

Regional Economic Report

July – September 2022

Summary

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During the third quarter of 2022, economic activity in Mexico continued recovering, reaching levels similar to those of the fourth quarter of 2019, prior to the health emergency. Its positive performance during the quarter reflected the continuing reactivation of services and the persisting upward trend in manufacturing. Looking ahead, the Mexican economy is expected to continue facing an environment of greater economic weakness and high global uncertainty.

In this context, during the third quarter of 2022, economic activity is anticipated to have continued expanding in all regions, although it is expected to have decelerated in the Northern, North-Central and Southern ones. Activity in the Northern and North-Central regions is foreseen to have remained above the levels observed during the first quarter of 2020, while the Southern region is estimated to have reached levels similar to said reference. Economic activity in the Central region is expected to continue exhibiting a gap relative to its pre-pandemic level.¹

The expansion of economic activity in the Northern region during the reported quarter reflects the favorable performance of manufacturing, mining and the agricultural and livestock product sectors. Some services, such as tourism, along with manufacturing and construction, are expected to have contributed to growth in the Central region. Growth in the North-Central region is expected to have been supported by certain tertiary activities, such as trade and tourism, and the agricultural and livestock product sector. Finally, the slight expansion in the Southern region is associated with the performance of manufacturing,

tourism, and the agricultural and livestock product sector.

To complement the analysis of regional economic activity, Box 1 shows, through estimates obtained using an econometric model, that, since 2021, external demand-related shocks have favored an increased production of manufactured goods, mainly in the Northern, North-Central and Central regions. In contrast, supply-related shocks have turned out to be a constraint. Regarding the recovery of tourism, Box 2 shows that, as a result of the pandemic, there has been an increase in the share of short-travel tourists, mainly in cities. Also, at the national level, business tourism shows a larger gap in its recovery compared to the rest of tourism activities. Nevertheless, there are significant differences in the recovery of business tourism between resorts, which could be linked to the possibility of using technologies that allow substituting, to some extent, business travel in certain sectors (such as services), but not in others (such as manufacturing). To analyze the adjustment process of regional labor markets in response to the pandemic, Box 3 describes how workers are more likely to change their employment sector rather than their local labor market. However, the probability of carrying out these changes is lower for women than for men. The model estimated in this Box suggests that women incur higher costs than men both when entering a new employment sector and when changing their geographic location.

During the third quarter of 2022, in all regions, inflation continued to be subject to upward pressures. This behavior continued to mainly reflect

¹ The Northern region includes Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; the North-Central region considers Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; the Central

region includes Ciudad de México, Estado de México, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and the Southern region includes Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.

the cumulative effects of the shocks from the COVID-19 pandemic and the military conflict between Russia and Ukraine, which have turned out to be deeper and longer lasting than anticipated. In November, annual headline inflation in the Northern, North-Central, Central and Southern regions was 8.14, 8.46, 6.99 and 8.43%, respectively. In all regions, annual core inflation continued increasing during the third quarter of 2022 and has remained under pressure so far in the fourth quarter. In a context of high global demand, this performance continued reflecting the effects of the aforementioned shocks, and possibly those of higher wage variations on production costs. During the third quarter, non-core inflation in all regions remained high and above the previous quarter figures. Nevertheless, during the fourth quarter so far, this indicator has shown a reduction in all of them. Both the lower inflation of agriculture and livestock products and the lower annual variation rates of certain energy products have contributed to this decrease.

Based on the information gathered during the program of interviews with business agents, in all regions, the diffusion indices of expectations for the demand for products they offer, for personnel hired, and for investment in fixed assets, for the next twelve months, continued in the expansion zone and at levels higher than those of the fourth quarter of 2019. Nevertheless, during the reported quarter, these indices showed a differentiated behavior among regions. The index corresponding to demand expectations decreased in the Central and Southern regions, while the Northern and North-Central ones registered an increase. The index corresponding to expectations regarding the number of workers employed in companies showed a reduction in the Central region, remained stable in the Northern region, and registered an increase in the rest of them. As for fixed asset investment expectations for the next twelve months, these registered a slight deterioration in all regions, except for the Northern one.

The interviewed business agents highlighted the following risks to regional economic growth. On the downside: i) that public safety indicators deteriorate; ii) that inflation persists at high levels; and iii) that low levels of both public and private investment continue.

Among upside risks, they mentioned: i) that public spending, particularly investment in infrastructure projects, turns out to be higher than expected; ii) that public safety is strengthened; iii) that more favorable conditions are observed, both domestically and internationally, thus promoting greater private investment; and iv) that inflation declines at a faster-than-anticipated rate.

Some business agents have mentioned that the occurrence of extreme weather events represents a risk for economic activity, such as the drought that recently affected several states in the Northern region, and that is possibly related to climate change. Box 4 estimates the extent to which Mexico's states could reduce their consumption of energy and their generation of pollutants to bring them to levels similar to those states with best anti-pollution practices, without affecting the production of the manufacturing sector, which could contribute to lower greenhouse gas emissions. In this scenario, the region that can contribute the most to energy savings is the Northern one, while those that can contribute the most to pollution reduction are the North-Central and Southern regions.

Economic activity in all regions is anticipated to continue recovering over the next twelve months, although at a more moderate pace. In particular, tertiary activities are expected to continue expanding as the effects of the pandemic dissipate, particularly in the Central region, where trade and services show a greater lag compared to the rest of the regions. The construction of large infrastructure projects is also foreseen to continue supporting activity in the Southern region. Among the external sources of growth, the process of relocating companies to supply the North American market is expected to continue contributing to investment in the Northern and Central regions, while it could also be reinforced in the Southern region.

The recovery of regional activity, however, is not exempt from risks. These risks include a possible recession in the United States, which could limit growth in more export-oriented states, such as those in the Northern and *Bajío* regions. A less favorable performance of the US labor market could also affect the flow of remittances to Mexico and, therefore, the levels of consumption of the receiving households,

mainly in certain states in the Central and Southern regions. Additionally, the controversies associated with the USMCA could increase uncertainty for investment decisions, particularly in the most manufacturing-oriented regions, such as the Northern and Central ones. These regions will also likely remain negatively affected by disruptions in the supply of inputs, as the pandemic or geopolitical conflicts could continue causing problems in global supply chains.

Given the risks faced by regional economies, it is important to strengthen the domestic sources of growth. In particular, the rule of law and public safety must be strengthened to grant certainty to firms and facilitate their operations. The construction or improvement of energy and transportation infrastructure in the Mexican states could also add to the latter, so that firms can use cleaner energy sources and have access, with more competitive transportation costs, to both commodity markets and potential customers. In view of the challenges posed by climate change for regional economies, it is essential to implement actions to mitigate and adapt to this phenomenon, particularly in the states that are most exposed to its impact or whose activities stand out for their greenhouse gas emissions.