

## Industrial production – Strongly negative in May, with all sectors in contraction

- **Industrial production (May): -3.3% yoy; Banorte: -1.8%; consensus: -1.5% (range of estimates: -3.9% to -0.2%); previous: -2.8%**
- **In the monthly comparison activity fell 2.1%, paring back the 1.5% gain of the previous month. By sectors, we highlight the 6.2% decline in construction, weakest since February 2010**
- **In our view, the report confirms that industrial activity is going through a rough period, which is likely to prevail as trade tensions remain high, impacting prospects for global growth**
- **Moreover, the slowdown in US industry and low infrastructure spending by the Federal Government remain as headwinds for activity in coming months**

**Industrial activity fell sharply in May.** Industrial production fell 3.3% yoy, below consensus at -1.5% but closer to our forecast of -1.8%. This is the seventh consecutive print in negative territory in the annual comparison, with industry declining 1.6% so far this year when compared to the same period of 2018. In our view, this print makes it virtually certain that industrial activity will decline for a third consecutive quarter in 2Q19 in comparison to the same period of the previous year.

By sector, manufacturing expanded 0.7%, with only 6 components in positive territory. Among these we highlight the 7.2% advance in computers and electronic devices, the 3.3% increase in the food industry, and +3.6% in transportation, with the latter two the most favorable for the month. On the contrary, oil and carbon transformation fell 14% while printing industries plunged 15.5%. In addition, fabrication of metallic goods declined 7.8%. Mining remains very weak at -8.9% yoy, an inch higher vs. the 9.0% of the previous month. This marginal improvement is explained by the moderation in the contraction of both oil and gas production (-9.7% vs. -9.8%) and non-oil mining (-3.9% vs. -5.1%).

Construction posted a significant decrease of 9.8%, lowest since April 2009 in the midst of the financial crisis. Inside, civil-engineering projects contracted 9.5% while edification fell 8.6%. We believe the former is largely explained by the slowdown in public spending, which is typical for the first year of a new administration. In this context, figures reported by the Ministry of Finance show a contraction of 16.4% YTD in physical investment. Additionally, we believe that May's performance was also due to the suspension of construction works in Mexico City. Although we recognize that the fight against corruption and the improvement of zoning is a praiseworthy effort, unfortunately it subtracts dynamism. In this context, and based on INEGI data, construction represents around 40% of industrial production in Mexico City, which makes it account to almost 10% of the city's GDP. In addition, the overall weight of the entity is around 17.5% of the country's total added value.

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Considering the latter, and assuming that half of projects have been suspended, this simple approximation translates into a 14.6bps impact in annual GDP in the first five months of the year. In this context, we will remain very vigilant for further developments in the sector considering its importance on national GDP.

**Industrial production: May 2019**

% yoy, nsa

	May-19	May-18	Jan-May, '19	Jan-May, '18
<b>Total</b>	-3.3	0.2	-1.6	0.2
Mining	-8.9	-6.5	-8.1	-5.7
Utilities	1.6	-1.2	-0.5	1.2
Construction	-9.8	0.0	-3.2	2.3
Manufacturing	0.7	2.7	1.0	1.3

Source: INEGI

**With seasonally-adjusted figures, activity contracted 2.1%.** The decline came after advancing 1.5% in April, highest since September 2018. It should be noted that all sectors were in negative territory. In this respect, construction fell 6.2%, more than reversing the 1.1% gain of the previous print, achieving its weakest performance since February 2010. In our view, the sector remains challenged, with idiosyncratic factors at play but also with muted business confidence and high uncertainty. Also on a concerning note, manufacturing edged-down 0.2%, its first contraction in the year. Transportation was the fourth weakest by falling 3.0%, remembering that this includes auto production. Nevertheless, the food industry, which is the largest, increased 1.1%. Lastly, mining continues to weaken, falling 1.3%, with the index reaching a new low since October 1995, which looks like an outlier in the historical series.

**Industrial production: May 2019**

% m/m, sa

	May-19	Abr-19	Mar-19
<b>Total</b>	-2.1	1.4	1.4
Mining	-1.3	-0.6	-0.6
Utilities	-0.6	2.0	2.0
Construction	-6.2	1.1	1.1
Manufacturing	-0.2	0.5	0.5

Source: INEGI

On a 3m/3m saar basis, industrial production worsened to -2.2%, remembering that the previous month it stood at +0.1%. This result points to a high probability that activity will contract on a quarterly basis for the third time in a row.

**Industrial production: May 2019**

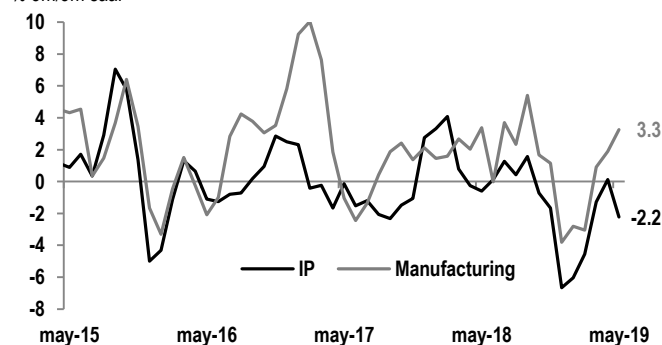
% 3m/3m saar

	Mar-May '19	Feb-Apr '19
<b>Total</b>	<b>-2.2</b>	<b>0.1</b>
Mining	-7.7	-3.1
Utilities	3.2	0.8
Construction	-18.2	-6.7
Manufacturing	3.3	1.9

Source: INEGI

**Industrial production: Total and manufacturing**

% 3m/3m saar



Source: INEGI

**The outlook for industrial activity remains challenging.** First and foremost, recent manufacturing indicators in the US, our main trading partner, remain weak. The ISM index in June declined further to 51.7pts, lowest since October 2016. In particular, the new orders component reached a neutral level of 50.0pts, a minimum in more than three years. According to *AMIA*, Mexico's auto production in the same month declined 5.5% yoy, below -1.5% in May and a new year-to-date low. The latter is compounded by low domestic sales, which declined 11.4% in June and have been contracting at a double-digit pace during the last three months. On a more positive note, exports kept climbing, albeit at a more modest pace of 1.7%. In this respect, we maintain our view that there is an elevated probability of deterioration from here.

Latest news have been mixed. In mining, some private companies announced in recent days that they have either started oil production (Italian company *Eni*, in Campeche) or drilling operations (*Marinsa* and *Grupo R*, in Tabasco). In our view, this could help reduce modestly the pace of decline in oil mining. Nevertheless, the improvement is likely to be marginal, at least for now, as these wells are at their early production phase. For example, *Eni* said that they would add 15,000bdp, which is around 1% of total Pemex production.

On the other hand, on Monday the US Commerce Department resolved that China and Mexico are unfairly subsidizing exports of fabricated structural steel. As of full-year 2018, the estimated value of US imports from Mexico is of US\$622.4 million. As a result and in the case of our country, they will apply countervailing duties of up to 74%. The final determination is scheduled on November 19<sup>th</sup>, 2019, with the possibility of extending the deadline.

It should be mentioned that this measure is fundamentally different from other threats such as those related to security concerns on Section 232. In particular, these are already contemplated in existing trade agreements and apply only to certain companies, not the whole sector. Despite of the latter, global trade tensions and uncertainty about the relationship with the US remains high. We believe this is likely to be an additional headwind to manufacturing in the midst of the political process to approve USMCA.

Considering its recent performance and the aforementioned risks, we still expect industry to stay weak, a situation that could extend to the rest of the year in a context of both global and local headwinds, with a significant negative effect from uncertainty regarding global trade.

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