Regional Economic Report
October – December 2021
Summary

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During the fourth quarter of 2021, economic activity stagnated, after having contracted during the third quarter. Services contracted for the second consecutive quarter, maintaining a differentiated behavior among its subsectors. In particular, business support services contributed significantly to the fall in tertiary activities, reflecting the entry into force of the new outsourcing regulation, while sectors such as transportation and warehousing, accommodation and food services performed better towards the end of the year, prior to the beginning of the fourth wave of COVID-19 infections. Industrial activity continued exhibiting low dynamism, reflecting mainly the unfavorable evolution of construction, while manufacturing registered a moderate reactivation, despite the persisting disruptions in global supply chains and the scarcity of certain inputs.

In this context, during the fourth quarter of 2021, economic activity is estimated to have shown weakness in the Central regions, while the Northern and Southern regions are expected to have registered certain growth. Economic activity levels in the North-Central, Southern and, especially, the Central region, are anticipated to have remained below those observed in the first quarter of 2021. In contrast, the Northern region is estimated to have remained above said levels of activity.[1] Box 1 illustrates that this heterogeneity in recovery has been observed not only at a regional but also at a state level. Both sectoral productive structures and idiosyncratic factors, which in both cases have been more favorable for the Northern region than for the rest of the regions, are contributing to said heterogeneity.

Weakness of economic activity in the Central region during the reported quarter is anticipated to have stemmed from a fall in construction —although public construction is above pre-pandemic levels—, from stagnation in mining as well as from low levels of some services, specifically business support services. The lack of dynamism in the North-Central region is estimated to have resulted from the negative performance of manufacturing production and a slight stagnation in certain tertiary activities, such as trade. In contrast, growth in the Northern region is anticipated to have continued to be largely supported by the positive performance of manufacturing other than that related to transport equipment. The Southern region's recovery is anticipated to have continued being supported by the favorable evolution of certain tertiary activities, such as trade and tourism, as well as an expansion of agricultural and livestock production and manufacturing.

Delving into the regional analysis included in this Report, box 2 analyzes the impact of manufacturing exports on the recovery of regional private consumption during the health emergency. The results suggest that the dynamism of non-automotive manufacturing exports has contributed to the recovery of consumption in the regions that are most closely linked to foreign markets, particularly in the Northern region, although it has been offset by the weakness in automotive exports. Box 3 uses a general equilibrium model to simulate the aggregate effects on each region produced by a decrease in victimization and the cost of crime in economic units

[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.

as a consequence of a possible increase in public safety. The results suggest that such a decrease would be reflected in increases in both investment and output in all regions, mainly in the Central one.

Various shocks related to the COVID-19 pandemic, which have been deeper and more prolonged than expected, continued exerting pressure on inflation in all regions of the country during the fourth quarter of 2021 and at the beginning of 2022. The supply of goods and services remains affected by disruptions in production and supply chains and higher input prices. In contrast, there has been an increase in the demand for goods due to a reallocation of household spending towards merchandise rather than services, in a context of economic recovery worldwide driven by significant economic stimulus programs in advanced countries. The global economic recovery has also exerted upward pressures on the international references of energy prices, in an environment of low levels of inventory and investment in this sector. In addition, the reopening of these activities and the increase in the demand they face, which had been contained for several months and has benefited from progress in vaccination campaigns, have also contributed to services inflation. The above has led to an imbalance between supply and demand in several markets, which has lasted longer due to a slow reestablishment of distribution channels and a lack of flexibility in supply, in addition to the spread of the omicron variant of the SARS-CoV-2 virus. Influenced by the aforementioned, annual headline inflation in all regions remains at high levels, registering 7.86, 7.49, 6.75 and 7.54% in February 2022, for the Northern, North-Central, Central and Southern regions, respectively. In turn, core inflation in all regions continued increasing during the fourth quarter of 2021 and in 2022 so far, driven by the increase in both merchandise and services inflation. Between the third and fourth quarters of 2021, non-core inflation increased in all regions due to higher annual variation in livestock and agricultural products' and energy prices. Although the latter started to decrease in December, which implied some decline in non-core inflation in all regions, livestock and agricultural product prices remain high.

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 in the expansion zone in all regions. In the North-Central and Southern regions, the expansion signal strengthened in relation to the previous quarter, while in the Northern one it weakened, and in the Central region it contracted for the second consecutive quarter. Meanwhile, the diffusion index of expectations regarding the number of workers employed in companies also continued in the expansion zone in all regions, although it declined in the North-Central, Central and Southern regions in relation to the level of the previous quarter. Regarding the diffusion index of fixed asset investment expectations for the next twelve months, it continued in the expansion zone in all regions during the fourth quarter of 2021. Said indicator continued trending upwards in the Central and Southern regions, while remaining stable in the North-Central one. In contrast, in the Northern region, after having registered relatively high levels, the indicator contracted for the third consecutive quarter.

The interviewed business agents highlighted the following risks to regional economic growth. On the downside: i) that the persistence of the pandemic leads to a less robust economic recovery; ii) that public safety indicators continue deteriorating; and iii) that domestic uncertainty persists and affects investment. On the upside: i) that private investment flows increase, particularly as a result of the effects of international and domestic stimuli; ii) that a greater control of the pandemic due to progress in vaccination coverage enables a more robust recovery; and iii) that public spending, particularly investment in infrastructure, is higher than expected.

During 2022, economic activity in all regions is expected to grow gradually. However, this recovery is not free from risks that could affect both its scope and pace of progress, as the performance of regional economies will continue to be influenced by the evolution of the pandemic, which is uncertain, in

addition to the risks posed by the Russia-Ukraine conflict. There is the possibility of new variants of the virus emerging, which is why vaccinating the world's population is a fundamental tool to mitigate said risk. The recovery of regional activity could also weaken if disruptions in global supply chains persist, which have affected the availability and price of various inputs. The Russia-Ukraine conflict increases the likelihood of longer lasting disruptions and further increases in various input prices. A deterioration in public safety conditions could also limit the recovery, especially in those states facing a higher incidence of crime.

It is difficult to anticipate what the more permanent consequences of the pandemic on regional economies will be, particularly in terms of human capital. In any case, and above all due to geopolitical risks, it is necessary to continue strengthening the institutional framework, providing greater legal certainty for investment and fighting insecurity in all regions. Likewise, it is key to implement measures that, as a whole, would 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.