Industrial production – Slight contraction in July despite resilient manufacturing

September 11, 2019

www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Senior Economist, Mexico
juan.alderete.macal@banorte.com

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

- **Industrial production (July): -1.7% yoy; Banorte: -1.8%; consensus: -1.8% (range: -3.2% to -0.8%); previous: -2.9%**
- **This is the ninth consecutive month with the indicator in negative territory on an annual basis. Year-to-date, industry has declined 1.8%**
- **Activity fell 0.4% m/m after advancing 1.1% in June, suggesting that this sector started 3Q19 with a modest performance. By sector, mining was down 2.9%, construction reversed some of the previous month's gain at -1.4% and manufacturing advanced 0.2%**
- **Survey and US data suggests that performance remained low in August, in a global context characterized by several unresolved challenges, including trade tensions and weaker economic growth**
- **We believe activity will improve gradually, aided by the depreciation of the peso and as construction recovers while manufacturing stays resilient, although still anticipating a contraction in full-year 2019**

Industrial activity fell again in July. Industrial production fell 1.7% yoy, virtually in line with consensus and our forecast of -1.8%. This is the 9th consecutive month in negative territory, resulting in a 1.8% yoy decline on a year-to-date basis. Both mining and construction declined, standing at -7.5% and -8.4 %, respectively. Within the former, oil and gas production fell 10.0%, lower than what advanced data suggested as although crude-oil seems to be stabilizing sequentially on Pemex's efforts to increase production, the annual rate remains negative (-7.6%). The non-oil sector inched lower by 0.5%. Going to construction, civil-engineering projects remained weak, declining 4.6%, with this sector more related to infrastructure spending. But this is not the only spot of weakness as edification remained in contraction at -6.6% after declining 5.4% in June, although explained in part by a more challenging base-effect.

We highlight that manufacturing returned to positive territory (3.0%) after a temporary dip of 0.8% in the previous month, with its highest in a little more than one year. We see this as positive, suggesting more resiliency than anticipated based on other data that signaled a possible slowdown in external demand. In this respect, the trade balance report showed that both exports and non-oil intermediate goods imports rebounded during the period. In particular, 11 out of 21 subsectors were positive. Among them, we noted the strong rebound of 17.7% in machinery and equipment, + 6.1% in computer equipment, +6.0% in transportation, and +4.1% in the food industry, which are very relevant considering that they make up about 50% of all manufacturing. On the contrary, furniture plunged 11.1%, metallic products -7.3% and textiles by -7.1%.

Industrial production: July 2019
% yoy, nsa

	Jul-19	Jul-18	Jan-Jul, '19	Jan-Jul, '18
Total	-1.7	1.3	-1.8	0.4
Mining	-7.5	-7.2	-7.7	-6.1
Utilities	-1.0	5.2	0.3	1.9
Construction	-8.4	4.6	-4.5	2.4
Manufacturing	3.0	2.4	1.0	1.6

Source: INEGI

With seasonally-adjusted figures, activity fell 0.4% m/m. This figure comes after advancing 1.1% in June, basically unrevised from what was originally estimated. We highlight that manufacturing grew for second consecutive month at 0.2%. In particular, machinery and equipment –related to investment– led the way at 5.2%. Although this came only after a -3.6% in June, it suggests that private sector investment may be improving gradually after been very weak in 1H19. It should also be noted that oil- and carbon-related manufacturing picked up 5.9% extending its strong advances of the previous two months. On the contrary, textiles (-3.8%) and clothing (-0.4%) seem to be on a decelerating trend, with both falling since May.

Mining reversed its previous month gain as it fell 2.9%. In particular, oil (-1.9%) remains challenged, while mining-related services plunged -10.4%, although not as severe considering its high volatility and the +14.7% in June. Last but not least, construction looks to have stayed muted (-1.4%), paring back some of the previous month advance, with both edification (-0.9%) and civil-engineering (-0.6%) declining. Nevertheless, the magnitude was relatively modest considering the performance observed in June. We remain cautious on this sector despite expecting an improvement in coming months. On a 3m/3m saar basis, industrial production was at -5.2%, worse at the margin relative to June at -2.1%.

Industrial production: July 2019
% m/m, sa

	Jul-19	Jun-19	May-19
Total	-0.4	1.1	-2.5
Mining	-2.9	2.6	-1.3
Utilities	-0.7	1.2	-0.5
Construction	-1.4	3.0	-6.2
Manufacturing	0.2	0.4	-0.2

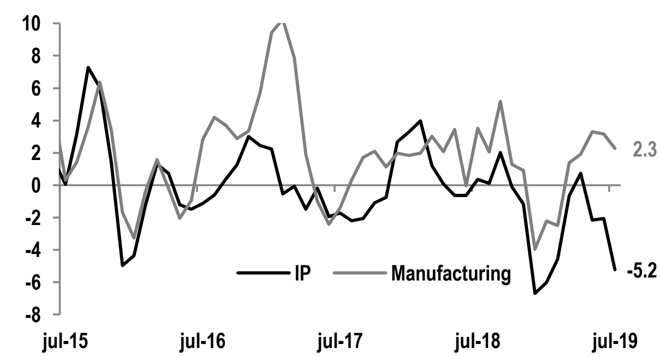
Source: INEGI

Industrial production: July 2019
% 3m/3m saar

	May-Jul'19	Apr–Jun'19
Total	**-5.2**	**-2.1**
Mining	-6.3	-6.1
Utilities	3.7	5.9
Construction	-18.7	-18.3
Manufacturing	2.3	3.2

Source: INEGI

Industrial production: Total and manufacturing
% 3m/3m saar



Source: INEGI

Industry is not out of the woods yet, despite positive manufacturing. In our view, several indicators continue to suggest that activity remains challenged. In manufacturing, both the preliminary PMI index and the ISM manufacturing in the US fell further in August when compared to the previous month, standing in contraction and at multi-year lows. This is likely to remain as a headwind for our country, given the deep integration of supply chains. Mexico's IMEF manufacturing index for the same month also dipped to 47.4pts, with previous figures revised lower –adding four months in contraction– and with the production and new orders subcomponents among those hit the hardest.

Moreover, we think trade tensions will probably be net negative for Mexico's manufacturing sector, in spite of some potential gains for our country. These could come from two main channels, in our view: (1) The depreciation of the Mexican peso, helping exports to gain relative competitiveness; and (2) the imposition of additional tariffs by the US to Chinese imports and countervailing measures by the latter country, as observed this month, providing scope for additional market share gains.

Both countries are supposedly going to renew talks soon, but skepticism remains high on this front given that recent history has been filled with temporary respite followed by further escalation. If no agreement is reached, the US is poised to increase tariffs again on October and December, with further retaliation by China. In our view, this situation, which has impacted business confidence and global growth (the IMF estimates that current and upcoming tariffs would reduce around 0.8% of global GDP) will be net negative for Mexico, even if some gains are due because of the stalemate.

In construction, we believe that the sector could show a stronger performance in 2H19, although likely limited in magnitude. Some of the sector's drags include low business confidence in an environment of high local uncertainty, relatively high financing costs, and low public spending. In our view, the last two could improve, with Banxico cutting interest rates after starting an easing cycle in August and the Federal Government accelerating infrastructure spending. Last but not least, news report affirm that Mexico's City government is aiming to accelerate the reactivation of this sector, which plunged during the first half of the month as the new administration suspended several construction projects on alleged irregularities. Business chambers also looking for a better performance.

All in all, we maintain our view of a stronger performance in coming months, albeit in a gradual fashion and not enough to make up for the decline already observed so far this year, reiterating our forecast of a 1.4% contraction in full-year 2019.

Analyst Certification.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalía Orozco Vélez, 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.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Economic Analysis			
Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Luis Leopoldo López Salinas	Analyst, Global Economist	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Fixed income and FX Strategy			
Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Corporate Debt			
Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Manager, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454