

## Industrial production – Weakness still present in September

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- **Industrial production (September): -1.8% yoy; Banorte: -1.5%; consensus: -1.7% (range: -2.1% to 0.8%); previous: -1.3%**
- **During 3Q19, industry fell 1.4%, above the -1.7% estimated in preliminary GDP data. This was driven by an upward revision in July data, from -1.8% to -1.3%. Year-to-date, the sector has accumulated a 1.7% decline**
- **Activity was flat in the monthly comparison after the 0.6% seen in the previous month. By sector, construction erased earlier gains as it plunged 2.1%, remaining as the weakest subcomponent. Manufacturing remains resilient at 0.6%**
- **In this respect and in line with our expectations, the auto sector was not heavily impacted during this month due to GM's labor strike in the US. Nevertheless, advanced data suggests that the adverse effect will be in October**
- **As a result, industrial activity is likely to have started 4Q19 on a weak footing, while we remain concerned about the performance in construction in a context of still muted business confidence**

**Industrial activity slightly below expectations in September.** Industrial production fell 1.8% yoy, below consensus (-1.7%) and our forecast (-1.5%), with the main downside surprise in construction. This is the 11<sup>th</sup> consecutive month in negative territory, resulting in a 1.7% yoy decline on a year-to-date basis. Performance in 3Q19 stood at -1.4%, which is higher than the -1.7% estimated by INEGI in the preliminary GDP print. This was driven by a significant upward revision in July's data, going from a previous print of -1.8% to the latest at -1.3%.

By sectors, we highlight a relatively positive result in mining at -2.8%, highest since April 2016 –barring the rebound in September 2018 due to a base effect after natural disasters in the same period of the previous year–. Despite still in negative territory, efforts by Pemex to stabilize production is beginning to be observed in data, with crude oil at 1.73mbpd (-5.3% yoy). The other sectors were also relatively good, with non-oil at -0.8% from -2.5% previously, while services within this component surged 13.8%.

On a more concerning note, construction fell 8.3%, with edification below our view of a more positive performance given reports that activity in important states such as CDMX started to gather pace. Although details are needed, we believe the headline suggests extended weakness in the city. On the other hand, civil engineering fell 4.3% despite the fact that capital investments by the Federal Government accelerated strongly at 27.5% yoy in real terms. In this respect, the sector keeps failing in showing more positive signals in terms of its underlying dynamism.

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Lastly, manufacturing picked up 0.8%, above expectations of a 0.2% advance but closer to our 0.4%. In this sense, transportation was resilient as it grew 1.9% despite GM's labor strike in the US, consistent with our view of a less pronounced effect in terms of production as companies were able to draw down inventories. In other subsectors, beverages and tobacco (4.2%) and food (1.8%) kept growing, in line with other indicators showing a relatively good performance in non-durable goods' purchases. Machinery and equipment and computers were also higher, both at 2.4%. On the contrary, textiles excluding clothing (-12.0%) and furniture (-7.4%) were among the weakest. In this respect, we still see a bias against domestic-facing sectors, in our view with the slowdown of activity and uncertainty reducing the marginal propensity to consume.

**Industrial production: September 2019**

% yoy, nsa

	Sep-19	Sep-18	Jan-Sep, '19	Jan-Sep, '18
<b>Total</b>	-1.8	1.4	-1.7	1.1
Mining	-2.8	2.5	-6.6	-5.3
Utilities	3.4	9.4	1.6	7.6
Construction	-8.3	-3.0	-4.7	2.6
Manufacturing	0.8	2.3	0.9	2.0

Source: INEGI

**With seasonally-adjusted figures, activity stayed flat.** This comes after increasing 0.6% in August. The only sector that declined was construction (-2.1%), more than reversing the 1.3% of the previous month and with the index at a level similar to those seen in mid-2013. This perspective helps see that the sector remains at very muted levels of activity, with both main subsectors were in negative territory. On the other hand, manufacturing advanced 0.6%, highest in five months. Within, the 1.2% in transportation reinforces our view about this sector's performance. Mining inched higher (0.1%), which is positive considering the 2.7% surge in August, adding two consecutive months in positive territory. This was more broad-based as both crude oil and gas, and non-oil mining, were both higher.

**Industrial production: September 2019**

% m/m, sa

	Sep-19	Aug-19	Jul-19
<b>Total</b>	0.0	0.6	-0.1
Mining	0.1	2.7	-1.4
Utilities	0.2	1.8	0.1
Construction	-2.1	1.3	-1.8
Manufacturing	0.6	-0.3	0.5

Source: INEGI

### Industrial production: August 2019

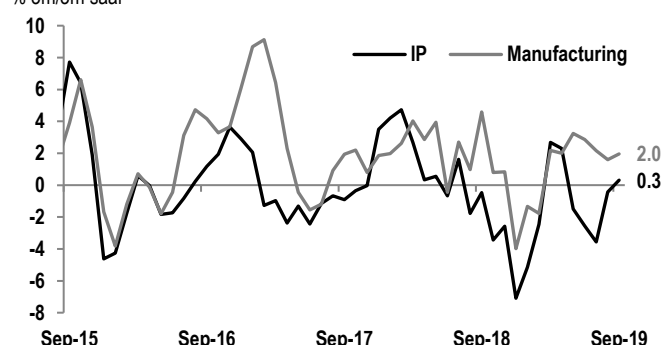
% 3m/3m saar

	Jul-Sep'19	Jun-Aug'19
<b>Total</b>	<b>0.3</b>	<b>-0.4</b>
Mining	5.9	4.6
Utilities	10.7	13.0
Construction	-10.8	-11.3
Manufacturing	2.0	1.6

Source: INEGI

### Industrial production: Total and manufacturing

% 3m/3m saar



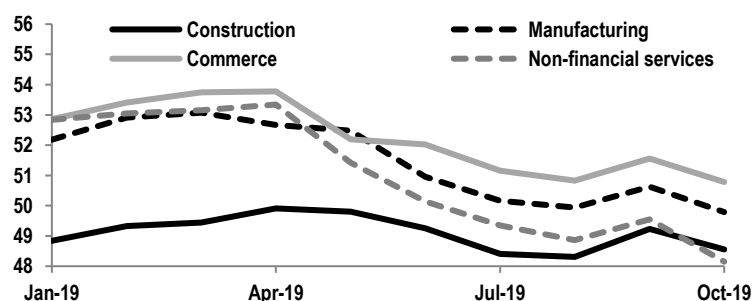
Source: INEGI

### Weakness likely to prevail in the short term, despite efforts to reactivate spending by the Federal Government.

In our view today's result was negative, particularly in construction and despite reports of more dynamism in the sector. The latter is more clearly observed in capital spending by the Federal Government according to public finance data. Nevertheless and on a more negative note, business confidence backtracked in October in all sectors (see chart below), including the 'adequate moment to invest' component, which remains muted after two consecutive months up –including in September–, in our view still affected by high levels of uncertainty and austerity measures. This is consistent with IMEF's manufacturing PMI, which plunged to a 2.5 year low in the month at 46.7pts, with reductions in both the production and new orders subcomponents. On the other hand, US manufacturing has given signs of a slight recovery, with both Markit's PMI and the ISM manufacturing index improving sequentially. Nevertheless, the latter now adds three consecutive months in contraction, which is still a reason to remain cautious about the prospects of this sector in our country.

### Business Confidence index

Index, nsa



Source: INEGI

We must also add that temporary shocks are likely to impact manufacturing in October, particularly autos which is the subsector with the fourth highest weight within total industrial production, at 8.5%. According to AMIA, auto production fell 16.3% yoy in the month, weakest since the 2009 financial crisis. The result was affected by both GM's labor strike in the US (resulting in the temporary suspension of operations since the beginning of the month in two of its Mexican plants, located in Silao, Guanajuato, and Ramos Arizpe, Coahuila) and the closing of two plants by Ford (in Hermosillo, Sonora, and Cuautitlán, State of Mexico) on preparations for production of electric cars.

In construction, last month's advance should be taken with a grain of salt given today's reversal. In our view, the government's announcement of the infrastructure plan with the private sector, which is scheduled to be released tomorrow and will include around 1,600 projects, should be positive. Nevertheless, the effect of these is likely to be more sizable until at least 2020, as it depends on speeding-up processes, something that the government announced that began just recently. An additional favorable factor is the more optimistic outlook about the ratification of USMCA in the US, which in our view would also help to reduce uncertainty in the private sector. Nevertheless, the possibility that this happens during the rest of 2019 looks challenging enough, with recent news pointing that it is more likely that it could materialize until 1Q20.

In mining, the report was relatively positive and helps reaffirm our opinion that the sector is likely to be less of a drag for the whole of industrial activity. Nevertheless, it should be mentioned that, in terms of crude oil, the slight recovery in production (in monthly terms) has been more visible only in the last four months up to September. The latter suggests that, in the case that this recent performance is maintained, oil will likely stay in negative territory in the annual comparison until about 1Q20 as base-effects kick in. Regarding non-oil, we believe the deceleration of economic activity, including in China which is the most important consumer of commodities in the world, suggests challenges to the sector will likely not go away soon.

We maintain our full-year forecast for industry to decline 1.5% yoy, although recognizing that temporary shocks which will likely affect dynamism in manufacturing (which has been very resilient so far) and the failure of construction to provide more definitive signs of improving point to risks that remain skewed to the downside.

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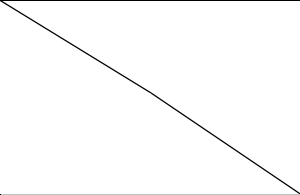
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