Regional Economic Report
April – June 2018
Summary

During the second quarter of 2018, economic activity in Mexico contracted as compared to the first one, which contrasts with the recovery during the previous two quarters. These results were partly due to both the reversal in the dynamism of investment in late 2017 and early 2018, especially in the construction sector, and the lower dynamism of exports. As regards industrial production, the negative trend of construction during the quarter is noteworthy, which was triggered by reductions in the subsectors of heavy and civil engineering construction and of construction of buildings. The mining, quarrying, and oil and gas extraction sector maintained a downward trajectory as well, as a result of the lower levels in the subsector of oil and gas extraction and the lack of vigor in the subsectors of metal ore mining and nonmetallic mineral mining and quarrying. In contrast, the manufacturing sector recovered slightly as compared to the weak performance exhibited during late 2017 and early 2018. Similarly, the significant drop in agriculture, forestry, fishing, and hunting and the deceleration in different services subsectors stand out.

During the analyzed period, productive activity lost dynamism across all regions in Mexico. Indeed, production levels in the Northern, North-Central and Southern regions are estimated to have contracted, while in the Central region, they slowed down. These developments contrast with the dynamism observed across all regions during the previous quarter. These results are largely attributed to the overall downturn in both the mining, quarrying, and oil and gas extraction sector and in the construction sector, throughout the country, except for construction in the Central region and manufacturing in the North-Central region. In the same vein, this development is related to the weak performance of both tourism (air transportation and traveler accommodation subsectors) in the Northern and Central regions and retail trade in the Central region, as well as the contraction of agricultural production (crop production subsector and animal production and aquaculture subsector) in the North-Central and Southern regions.

To complement the analysis of the regional economic activity published in this Report, several analytical boxes are included. Box 1 presents an analysis of the relation between the institutional and the economic performance in the Mexican regions. Box 2 assesses the contribution of economic and spatial structure (the latter measured using the distance among states) to the growth of regional manufacturing exports during the period 2007 – 2016. Finally, Box 3 estimates the impact of workers' remittances on physical and human capital formation in households that receive remittances in different regions of Mexico.

After averaging 5.31% in the first quarter of 2018, annual headline inflation fell to 4.55 and to 4.51% in April and May, respectively. In June, however, annual headline inflation rebounded to 4.65%, and in August it reached 4.90%. This resulted from the materialization of certain upward risks that had been previously pointed out, which led to significant increases in non-core inflation. Specifically, some energy products showed higher-than-anticipated price increments, due to both accumulated increases in their international references and the exchange rate depreciation observed over most of the second quarter of 2018. Core inflation maintained a downward trend during the analyzed quarter, as a result of both the greater-than-anticipated easing of the cyclical conditions of the economy and the impact of the monetary policy actions implemented by Banco de México, which have prevented the different shocks that have affected the Mexican economy from generating second-round effects.

The evolution of headline inflation since early 2018 was perceived across all regional economies. However, since the end of last year, inflation levels have been higher in the Central region than in the other ones, principally due to the effect caused by energy prices and the prices of some services in such

region. In particular, the annual percentage change of housing prices and of the prices of services other than education has been higher in the Central region as compared to other regional economies. According to the interviewed business agents, this resulted from a higher demand in some entities of that region, especially in those where the automotive cluster has a strong presence.

Business agents consulted in the four regions expect the demand for their own goods and services to grow during the following twelve months, although this signal was less intense with respect to the previous quarter. In the same vein, they anticipate an increase in the number of hired personnel and in physical capital, although in general this signal was also weaker as compared to the last quarter.

During the period analyzed in this Report, the interviewed business agents listed the following risks to regional economic growth. Among downward risks, they signaled: i) a deterioration in public safety; ii) that the uncertainty prevailing in both the domestic and the external environment leads to lower levels of investment; and, iii) that the NAFTA renegotiation is not favorable for the Mexican productive sector. In addition, in the South they stressed the impact of adverse weather conditions on the performance of the regional economies. In this respect, Box 4 quantifies the impact of tropical cyclones on the economic activity of Mexican coastal states. In contrast, among the upward risks, they signaled the following: i) that NAFTA renegotiation is favorable for Mexico; and ii) that investment levels turn out to be higher than anticipated.

With regard to the expected development of prices for the following twelve months, most interviewed business agents anticipate sales prices of their own goods and services together with their input prices and labor costs to be lower or equal to those observed during the previous year.

In view of the complex outlook faced by the regional economies, both in the external and the domestic fronts, it is important to continue strengthening the macroeconomic framework, and to keep encouraging the implementation of measures that trigger higher productivity, given that, ultimately, it is the only way to generate better-paid jobs and to reduce poverty in a sustainable manner. Specifically, it is key to maintain the openness of the economy, improve the country's institutional framework, and face the structural problems that could limit the efficiency in the microeconomic functioning of the regional markets. For this reason, policies aimed at reducing insecurity, raising the level of competition among companies, curbing corruption, improving both the governance of public institutions and infrastructure provision, and guaranteeing full respect of private property are essential to encourage a better economic performance and, thus, a better welfare of the population in all Mexican regions.