Regional Economic Report

July – September 2019

Summary

During the third quarter of 2019, Mexico's GDP remained at levels similar to those of the previous quarter, after having exhibited slight consecutive falls from the fourth quarter of 2018 to the second quarter of 2019, according to most recent data. This behavior reflected the loss of dynamism of aggregate demand, in a context in which uncertainty associated to both external and domestic factors prevailed. In particular, weakness in consumption and the unfavorable performance of gross fixed investment continued, while manufacturing exports decelerated as compared to the previous quarter. In line with the aforementioned, on the production side, the above described performance evidenced a weakness in services, as well as in a negative evolution of secondary activities, while primary activities reverted the contraction exhibited during the second quarter. Within industrial activity, the decreasing trend that construction has been registering since the beginning of 2018 intensified. On the other hand, manufacturing activity continued trending upwards, although with a certain lack of dynamism with respect to the previous quarter. Finally, mining seems to have halted the downward trajectory it has been showing since 2014 and has even registered an incipient change of trend to the upside.

The weakness of Mexico's economic activity reflected the lack of dynamism exhibited by the Central and Southern regions.[1] Indeed, during the third quarter, economic activity in the Central region is expected to have remained at levels similar to those of the previous quarter. Although the North-Central and Southern regions are foreseen to have grown, such an expansion would have occurred after the falls observed in the previous quarter, in such a way that economic activity in these regions would continue to be at levels similar to those observed at the end of 2018. In contrast, the Northern region is expected to continue following a positive trend. The decline of manufacturing, construction and tourism and the stagnation of commerce is expected to have contributed to the stagnation of economic activity in the Central region. The continuing growth in the Northern region reflected the increase of the manufacturing, mining, commerce and agricultural and livestock product sectors; while the growth foreseen for economic activity in the North-Central and Southern regions, after having fallen in the previous quarter, is associated with the positive evolution of mining, tourism and the agricultural and livestock product sector; as well as of commerce and construction, for the case of the North-Central region.

Annual headline inflation decreased from an average of 4.21% during the second quarter, to 3.31% in the third one, laying at 2.97% in November. This behavior mainly stemmed from a sharp fall of non-core inflation, particularly, from the lower annual change of energy prices, although that of agricultural and livestock product prices also decreased. In contrast, annual core inflation, which better reflects price pressures in the economy, continued showing persistence and averaged 3.78% during the third quarter, although it recently decreased slightly to 3.65% in November.

The evolution of headline inflation at the national level permeated through most regions. Indeed, between the second and third quarters of 2019, average annual inflation in all regions analyzed in this Report fell. This decrease is mainly associated to the behavior of non-core inflation, as annual core

1 States are grouped into the following regions: Northern region: Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas; North-Central region: Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; Central region: Ciudad de México, Estado de México, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and, Southern region: Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz, and Yucatán.

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inflation in all regions continues to show persistence, although it is slightly decreasing at the margin.

Business agents of the four regions interviewed for this report anticipate demand for own goods and services to increase in the next twelve months. They also expect hired personnel and physical capital to grow. However, in all cases, except for demand in the North-Central region, the signal is lower than that recorded in the same period of the previous year.

Business agents interviewed pointed out the following risks to regional economic growth. To the downside: i) that the levels of public insecurity increase; ii) that the environment of domestic uncertainty persists, which has been affecting investment; and, iii) that the United States imposes tariffs on Mexican exports or that ratification of USMCA is extended. As to upward risks, business agents highlighted: i) that both public and private investment are revamped; and, ii) that the trade agreement with the United States and Canada is ratified.

As to the expected evolution of sales prices for the next twelve months, most business agents interviewed anticipate that the annual growth rate of sales prices of goods and services offered by them will be lower than or equal to that recorded in the previous year. In addition, most business agents interviewed in all regions expect their wage costs and the prices of inputs they use to increase at an annual rate similar to that observed in the previous twelve months.

To complement the analysis of regional economic activity, four analytical boxes are included in this Report. Box 1 proposes a measure of Mexican states' productivity relative to that of the United States through the use of luminosity data captured from space. The results indicate that Northern states have a productivity per luminosity unit closer to that of the United States, followed by the Central and Southern states, in that order. Box 2 shows that directors of companies of those sectors that may have been benefiting from greater indirect protection from the US market as a result of the trade conflict between China and the United States, also report a higher average subjective probability to such conflict having a positive effect on their activity. Box 3 analyzes the factors that have influenced the recent increases in higher education tuition at the regional level, such as the price of electricity and communication services as well as the greater number of skilled jobs, possibly because the existence of more jobs of this type encourages workers to increase their education level. Finally, Box 4 shows that the percentage of firms that have reported being extorted has increased and that, in the case of non-manufacturing firms, this has led to lower activity.

The regional economies face a complex environment characterized by a high level of uncertainty, stemming from both external and domestic factors, which has been affecting investment levels. Public insecurity problems in several Mexican states also limit companies' productive activity. In this context, in addition to maintaining a sound macroeconomic framework, adopting measures that foster an environment of confidence and certainty for capital accumulation and strengthen the institutional framework, the rule of law, and public security are imperative.