Regional Economic Report
July – September 2021
Summary

During the third quarter of 2021, economic activity halted its recovery and contracted relative to the previous quarter, while a heterogeneous performance persisted across its different sectors. This was caused by the upsurge of the pandemic during said period. The above was accompanied by a strong fall in business support services due to the transition to the new labor outsourcing regime. Although the latter does not seem to have affected aggregate formal employment, it accounted for a significant part of the fall in services during the quarter. The automotive industry remained weak as a result of the continued shortage of semiconductors, which also affected the manufacturing of computer, communications, measurement and other types of equipment.

In this context, economic activity is estimated to have contracted in the North Central, Central and Southern regions, after having witnessed a recovery during previous quarters.[1] In contrast, economic activity in the Northern region is anticipated to have continued expanding. Based on these projections, the weak performance in the Central region is notable, as compared to the rest of the regions in the context of the pandemic.

The decline in economic activity in the Southern and central regions during the third quarter of 2021 is estimated to have derived from a less favorable evolution of the tertiary activities. Indeed, trade weakened in said regions and a lower recovery rate of tourism was observed, partly as a result of a temporary reduction in mobility due to the intensification of the pandemic. A considerable decline in business support services is anticipated, due to the implementation of the labor outsourcing regime, which is expected to have particularly affected the Central region, where a greater part of these services is concentrated. The slowdown of the recovery in the Southern, North-Central and Central regions is anticipated to be explained by the weakening of mining, and, with the exception of the Central region, of construction, although in the Southern region public construction remains at relatively high levels. In the North-Central region, manufacturing is expected to have stagnated, basically due to the negative evolution of the automotive industry in light of the persistent shortage of certain inputs, which would have been offset by the expansion of manufacturing excluding transport equipment. A decline in agricultural and livestock production would have also been observed in the North-Central region. In contrast, the Northern region's recovery is anticipated to have continued being supported by the performance of manufacturing other than transport equipment, while construction and agricultural and livestock product production would have performed favorably, which would have compensated certain weakening of some tertiary activities and of mining.

In a context in which bank financing to firms continued contracting, Box 1 reviews the evolution of bank credit to firms at the regional level before and during the COVID-19 pandemic, and estimates the degree in which aggregate supply and demand shocks, as well as credit market shocks, affected said evolution. The box shows a heterogeneous performance of credit at the regional level. Output shocks have been relevant to explain its contraction during the health emergency in all regions, being said shocks stronger in the Central region.

The COVID-19 pandemic forced a considerable number of workers to perform their labor remotely, outside of their usual workplace. Box 2 shows that the recovery of employment in some sectors, which

[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.

entail close physical proximity to consumers, has tended to be slower in municipalities where a higher share of employment could potentially be carried out remotely at the beginning of the pandemic. This supports the hypothesis that, as a result of the transitioning to the remote working scheme, the demand for services close to usual workplaces declined.

During the reported quarter and the beginning of the fourth one, annual inflation in all regions registered high levels, as it continued to be affected by both direct and indirect effects associated with the pandemic. In all regions, core inflation continued to follow an upward trend, while non-core inflation rebounded. The upward trajectory of inflation in the regions was driven by cost pressures, bottlenecks in supply chains, a significant reallocation of household spending towards merchandise, a gradual reopening of services, as well as pressures on energy prices. This occurred in a context of a global imbalance of supply and demand, which was intensified by the global economic recovery and the economic stimuli implemented by several advanced economies, while at the same time a slow reestablishment of production and distribution chains has been observed.

Starting in February 2020, Banco de México began to measure the twelve-month inflation expectations of Mexican companies by including a special module in the Monthly Survey of Regional Economic Activity (EMAER, for its acronym in Spanish), which is conducted for the purposes of this Report. The objective of Box 3 is to present the instrument used to collect data on inflation expectations of firms and describe the main results obtained so far. The results show that at the national, regional and sectoral levels, twelve-month inflation expectations of companies have increased during the complicated economic situation associated with the COVID-19 pandemic, particularly starting from the first months of 2021.

The results of the most recent program of interviews to business agents suggest that, in all regions, the diffusion index of expectations for demand for the goods and services they offer continued registering an expansion, improving in relation to the previous quarter in the north, while in the central and Southern regions it registered a reduction. In all regions, the level of the diffusion index continued to exceed that reported in the fourth quarter of 2019. Meanwhile, the diffusion index of expectations regarding the number of workers employed in companies also remained in the expansion zone in all regions, in addition to the fact that said expectations increased during the reported quarter, except in the north. Regarding fixed asset investment expectations for the next twelve months, the results suggest that these continued to improve in the North-Central and Southern regions, while the corresponding diffusion index remained above 50 points in all regions. Most of the agents interviewed in the different regions anticipate that the selling prices of the goods and services they offer, the prices of inputs, and wage costs will increase at a similar or higher rate for the next twelve months compared to what was observed during the previous twelve months.

The interviewed business agents highlighted the following risks to regional economic growth. To the downside: i) that public safety indicators continue to deteriorate; ii) that domestic uncertainty persists and affects investment; and iii) that the intensification of the pandemic leads to a reversal of the economic reopening that has been observed. Among upside risks, business agents mentioned: i) that the number of infections remains low due to increased vaccination coverage; ii) that the flow of private investment increases due to the possibility of a continued growth in the US economy; and iii) that public spending increases at the federal and local levels.

The economic recovery is expected to continue in all regions, although it is not free from risks, which could affect both its scope and pace of progress. Although the number of infections has diminished and progress in vaccination has allowed for health and economic activity to be less affected during the rebound in the pandemic observed in the reported quarter as compared to previous waves, there is a possibility that more contagious variants of the virus emerge, thus limiting the recovery of regional economies, especially those that tend to specialize in the tertiary activities most susceptible to be affected by a worsening of the pandemic. In addition, external sources of growth, which have been fundamental to

the recovery of the most export-oriented states, could weaken if disruptions in global supply chains, which have affected the availability and price of various inputs, persist.

It is difficult to anticipate what the more permanent consequences of the pandemic on regional economies will be, particularly regarding their human capital. In any case, it is necessary to continue strengthening the institutional framework and provide greater legal certainty for investment in all regions. Likewise, it is key to implement measures that, as a whole, contribute to increase productivity in the different regions of the country. All of the aforementioned with the aim to achieve higher rates of growth and wellbeing for the population.