized works for construction	7.6	7.0	2.0	18.4	5.1
Manufacturing	2.4	0.8	11.5	31.6	19.3
Food industry	1.2	-0.9	0.9	0.5	-0.6
Beverages and tobacco	-2.2	1.8	19.7	46.3	31.0
Textiles - Raw materials	2.8	13.0	29.0	109.5	33.0
Textiles - Finished products ex clothing	1.2	2.4	24.1	64.1	31.1
Textiles - Clothing	6.1	13.3	40.7	114.5	20.0
Leather and substitutes	3.7	7.3	35.5	168.8	53.2
Woodworking	-1.1	6.0	11.7	32.8	17.5
Paper	1.4	3.9	8.0	10.1	0.4
Printing and related products	-1.2	13.8	12.3	29.8	2.4
Oil- and carbon-related products	21.7	15.0	-19.9	-5.1	-8.8
Chemicals	0.0	2.8	3.5	5.5	-0.2
Plastics and rubber	1.3	6.7	12.0	39.8	23.0
Non-metallic mineral goods production	0.8	6.4	10.8	36.7	20.1
Basic metal industries	12.3	5.3	7.9	12.6	-4.2
Metal-based goods production	0.6	1.6	30.7	51.4	23.2
Machinery and equipment	-1.9	8.1	1.8	30.1	20.4
Computer, communications, electronic, and other hardware	3.3	-4.2	9.6	22.1	16.5
Electric hardware	4.9	2.9	20.2	22.8	5.2
Transportation equipment	5.1	-2.9	25.1	155.8	121.3
Furniture, mattresses and blinds	0.9	2.2	19.4	81.0	53.8
Other manufacturing industries	1.5	6.8	9.8	22.2	7.7

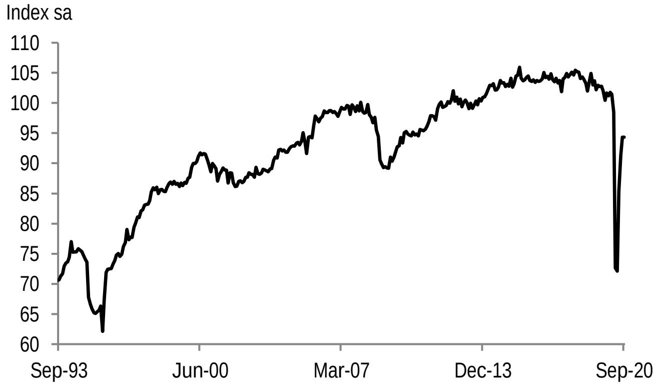
Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa



Source: INEGI

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