Industrial production – Stronger headwinds in June

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- **Industrial production (June): 13.5% y/y nsa; Banorte: 14.5%; consensus: 15.5% (range: 13.6% to 25.9%); previous: 36.4%**
- **Relative to the previous two months, the positive base effect starts to unwind, as the reopening started in June 2020, noting the designation of key sectors as essential. With seasonally adjusted data, activity grew 13.6% y/y**
- **In sequential terms, industry declined 0.5% m/m, with broad losses, highlighting construction (-2.0%) and mining (-0.8%). Meanwhile, manufacturing was more modest albeit with a third month lower at -0.1%. With this, activity stands 3.4% below February 2020, before the pandemic started**
- **In our view, industry has stagnated after having led the recovery since the reopening started. This has been partly a result of supply-chain issues –which could be extending beyond manufacturing– and probable distortions due to the increase in COVID-19 cases, among other factors**
- **Today's print implies a 27.9% y/y expansion in IP in 2Q21 (+0.3% q/q). Risks prevail ahead due to supply issues, virus dynamics, and other idiosyncratic factors**

Industry moderates in annual terms as the base effect is less favorable. The indicator reached 13.5% y/y (see Chart 1), below consensus (15.5%) but closer to our 14.5%. Relative to the previous two months, the base effect becomes less favorable as the reopening started in the same month of 2020. In that occasion some key industries were added to the list of essential activities –such as construction and some categories within manufacturing–, boosting their output. Specifically, these grew 15.2% and 16.3%, respectively (see Chart 2). Meanwhile, the base effect is more stable for both utilities (7.1%) and mining (5.0%). On the latter, our country was still part of the OPEC+ agreement last year, slashing production by 100kbpd. Calendar effects where relatively negligible, with the same number or working days in the annual comparison. As such, growth using seasonally adjusted figures is quite similar at 13.6% y/y, weaker than implied both by INEGI's *Timely Indicator of Economic Activity* and the preliminary GDP. For details, please refer to Table 1.

Negative marginal performance, with construction leading lower. Industry fell 0.5% m/m, with lingering weakness for at least the three previous months (Chart 3). In our view, this is related to supply issues that surfaced since late last year, with some of them exacerbating through 2021. This comes on top of worsening virus conditions globally since late May –and which have exacerbated further until today–, along other negative factors. With today's result, activity stands 3.4% below February 2020, just before the pandemic struck (Chart 4).

Construction was weakest at -2.0%, erasing the 1.5% expansion from the previous month. Inside, losses were driven by both edification (-3.5%) and civil engineering (-1.7%), while specialized works rose 3.0%. In our view, this suggests that a rocky path for the sector seems to be the norm, expecting high volatility in sequential data. In addition, the decline in civil engineering might be related to the end of the electoral season, likely remaining muted going forward except for advances in key projects of the Federal Government.

Meanwhile, mining backtracked 0.8% after two months higher. The adjustment was driven by services related to the sector (-2.4%), albeit with weakness in both oil (-0.7%) and non-oil (-0.6%). In particular, the slight decline in the former contrasts with signs of stability within Pemex's output in both crude oil and gas, albeit likely influenced by ongoing problems by the state-owned company. Meanwhile, on the latter there were some reports of union workers taking ¿ some of the facilities, demanding better safety conditions and higher wages.

Lastly, manufacturing fell more modestly at -0.1%. However, this marks a third month in contraction, in our view highly impacted by the scarcity of raw materials. In this context, 12 out of the 21 sectors had a sequential decline (Table 2), with some of the most exposed to the latter extending further down such as autos (-1.0%), electrical equipment (-5.5%) and basic metals (-2.3%), among others. Meanwhile, other sectors that are most isolated like the food industry (+1.6%) remain skewed to the upside. Some volatility persists across sectors, with base effects being key to determine some of their performance.

The outlook remains very uncertain. Today's report is consistent with other timely indicators that point to weakness in activity during the month. In addition, it implies a slight downward revision for industry within 2Q21 GDP, now at 27.9% y/y (preliminary: 28.2%). In turn, this would result in a 0.3% q/q expansion (preliminary 0.4%) with seasonally adjusted data. As we have said previously, the most salient risk remains supply-chain issues, most relevant for manufacturing. Among them, the shortage of semiconductors has grabbed headlines the most and still looks some time away to be resolved. According to the CEO of one of the main chipmakers for autos, they expect the supply constraint to extend into 2022, especially as the industry pivots to more electric cars. In a similar manner, according to AMIA, the global supply of semiconductors could normalize at least until the end of 2021, worse than projected at the beginning of the year. On more immediate developments, IMEF's manufacturing PMI for July was unchanged at 52.2pts, while *Markit*'s metric rose slightly, to 49.6pts. Specifically, the latter report assures that production was still impacted by the lack of raw materials – albeit at a more modest pace than previously– while backlogs kept increasing. Nevertheless, July's auto production came in at 222.8 thousand units, implying a 26.5% y/y contraction and lower relative to June in absolute terms. While most of the deceleration is likely related to stoppages –with at least 3 firms reporting shutdowns–, we should also mention that there was some scheduled retooling, such as Mazda late in the month. Turning to August, at least GM and Toyota announced additional stoppages and likely others joined them. On a more positive note, Audi resumed production of one of its vehicles, while Honda is working overtime in its Guanajuato plant to make up for previous losses.

On more idiosyncratic issues, railway blockades in Michoacán continued intermittently during July and so far in August. Signals from this are not being taken lightly, with *Kansas City Southern* –one of the main train operators in the country– announcing no new investments in the state due to prevailing and constant disruptions. In this context, Oscar del Cueto, president of the *Mexican Association of Railway Operators* stated that cargo that used to arrive to the Lázaro Cardenas port (in said state) is now being redirected to the US due to transportation problems. On regulatory issues, disputes continue between Mexico / Canada and the US regarding the auto sector and rules of origin. While meetings between top diplomats have taken place (including between Economy Minister Tatiana Clouthier and Secretary of Commerce Gina Raimondo), an agreement has not been reached. We should remember that autos face a 2.5% import tax if they don't comply with the legislation, while light trucks go as high as 25%. While we expect an eventual agreement, we remain highly vigilant on the outcome considering the importance of the sector.

On mining, after a fire in a gas duct in the *Ku-Maloob-Zaap* field (one of the most important of the country) in early July, Pemex has mentioned they expect it to come back online in early August. While it isn't clear if production in the field continued using other transportation methods, we do believe a hit is likely. On the other hand, President López Obrador recently stated that the cost of extraction has fallen and now is closer to US$3 per barrel in some fields. However, some analysts think this might be a tall order, as they stood at around US$11 last year. In our view, some of these problems, along the recent downgrade of the company's credit rating by Moody's, keeps reflecting a challenging outlook, in which a substantial production increase is unlikely. In non-oil, some blockades continue from union workers, albeit with improvements in recent days, as several sites have reopened, including one from Canadian miners, *Equinox Gold*. In addition, high prices in key metals should continue fostering higher production, with producers looking to capitalize on them.

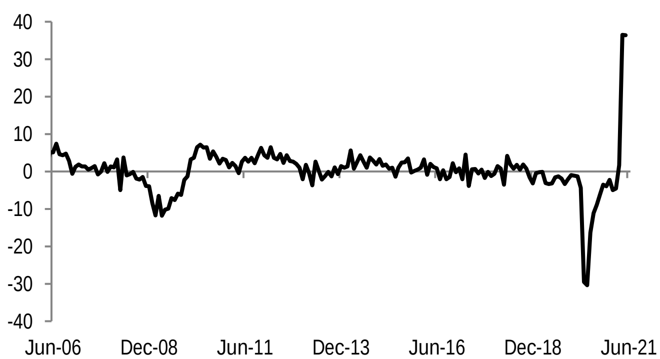
Lastly, timely data from business confidence and the aggregate trend indicator for construction in July kept ticking up, with gains across all components. While it is not strongly correlated to monthly performance, it suggests that the recovery trend might extend further. On news, progress on key infrastructure projects seems to have accelerated, specifically on the *Santa Lucía* Airport, which has neared a 62% advance. Moreover, the head of the *Mexican Construction Industry Chamber* (CMIC, in Spanish), Francisco Solares, continued pushing for a greater role of the private sector in public works, stating that they have been displaced by the *Army* in many instances. A potential aid to partially alleviate this could be a new public-private infrastructure plan that is arguably on the works and should be unveiled soon, as stated recently by President López Obrador.

Table 1: Industrial production
% y/y nsa

	Jun-21	Jun-20	Jan-Jun'**21**	Jan-Jun'**20**
Industrial Production	13.5	-16.3	10.5	-13.8
Mining	5.0	-5.0	1.6	0.4
Oil and gas	3.5	-2.9	-0.6	2.4
Non-oil mining	11.5	-11.4	15.2	-11.2
Services related to mining	3.4	-6.2	-5.9	10.9
Utilities	7.1	-12.6	-0.9	-4.8
Electricity	7.8	-14.7	-1.9	-5.3
Water and gas distribution	4.6	-4.3	2.3	-3.2
Construction	15.2	-25.9	9.5	-20.6
Edification	14.1	-27.6	9.7	-21.8
Civil engineering	1.2	-21.9	-1.2	-18.6
Specialized works for construction	36.9	-20.9	19.6	-16.8
Manufacturing	16.3	-16.0	15.2	-15.9
Food industry	5.5	-0.9	1.6	-0.2
Beverages and tobacco	14.2	-15.2	19.2	-17.5
Textiles - Raw materials	80.0	-50.8	44.6	-40.6
Textiles - Finished products ex clothing	29.7	-25.2	24.4	-23.0
Textiles - Clothing	98.7	-57.5	26.4	-38.7
Leather and substitutes	68.4	-52.3	32.9	-42.1
Woodworking	37.8	-25.4	18.3	-20.5
Paper	19.7	-13.6	9.4	-7.8
Printing and related products	55.6	-30.6	17.6	-17.8
Oil- and carbon-related products	-0.1	-11.0	15.5	-6.2
Chemicals	2.7	-8.0	-1.7	-4.7
Plastics and rubber	29.0	-17.5	26.1	-17.6
Non-metallic mineral goods production	21.4	-16.7	19.4	-14.0
Basic metal industries	29.1	-19.1	13.5	-11.7
Metal-based goods production	39.1	-25.2	26.7	-19.1
Machinery and equipment	27.4	-21.4	23.0	-24.0
Computer, communications, electronic, and other hardware	9.3	-11.3	15.8	-12.5
Electric hardware	33.2	-16.5	25.6	-7.5
Transportation equipment	16.4	-26.1	34.8	-35.0
Furniture, mattresses and blinds	44.4	-22.8	37.2	-27.6
Other manufacturing industries	25.2	-17.5	12.9	-14.6

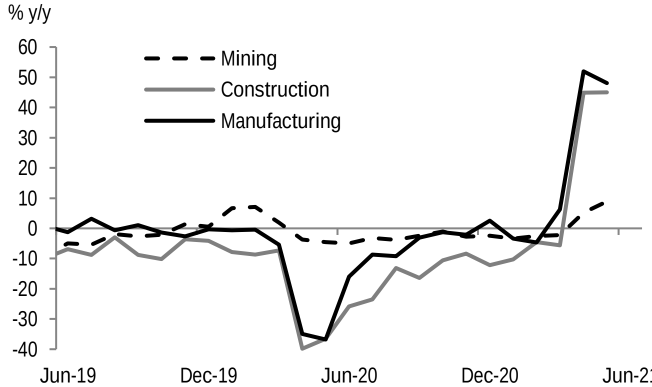
Source: INEGI

Chart 1: Industrial production
% y/y



Source: INEGI

Chart 2: Industrial production by sector
% y/y



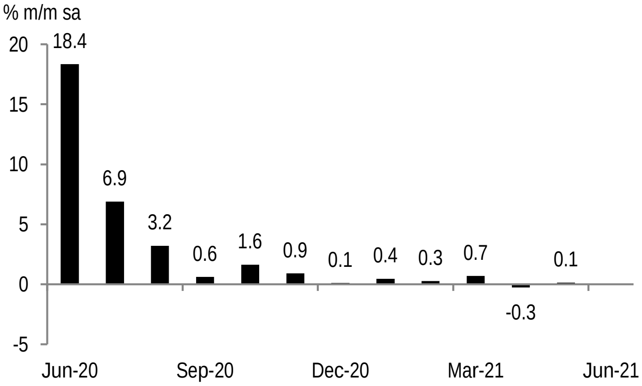
Source: INEGI

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

	% m/m			% 3m/3m	
	Jun-21	May-21	Apr-21	Apr-Jun'21	Mar-May'21
Industrial Production	-0.5	0.0	-0.4	-0.1	0.6
Mining	-0.8	0.7	0.8	-0.3	-0.3
Oil and gas	-0.7	0.3	0.4	0.0	0.5
Non-oil mining	-0.6	1.3	-0.9	-4.1	-5.3
Services related to mining	-2.4	3.1	6.0	6.2	6.8
Utilities	-0.5	1.1	-0.9	1.5	1.2
Electricity	-0.7	1.6	-1.7	1.3	1.1
Water and gas distribution	0.1	-0.2	1.6	1.9	1.6
Construction	-2.0	1.5	-0.4	0.6	2.5
Edification	-3.5	2.9	-0.7	0.0	1.5
Civil engineering	-1.7	-0.8	-4.8	-1.9	5.5
Specialized works for construction	3.0	-1.3	3.1	3.6	2.7
Manufacturing	-0.1	-0.7	-0.9	0.0	0.7
Food industry	1.6	0.4	0.5	1.8	1.1
Beverages and tobacco	-1.8	-0.1	0.1	-2.0	-0.3
Textiles - Raw materials	0.3	-1.4	1.5	3.9	4.2
Textiles - Finished products ex clothing	-1.8	6.9	-13.2	-7.2	-2.4
Textiles - Clothing	-0.9	3.8	0.6	8.6	10.5
Leather and substitutes	1.2	0.8	-3.3	-1.6	0.3
Woodworking	5.0	1.1	-1.7	3.0	1.6
Paper	-2.8	-2.1	9.6	7.8	6.1
Printing and related products	1.2	21.0	-17.7	-2.9	-1.6
Oil- and carbon-related products	-6.4	6.3	-23.2	-15.1	-1.3
Chemicals	0.6	-1.4	1.2	-0.5	-1.7
Plastics and rubber	-0.8	1.7	-0.2	2.6	1.6
Non-metallic mineral goods production	-0.2	-1.2	-1.7	-0.6	1.1
Basic metal industries	-2.3	0.3	0.6	0.9	2.1
Metal-based goods production	0.5	-0.5	-4.1	-1.1	1.8
Machinery and equipment	3.0	0.1	-6.2	-0.1	3.7
Computer, communications, electronic, and other hardware	0.9	-2.7	0.7	-1.6	-1.4
Electric hardware	-5.5	-2.6	3.2	2.2	7.0
Transportation equipment	-1.0	-3.0	-3.4	-2.2	-1.0
Furniture, mattresses and blinds	-0.5	17.6	-12.2	-1.3	-0.2
Other manufacturing industries	-4.9	8.6	0.5	4.7	3.5

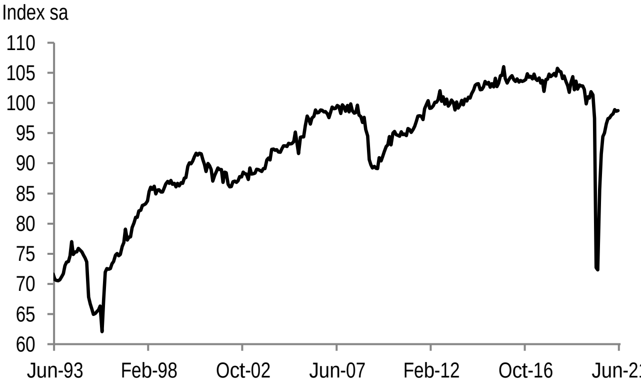
Source: INEGI

Chart 3: Industrial production
% m/m sa



Source: INEGI

Chart 4: Industrial production
Index sa



Source: INEGI

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