

3Q19 GDP – A slight improvement despite temporary shocks on the horizon

- **Gross Domestic Product (3Q19 F): -0.3% yoy; Banorte: -0.3%; consensus: -0.4% (range of estimates: -0.4% to -0.1%); preliminary figure: -0.4%**
- **Services were the main driver behind the revision, up by about 20bps to 0.1% yoy (previous: -0.1%). Industrial activity was also higher by a similar amount, to -1.5% yoy from -1.7%, while primary activities were unchanged at 5.4%**
- **Year-to-date, GDP growth remained basically flat in the annual comparison (0.0%)**
- **In seasonally-adjusted terms, activity was also flat (0.0% q/q). Secondary activities were still weak at -0.1%, adding two consecutive quarters in contraction. Services improved marginally, at 0.1% from 0.0% in 2Q19**
- **Considering revisions to previous data, activity had its more positive performance since 3Q18 (seasonally-adjusted), albeit with largely downward adjustments in the last three quarters**
- **In addition, September's IGAE stood at +0.1% yoy (+0.3% m/m), significantly above the figure of around -0.8% yoy implied by the preliminary estimate. In this respect, performance in the period in question was relatively strong, particularly in services as they picked up 0.4% m/m**
- **As a result, we adjust again our 2019 GDP forecast to -0.1% yoy from 0.3% previously, without evidence to support stronger momentum in the last quarter and temporary shocks that will likely impact industry in October**
- **We reiterate our 1.4% forecast for 2020, with risks slightly skewed to the downside**

GDP declined 0.3% yoy in 3Q19, 10bps above the preliminary estimate. This was in line with our expectations and slightly above consensus. Despite of the latter, growth during the first nine months of the year stayed flat when compared to the same period of 2018. Taking a look at the breakdown, the secondary sector was revised up about 20bps, to -1.5% yoy from -1.7% in the preliminary estimate. According to the monthly industrial production series, this was mainly from an upward adjustment in July's data, going from -1.8% to -1.3%. By sector, construction remained the weakest as it plunged 6.9% yoy, despite efforts by the Federal Government to boost capital spending and with low appetite from the private sector. Manufacturing (1.3%) and utilities (2.5%) were up, while mining moderated its decline (-4.2% from -7.8% in 2Q19) on efforts to increase oil production by Pemex.

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Fears about low dynamism in services were confirmed, adding two consecutive quarters very close to zero, standing at +0.1%. In the details, we highlight that government activities contracted 1.9%, negative for a fourth consecutive quarter. This is likely related to austerity measures and weaker than expected revenues so far this year on oil income and muted levels of economic activity. We also noted the negative outcome in financial services and wholesales (both at -3.6%). Moreover, corporates fell 2.5%, which we believe may be related to the effect of higher uncertainty on the private sector. On a more positive note, retail sales gathered strength as they advanced 2.9%, with mass media and transportation also positive at 4.1% and 1.3%, in the same order.

GDP 3Q19

% yoy

	Final		Preliminary	
	NSA	SA	NSA	SA
Total	-0.3	-0.2	-0.4	-0.4
Agricultural	5.4	5.4	5.4	5.3
Industrial production	-1.4	-1.5	-1.7	-1.8
Services	0.1	0.1	-0.1	0.0

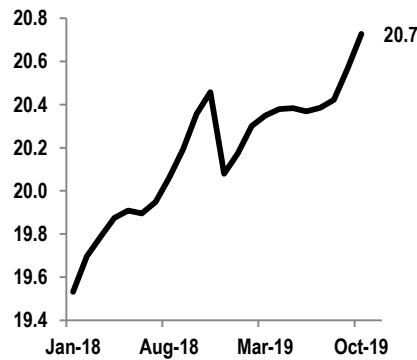
Source: INEGI

Slight improvement in seasonally-adjusted figures, although the economy remains stalled. In particular, GDP in the period was flat at 0.0% q/q, weaker than the preliminary report. Moreover, past data was mostly revised downwards. As a result, the final series shows that activity declined in each of the last three quarters. This was certainly possible as these figures have been hovering very close to zero since 4Q18. In this respect, data shows that the economy indeed added at least two consecutive quarters in contraction, catalogued as a ‘technical recession’. These adjustments show more definitely the weak performance that has been present since 4Q18.

Nevertheless and as mentioned before, we believe Mexico is not in recession. We guide ourselves with the definition of the National Bureau of Economic Research (NBER), which states it as: “...a recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales...”¹. Based on the latter, we argue that Mexico is not in a recession as we have not observed a significant increase in the unemployment rate, while formal job creation and retail sales keep growing (see charts below).

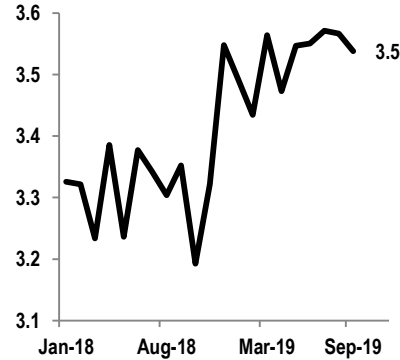
¹ Source: NBER, <https://www.nber.org/cycles.html>

Formal employees*
Million workers



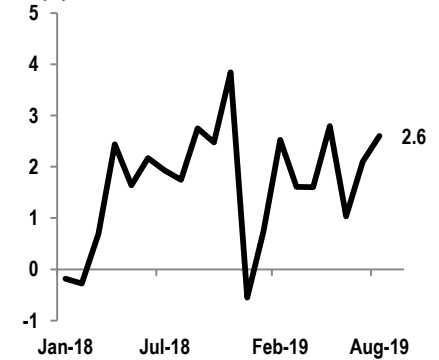
*Number of insured workers with Social Security from IMSS
Source: IMSS, Labor Ministry

Unemployment rate
%, sa



Source: Banorte with data from INEGI

Retail sales
%, yoy



Source: Banorte with data from INEGI

Industry remains a drag as it contracted 0.1%, with construction dipping 2.8% on top of the heavy decline of -4.1% in 2Q19. Manufacturing (0.5%) remains as the bright spot despite decelerating sequentially, with Mexico benefitting from the trade war between the US and China as some companies see our country as the best platform available to enter the US market, explaining some of this resiliency despite weaker global growth. In addition, mining expanded 1.2% and it was its highest advance since 4Q13. Taking a look at the breakdown, services advanced 0.1%, with 8 out of 15 sectors showing positive growth. Nevertheless, it should be noted that both wholesale and retail sales declined. Although it is worth noting that the contraction in retail sales came after four consecutive months growing.

GDP

%yoy nsa; % q/q sa, %q/q saar

	% yoy, nsa		% yoy, YTD		% q/q		% q/q saar	
	3Q19	2Q19	3Q19	2Q19	3Q19	2Q19	3Q19	2Q19
Total GDP	-0.3	-0.9	0.0	0.1	0.0	-0.1	0.1	-0.2
<i>Agriculture</i>	5.4	-0.2	2.0	0.6	3.3	-1.5	13.8	-5.7
<i>Industrial activity</i>	-1.4	-3.0	-1.7	-1.8	-0.1	-0.2	-0.5	-0.7
Mining	-4.2	-7.8	-6.6	-7.7	1.2	-0.7	4.9	-2.6
Utilities	2.5	1.8	1.6	1.1	1.7	2.2	7.2	9.0
Construction	-6.9	-7.1	-4.7	-3.6	-2.8	-4.1	-10.8	-15.6
Manufacturing	1.3	-0.2	0.9	0.7	0.5	0.8	1.9	3.4
<i>Services</i>	0.1	-0.1	0.6	0.9	0.1	0.0	0.3	0.2
Wholesale commerce	-3.6	-3.9	-2.3	-1.7	-0.48	-1.0	-1.9	-3.8
Retail sales	2.9	2.1	2.6	2.4	0.0	1.4	-0.1	5.8
Transportation and storage	1.3	0.9	1.2	1.1	0.02	1.0	0.1	4.2
Mass media and information	4.1	-5.2	-0.5	-3.0	4.94	-0.2	21.3	-0.9
Financial services	-3.6	1.8	1.3	3.9	-0.96	-1.7	-3.8	-6.5
Real estate	0.9	1.0	1.2	1.3	0.25	0.0	1.0	0.1
Professional services	0.7	-3.1	1.3	1.6	1.50	-3.1	6.1	-11.8
Corporations	-2.5	-4.8	-2.8	-3.0	0.90	0.7	3.7	2.6
Business support	2.7	5.6	5.2	6.6	-0.46	0.7	-1.8	2.9
Education	-2.0	-2.2	-1.0	-0.5	-1.06	-0.4	-4.2	-1.4
Healthcare	-0.8	1.3	0.7	1.5	-0.50	0.2	-2.0	0.9
Recreation, sports and cultural events	-1.5	0.5	-0.6	-0.1	1.18	1.6	4.8	6.6
Temporary lodging services	0.6	2.0	0.4	0.3	0.17	1.6	0.7	6.6
Other services	1.1	3.8	2.0	2.4	-1.92	2.0	-7.4	8.2
Government activities	-1.9	-4.8	-3.3	-4.0	-0.01	-0.5	-0.1	-1.8

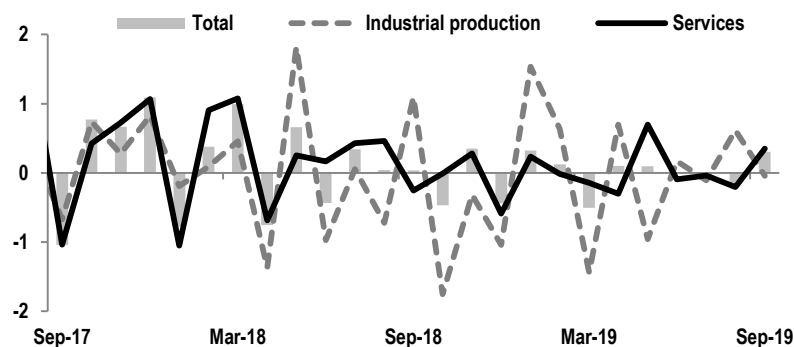
Source: INEGI

Economic activity in September shows tentative signs of revival. In particular, the *Global Economic Activity Indicator* (IGAE), also released today, increased 0.1% yoy, significantly above the implied figure of -0.8% in the preliminary release, with consensus at -0.5% (Banorte: -0.6%). Revisions to past data were mixed, with August from -0.9% to -1.0% while July went from 0.3% to 0.5%. By sector, primary activities were unusually strong as they surged 9.4%, highest since February 2018, industry contracted for eleventh consecutive month, while services recovered to 0.6%.

Using seasonally-adjusted figures, the economy fully retraced the decline of the previous month, increasing 0.3% m/m. In this respect, these figures seem to suggest a relative pickup, although more data is needed for confirmation as it was also influenced by revisions to past figures. Nonetheless, we highlight services at 0.3% m/m, not observed since May. This suggests that domestic demand may be finally gathering some pace, with other fundamental data such as real wage gains and remittances growth still positive. As already known, industry was flat after a brief rebound in August.

GDP monthly proxy (IGAE)

% m/m (sa)



Source: INEGI

Following the report, we now expect GDP at -0.1% yoy in 2019. This figure implies a downward revision from our previous 0.3% yoy (see table below). First and foremost, we expect manufacturing to have suffered at least in October as a result not only of the temporary shock in the auto sector –due to a series of events, mainly GM’s strike in the US– but also the temporary closure of auto plants by Ford and VW. This is suggested by AMIA data, which showed vehicle production down 16.3% yoy, weakest since September 2009. Additional information about manufacturing will be known in the trade balance report, to be released on Wednesday.

Also in the industrial sector, we will be looking closely to the Federal Government’s Infrastructure Plan, scheduled to be released tomorrow, which in our view may be of some help for growth in 2020, in particular for construction. From what we know so far, the plan will rely heavily on coordination with the private sector through partnerships. In our view, this is very important as public resources for investment remain low due to fiscal limitations; moreover, the approved budget for next year privileges spending in social programs. For details about the latter, see: “*FY2020 Budget – Focused on social spending, with fiscal responsibility*”, <pdf>, November 22nd, 2019.

Meanwhile, oil and gas production –included in mining– has remained weak, with Pemex’s crude oil at 1,616kbbpd in October, its lowest level since the late 70’s, affected by maintenance works according to the company’s CEO, Octavio Romero, and after several months with signs of stabilization. This latter caveat makes us think the impact will be temporary.

Our downward revision is mostly due, once again, to an additional adjustment in services, from 0.9% in full-year 2019 to 0.5%. When 2Q19 final data was released we expected a gradual recover for the rest of the year, a situation that has failed to materialize. Fundamentals remain broadly positive and we have seen some normalization in government spending. Nevertheless, the IMEF non-manufacturing gauge remains in contraction territory, at 48.1pts in October. We believe high uncertainty has induced an increase in consumers’ savings, as suggested by the accumulated current account surplus so far this year. Although other signs have been more positive, such as durable-goods consumption growing in annual terms in August for the first time in almost one year, and reports of a strong performance in *El Buen Fin* (Mexico’s Black Friday), dynamism has remained disappointing.

All in all, we expect 4Q19 GDP at -0.2% yoy (see table below). This figure would remain weak despite being higher than this quarter’s performance, helped to some extent by a more favorable base-effect, with GDP at 1.7% yoy in the fourth quarter of 2018 after advancing 2.5% in 3Q18.

GDP growth forecasts

% yoy, nsa

	1Q19	2Q19	3Q19	4Q19f	2019f	2020f
GDP (aggregate supply)	1.2	-0.9	-0.3	<u>-0.2</u>	<u>-0.1</u>	<u>1.4</u>
Primary sector	2.2	0.4	-0.3	<u>1.9</u>	<u>2.0</u>	<u>1.5</u>
Secondary sector	-0.5	-3.0	-1.4	<u>-1.7</u>	<u>-1.7</u>	<u>0.6</u>
Tertiary sector	1.9	-0.1	0.1	<u>0.4</u>	<u>0.5</u>	<u>1.8</u>
GDP (aggregate demand)	1.2	-0.9	-0.3	<u>-0.2</u>	<u>-0.1</u>	<u>1.4</u>
Private consumption	1.1	-0.3	<u>1.7</u>	<u>2.5</u>	<u>1.3</u>	<u>1.8</u>
Investment	-0.8	-7.3	<u>-5.9</u>	<u>-4.2</u>	<u>-4.6</u>	<u>0.3</u>
Government spending	-0.8	-2.3	<u>-0.4</u>	<u>0.8</u>	<u>-0.7</u>	<u>0.9</u>
Exports	2.7	2.5	<u>3.2</u>	<u>2.0</u>	<u>2.6</u>	<u>3.1</u>
Imports	1.9	-1.4	<u>-0.5</u>	<u>-0.2</u>	<u>-0.1</u>	<u>2.5</u>

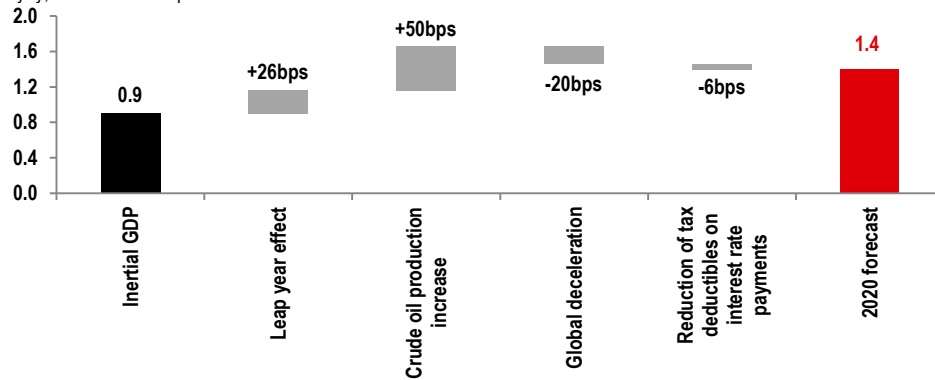
Source: Banorte

For 2020 we remain constructive, but risks are tilted to the downside. We reiterate our 1.4% yoy estimate but recognize risks are tilted to the downside, as economic performance continues lacking momentum. Among the factors that could help GDP, we highlight: (1) Efforts to boost crude-oil production, which may add around 50bps to annual growth next year; (2) monetary policy easing by Banxico, reducing the incentive to save and financial costs for investment; (3) lower uncertainty, with expectations of an agreement regarding USMCA no later than 1Q20; and (4) Mexico continuing to gain market share in the US at the expense of China, even with a possible deal between these two countries.

In addition, main downside risks include: (1) Further austerity measures by the Federal Government on the possibility of lower fiscal revenues, especially given that degrees of freedom in this front are limited; (2) a deeper slowdown of the global outlook, as Mexico remains a very open and small economy; and (3) another bout of uncertainty that halts investment as the US election approaches, similar to what happened after Trump’s win. The chart below shows the main drivers behind our expectation of stronger growth in 2020.

2020 GDP growth forecast

% yoy, contribution in bps



Source: Banorte

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