Regional Economic Report
October – December 2019
Summary

Incoming information suggests that during the fourth quarter of 2019, Mexican economic activity continued on the same moderate downward path it has been following for several quarters. Thus, for 2019 as a whole economic activity slightly contracted. The referred behavior during the last quarter of 2019 resulted from the unfavorable evolution gross fixed investment has continued to show, the quarterly fall in manufacturing exports, and from certain loss of dynamism from private consumption.

On the production side, the evolution of economic activity during the reference period reflected the contraction of industrial activity and of primary activities, while services grew at a low rate. Within secondary activities, construction continued to fall, although it seems to have stopped trending downwards towards the end of the quarter. As for manufacturing activity, it trended slightly downwards in October-December due to the unfavorable evolution of transport equipment production and of the rest of manufacturing. Finally, mining recovered incipiently, which was largely associated with the recovery in the oil production platform.

The moderate downward path that economic activity continued to show during the reported quarter reflected the weakness of the Northern and Central regions.[1] Indeed, during the fourth quarter of 2019, production in the Northern region is foreseen to have fallen significantly, after having shown a positive trend for several quarters. On the other hand, the stagnation that Central and North-Central regions have been exhibiting for several quarters is estimated to have continued. In contrast, the Southern region is expected to have expanded for a second consecutive quarter, although starting from low levels. The contraction of manufacturing production is foreseen to have largely contributed to the expected fall of economic activity in the Northern region, although the fall in the construction and the agricultural and livestock product sectors are also associated with such a contraction. The negative performance of manufacturing, construction, and primary activities is also estimated to have influenced the stagnation that is anticipated to continue in the central regions as well as of mining in the Central region. Finally, the expected growth of economic activity in the Southern region is foreseen to have reflected the expansion of mining, manufacturing, commerce, and tourism in that region.

Between the third and fourth quarter of 2019, annual headline inflation decreased from an average of 3.31 to 2.94%, even laying at 2.83% in December, its lowest level since August 2016 and the second lowest for the year-end since the Consumer Price Index (CPI) was first measured in 1969. Nevertheless, in early 2020, annual headline inflation picked up, registering 3.70% in February. This evolution mostly reflects the behavior of annual non-core inflation, which decreased from a particularly low level of 1.87% during the third quarter to 0.86% in the fourth quarter, the lowest level registered by this indicator in a quarter. The latter was associated to lower annual growth rates of agricultural, livestock and energy product prices. In early 2020, annual non-core inflation rose to 3.81% in February, as a result of higher annual rates of change of fruit and vegetable prices, as well as of the upward effect stemming from the comparison base on gasoline prices, which had decreased at the beginning of the previous year due to a reduction of the Value Added Tax (VAT) in the northern border. As for annual core inflation, it continues to show resistance to decline, laying at an average of 3.78% during the third quarter of 2019 and of 3.64% in the fourth one. In February 2020 it stood at 3.66%, influenced by the upward effect of the increase in cigarettes and sugary beverages' excise taxes (IEPS, for its acronym in Spanish).

[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.

During the fourth quarter of 2019, average annual headline inflation in all regions analyzed in this Report fell vis-à-vis the previous quarter. This decrease was mainly due to the low levels of their respective non-core inflations. In early 2020, regional headline inflation rose in response to the higher levels of non-core inflation and to the increase in cigarettes and sugary beverages' excise taxes. In particular, although annual inflation in the Northern region was lower throughout 2019, it increased notably at the beginning of 2020. Such behavior was mainly due to the evolution of gasoline prices and, to a lower extent, to that of certain merchandise prices in the border strip with the United States, which reflected the arithmetic effect stemming from the VAT reduction from 16 to 8% in early 2019.

Most business agents of the four regions interviewed for this report anticipate demand for their own goods and services to increase in the next twelve months at a higher or equal rate than that observed in the previous twelve months. In line with the above, most interviewed business agents also expect hired personnel and physical capital to grow, albeit at a lower rate than that registered in 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, which has been affecting investment, persists; and, iii) that public spending is lower than expected, particularly that corresponding to federalized expenditures.[2] As to upward risks, business agents highlighted: i) that the levels of private investment are higher than expected, particularly due to the ratification of the USMCA; and, ii) that public investment in infrastructure is revamped.

As to the expected evolution of sales prices of goods and services for the next twelve months, most business agents interviewed foresee that the annual growth rate of sales prices of goods and services offered by them will be lower than or equal to that registered 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, three analytical boxes are included in this Report. In Box 1, the results presented suggest that tightening of the US immigration policy and increased granting of temporary work visas contributed to reduce migration flows of Mexican citizens to that country, while a recomposition towards a predominantly documented migration is observed, albeit with heterogeneous effects among Mexican regions. In Box 2 a model of accounting multipliers and Regional Social Accounting Matrices (SAM) is used to analyze the possible regional impact of an increase in Mexican exports to the United States, which may be associated, to a certain extent, with the imposition of tariffs on China by the United States. The results indicate that the Northern region may have benefited the most, both in absolute terms and in those relative to its GDP, by the above mentioned shock. Finally, Box 3 shows that the slowdown of formal employment during 2019 was sharper in the Northern region than in the rest of regions, mainly due to evolution of the manufacturing sector, while in the Southern region, in contrast with the Northern and Central regions, the growth rate of employment slightly recovered in the second half of that year, mostly due to higher labor recruitment in the construction sector.

In an environment of economic weakness and marked uncertainty, improvements in the trade relationship in North America have lowered the uncertainty associated with one of the factors that had been negatively affecting investment in Mexico's regions, particularly in those that have closer links to external markets. To fully benefit from this progress in trade, for the inclusion of the different country regions in global value chains, and to achieve the recovery of investment and growth, in addition to further strengthening the economy's fundamentals, it is essential to address the barriers that, to a greater or lesser extent, have prevented the country's regions from growing at a higher rate from a medium term perspective. Adopting measures that foster an environment of confidence and certainty for capital accumulation and that strengthen the institutional framework, the rule of law, and public security are, therefore, imperative.

[2] Although some business agents identified the coronavirus outbreak as a downside risk, during most of the interviewing period (January 6-30, 2019) that outbreak was mostly limited to China.