Regional Economic Report
July – September 2024
Summary

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During the third quarter of 2024, economic activity expanded at a higher growth rate than in the previous three quarters, a period characterized by significant weakness. Primary sector activities exhibited a relatively high positive contribution. Meanwhile, secondary and tertiary activities registered a greater expansion compared to the previous quarter.

At the regional level, economic activity is estimated to have expanded in the north and the central regions during the third quarter of 2024.[1] In contrast, the Southern region is estimated to have weakened. Nevertheless, compared to the other regions, the Southern one would have remained at relatively higher levels than those observed before the pandemic. From a sectoral perspective, during the reported quarter, growth in the Northern and Central regions is expected to have been driven by the expansion of industrial activities, except in the North-Central region. Agricultural and livestock production is also expected to have contributed to the favorable performance of economic activity, especially in the central regions. Similarly, growth in the center would have benefited from the positive evolution of commerce and certain services, such as tourism. In contrast, the anticipated contraction in the Southern region is expected to have been caused by a fall in activity in certain industrial sectors. In addition, in the Southern region, tourism continued decreasing and commerce stagnated.

To complement the regional economic analysis presented in this Report, Box 1 estimates the intensity of water use in productive activities. It also identifies the main sectors in Mexico that are net importers and exporters of virtual water (the amount of water required to produce a good or service throughout its production chain). The results indicate that the country is a net importer of virtual water, primarily due to imports of agricultural and livestock products, which are characterized by their high water use intensity. An analysis of trade flows across states suggests that states specialized in agricultural production tend to export virtual water, while those focused on tertiary activities, which consume less water resources, are more likely to import it. Box 2 analyzes regional wage dispersion and the factors that influence it. Using an econometric model, we decompose wage variance in the formal labor market into three components: 1) wage differentials due to worker characteristics, such as skills; 2) wage differentials due to workplace characteristics, such as productivity; and, 3) the labor market selection process, which matches more educated workers with more productive firms. The results show that, in all regions, all three components contribute to wage variance, with the component related to individual characteristics being the most significant. Additionally, wage dispersion is found to have decreased in all regions in recent years, primarily due to a reduced contribution from the component associated with workplace characteristics. Finally, Box 3 examines, from a regional perspective, the lack of essential micronutrients such as vitamin A, zinc, and iron in households' intake across the country that fail to meet their calorie requirements. In 2022, just over one-third of these households had intakes below the recommended levels. While some improvement

[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.

was seen between 2006 and 2022, the results indicate that food insecurity in Mexico is not only linked to the quantity of available food but also to its nutritional quality.

During most of 2024, annual headline inflation in all regions followed an upward trajectory, driven by a rise in non-core inflation, which was affected by supply shocks. After July, headline inflation decreased in all regions throughout the third quarter as the effects of the aforementioned shocks gradually dissipated. Although non-core inflation has subsequently experienced supply-side effects once more, headline inflation in all regions declined in November from its third-quarter level. In the third quarter and so far in the fourth, annual core inflation continued decreasing in all regions. Within this component, merchandise inflation continued trending downwards, while services inflation declined gradually but still remained at high levels.

The diffusion indices, which reflect the interviewed business agents' expectations regarding the demand for products they offer, for personnel hired, and for investment in fixed assets for the next twelve months, continued anticipating growth in the referred variables. In the Central region, demand and hiring expectations, in particular, have remained higher than those observed in the other regions. Regarding expectations for fixed asset investment for the next twelve months, the strongest sign of expansion was registered in the Northern region, as the corresponding index continued to be higher than those of the southern and central regions.

Expectations for sales prices, wage costs and input costs in all regions over the next twelve months suggest a significant moderation in inflationary pressures compared to the most critical stages of the episode related to the pandemic and the war in Ukraine. Most business agents continued reporting that they expect these variables to increase at a similar or lower rate over the next twelve months, compared to the previous twelve months.

Looking ahead, regional economies are foreseen to continue expanding, despite a complex and uncertain environment that poses challenges to their growth, although their pace of growth could be moderate. On the external front, one of the main challenges is that growth in the United States is lower than expected, which could reduce exports to that market. Also, there is uncertainty about the type of policies that the United States would be adopting across different fields such as international trade and immigration policies. Based on how these factors evolve, not only those states that are more linked to the international market, especially in the north and central regions, or those that have historically been migrant-sending states, particularly in the central regions and the south, could register fluctuations in their economic activity, but it can also be perceived in the other Mexican states as a result of the indirect effects that the aforementioned external shocks could generate due to inter-state economic relations. On the domestic front, one of the main challenges remains public insecurity, identified by business agents as a factor affecting their business operations in various parts of the country. The business agents consulted also mentioned the uncertainty associated with legislative reforms. They also perceive the threat posed by the possible occurrence of extreme weather events, such as droughts, floods and frosts, which have a differentiated impact on regional economic activity. All this takes place in a context in which business contacts identify the risk of a lower flow of public resources to the regions in light of the fiscal consolidation announced for 2025, especially public resources channeled to infrastructure investment.

In light of these challenges, it is essential to continue strengthening domestic sources of growth and generating favorable conditions for investment. In this regard, leveraging the opportunities offered by nearshoring is of strategic relevance, particularly due to the likely escalation of tensions between China and our main trading partner, the United States. It is essential to continue promoting public and private construction of infrastructure for transportation, water-supply, and energy generation, in particular, to foster a more favorable environment for attracting investment. Also, promoting human capital formation strengthens the competitiveness of the regions by increasing the availability of qualified personnel. Since this Report was first released, interviewed business agents have pointed out that it is essential to strengthen public safety and the rule of law, as both are fundamental pillars to create an

environment of stability and confidence for the development of regional economic activity.

In addition, given the risk that climate change poses to regional economies, it is imperative to implement mitigation and adaptation policies in the most vulnerable areas and sectors. These measures would not only enable the regions to face current challenges, but would also foster more inclusive and sustainable growth in the long term, improving the living conditions of the population.