3Q21 GDP – Slight contraction, but the recovery will continue

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- **Gross Domestic Product (3Q21 P, nsa): 4.6% y/y; Banorte: 5.4%; consensus: 6.0% (range: 4.7% to 6.7%); previous: 19.6%**
- **Gross Domestic Product (3Q21 P, sa): -0.2% q/q; Banorte: 0.1%; consensus: 0.0% (range: -1.5% to 0.7%); previous: 1.5%**
- **The annual rate remains high because of a base effect, while calendar effects were modest. With seasonally adjusted figures, activity grew 4.8% y/y**
- **Sectors were mixed, with sequential increases in primary activities (+0.7% t/t) and industry (+0.7%), even despite persistent supply shocks in the latter. In contrast, services declined 0.6%, affected by the deterioration in epidemiological conditions**
- **According to our calculations, today's print implies activity at around -0.4% m/m in September (1.6% y/y), extending August's losses**
- **Given these results we revise our 2021 GDP estimate to 5.7% from 6.2%. In addition, we maintain our 2022 estimate at 3.0%**
- **Revised figures will be published on November 25th**

GDP below expectations, at 4.6% y/y in 3Q21. This compares to consensus at 6.0% and our forecast of 5.4%. It is also consistent with the result in August's GDP-proxy, released earlier this week. The deceleration relative to the +19.6% seen in the previous quarter is only in part because of a less favorable base effect, as the reopening gathered some traction in 2020. Nevertheless, it remained high relative to historical standards (Chart 1). Calendar effects were modest, with the same working days relative to the previous year. With seasonally adjusted figures activity grew 4.8% y/y (Table 1). In our view, performance was dragged by several factors, including (1) A deterioration in global and local epidemiological conditions throughout July and August, improving only in September; (2) persistent supply restrictions, mainly affecting auto manufacturing; (3) higher price pressures, highlighting an increase in commodities' prices in international markets, affecting households' real incomes; and (4) other adverse events, including weather-related ones. On the contrary, there was still some boost from higher demand, both from abroad but also domestically. Back to original data, primary activities stood at 0.7% y/y, industry at 5.3% and services at 4.1%, as seen in Chart 2.

Sequential decline amid a more challenging backdrop. Activity fell 0.2% q/q (Banorte: 0.1%; consensus: 0.0%), much lower than the +1.5% of 2Q21 (Chart 3). This suggests a sizable impact from the adverse factors stated above and translates to a -0.9% q/q annualized rate (Table 2), below the 2.0% in the US in the same period. With these figures, activity in 3Q21 was 3.8% below 4Q19 –before the pandemic– and 4.9% lower than its historical high, in 3Q18.

Most of the impact was in services, at -0.6% (Chart 4). Subsector data is still not known, but based on July's and August's IGAE, weakness likely centered on professional services. Meanwhile, tourism and entertainment look more uncertain, with a boost earlier in the period likely dampened later by worsening conditions. Lastly, more essential categories like education, healthcare, financial and government services might have been more stable.

Industry was more resilient, at 0.7%. The most positive surprise was construction, which showed more dynamism after lagging in previous quarters. Manufacturing has been more muted, impacted by continuous supply shocks, including an extension of previous problems (*e.g.* semiconductors) and other issues like higher delivery times on scarcity of inputs, as well as higher shipping rates on energy shortages and port closures in China. On mining, oil sector dynamics were impacted by two accidents: (1) An underwater gas fire in early July; and (2) a fire in the *Ku-Maloob-Zaap* complex in late August. The primary sector rose 0.7%, likely benefited by milder droughts despite other weather events in the quarter.

GDP implies an additional fall in September. Considering that the monthly GDP-proxy (IGAE) averaged 5.7% y/y in July-August, today's estimate implies that September was close to 1.6% y/y (nsa). According to our calculations, this would translate to a 0.4% m/m contraction. Nevertheless, there are mixed signals for the period. For example trade balance figures point to a relevant rebound. On the other hand, we cannot rule out the additional deceleration, as suggested by IMEF's PMIs and job losses. In addition, ANTAD's sales showed higher dynamism, albeit with durable goods still limited (*e.g.* such as auto sales, according to AMIA), explaining some weakness. Based on anecdotical evidence, we also think additional steam may have existed in recreational activities as people were less cautious on the virus (with consumer confidence also higher), as well as in education given the partial return to in-person classes. In industry, oil mining may pick up slightly, while manufacturing seems to have remained in a very difficult position, especially auto production.

We revise our 2021 full-year estimate to 5.7% from 6.2% previously. We think that today's report suggests a higher impact from the 'third wave'. Nevertheless, it also suggests that the magnitude of the effect each time is more limited, with the population adapting more to the pandemic. In this context, year-to-date activity stands at 6.1% y/y nsa, less than our original forecasts. Given this situation, we revise our full-year forecast to 5.7% from 6.2% previously (see Table 3 and Table 4). In addition, we maintain our 2022 forecast at 3.0%, expecting that the recovery will continue at a relatively favorable pace starting in the fourth quarter of this year.

For the latter, we consider there more upside for services relative to industry. Specifically, we believe tourism and entertainment are poised for an acceleration after the latest wave and ahead of the holiday season. In our view, the population's fatigue is still high and recent improvements in the 'traffic light' indicator (*e.g.* with Mexico City and the State of Mexico in 'green' since October 18th) will help consumption spending. These will likely ramp up also because of pent-up demand. In this sense, high-frequency mobility data has climbed back to pre-pandemic levels. Fundamentals are somewhat mixed.

The most positive is remittances, likely maintaining a brisk pace; nevertheless, employment has decelerated (but expecting it to recover as activity gathers pace) and prices remain pressured. The virus remains a key risk, albeit likely losing relevance as the vaccination process continues. In this sense, close to 54.7 million persons are already fully vaccinated (around 43% of the total population).

Risks for industry are more tangible, especially for manufacturing as the global supply crunch continues. Regarding semiconductors, problems seems far from being solved. According to industry insiders and some company executives, shortages will likely extend to 2H22 and possibly into 2023, albeit with wait-times progressively improving. In this sense, according to *Susquehanna Financial Group* (and as reported by Bloomberg), total lead times –which include the moment from when a chip is ordered until it is delivered– in October were practically unchanged at 21.9 weeks, very high but with its slowest increase in nine months. These issues get compounded with other disruptions, such as those related international prices of energy and logistics. On the former, tight supply has resulted in relevant prices hikes and added shortages in some regions, including Europe and China. On the latter, there are several issues impacting flows, including: (1) Shutdown of Chinese ports due to COVID-19 outbreaks; (2) lag in offloading on American ports (*e.g.* Los Angeles and Long Beach); (3) lack of shipping containers; and (4) persistently high fares.

Looking further ahead, fiscal stimulus in the US will be rather large relative to previous years, but less than originally contemplated by the Biden administration. While a net boost will likely remain, it affects our view at the margin on the possible windfall to our country next year. The latter, along expectations of tighter monetary policy –amid concerns about higher inflation– could also influence activity, particularly investment. Domestically, we expect inflation pressures to gradually decrease. In addition, fundamentals should strengthen –mainly employment and wage gains– as the recovery gathers pace again. Tourism –both from domestic and abroad– should accelerate as the virus gets tamed further. Another favorable factor should be minor changes to the tax code, with no tax increases –other than the usual adjustments to excise taxes– to corporations and consumers, contrary to previous expectations of a more significant overhaul.

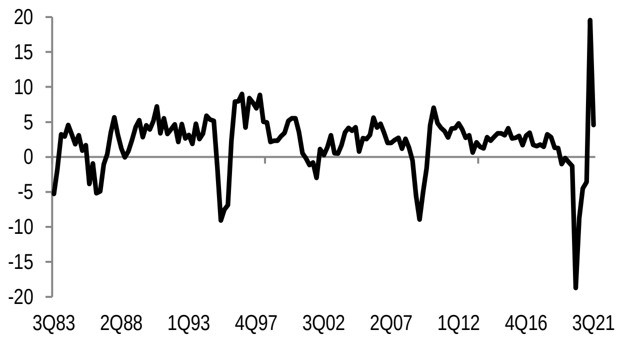
With these adjustments, we expect the economy to reach pre-pandemic levels (4Q19) on late 2Q22 vs. 1Q22 previously, reestablishing the recovery that began on 3Q20. This delay is mostly explained by the factors outlined above. On the other hand, we now see a more vigorous expansion in 2H22 as supply chain disruptions fade away and price pressures decline gradually, allowing for higher output –and consumption– globally and in our country.

Table 1: GDP
% y/y nsa, % y/y sa

	nsa						sa					
	3Q21	2Q21	3Q20	2Q20	Jan-**Sep'21**	Jan-**Sep'20**	3Q21	2Q21	3Q20	2Q20	Jan-**Sep'21**	Jan-**Sep'20**
Total	4.6	19.6	-8.7	-18.7	6.1	-9.6	4.8	19.5	-8.7	-18.8	6.4	-9.8
Agricultural	0.7	6.7	3.3	-3.9	3.4	-1.3	0.5	6.8	3.2	-3.7	3.1	-1.1
Industrial production	5.3	27.9	-8.7	-25.4	8.7	-12.1	5.4	27.9	-8.6	-25.4	9.1	-12.4
Services	4.1	17.1	-8.9	-16.3	5.2	-8.7	4.5	16.9	-8.8	-16.4	5.4	-8.8

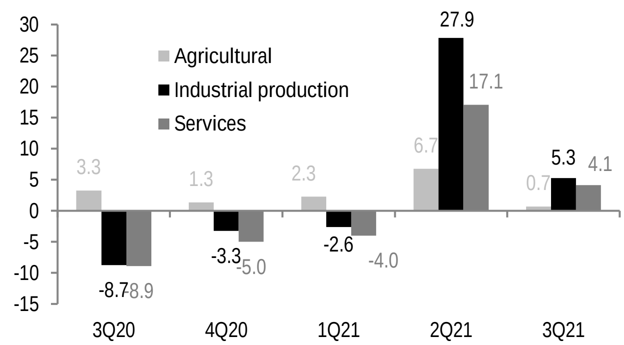
Source: INEGI

Chart 1: GDP
% y/y nsa



Source: INEGI

Chart 2: GDP by sectors
% y/y nsa



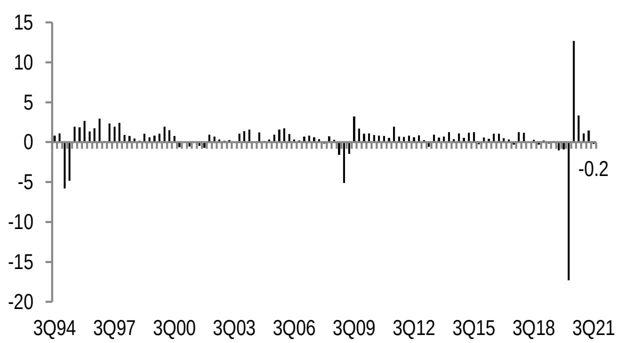
Source: INEGI

Table 2: GDP
% q/q sa, % q/q saar

	% q/q				% q/q saar			
	3Q21	2Q21	1Q21	4Q20	3Q21	2Q21	1Q21	4Q20
Total	-0.2	1.5	1.1	3.3	-0.9	6.0	4.5	14.1
Agricultural	0.7	0.8	1.1	-3.1	2.9	3.4	4.6	-11.9
Industrial Production	0.7	0.3	0.5	3.6	2.9	1.2	1.9	15.4
Services	-0.6	2.0	1.4	3.4	-2.4	8.3	5.6	14.4

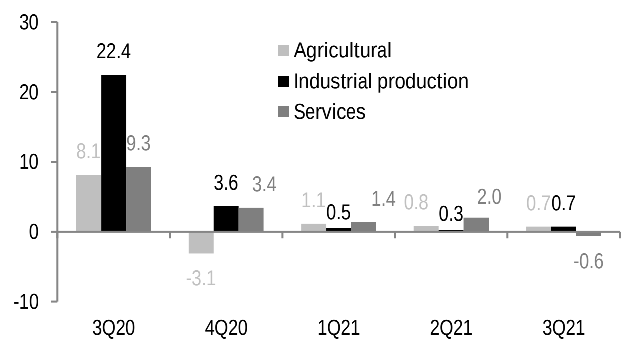
Source: INEGI

Chart 3: GDP
% q/q sa



Source: INEGI

Chart 4: GDP by sectors
% q/q sa



Source: INEGI

Table 3: GDP 2021: Supply
% y/y nsa; % q/q sa

% y/y	1Q21	2Q21	3Q21	4Q21	2021
GDP	-3.6	19.6	4.6	4.3	5.7
Agricultural	2.3	6.7	0.7	5.8	4.1
Industrial production	-2.6	27.9	5.3	3.9	7.4
Services	-4.0	17.1	4.1	4.2	4.9
% q/q					
GDP	1.1	1.5	-0.2	1.2	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

Table 4: GDP 2021: Demand
% y/y nsa; % q/q sa

% y/y	1Q21	2Q21	3Q21	4Q21	2021
GDP	-3.6	19.6	4.6	4.3	5.7
Private consumption	-4.3	22.6	8.2	6.9	7.6
Investment	-5.0	34.1	11.0	3.4	9.0
Government spending	-0.7	3.9	-1.4	2.5	1.1
Exports	-4.1	41.9	9.2	7.4	11.6
Imports	-1.1	35.1	22.5	10.0	15.2
% q/q					
GDP	1.1	1.5	-0.2	1.2	--

*Note: Underlined figures indicate forecast
Source: INEGI, Banorte

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We, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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