Regional Economic Report
April – June 2019
Summary

During the second quarter of 2019, the stagnation that Mexico's economic activity had been registering during the previous quarters continued. Such behavior was due to the greater weakness of the domestic aggregate demand components, in a context of marked uncertainty generated by both external and domestic factors. In particular, gross fixed investment continued exhibiting an unfavorable performance, mostly in the items of investment in construction and imported machinery and equipment. The weakness that private consumption has been exhibiting since the end of 2018 also intensified, reflecting, in turn, the lackluster performance of services consumption as well as the stagnant consumption of goods. In contrast, during the April-June period, manufacturing exports recovered. In line with the above, on the production side, the stagnation of economic activity reflected the weakness that continued to be observed in industrial production and the significant contraction of primary activities, while tertiary activities recovered slightly relative to the decrease observed during the first quarter, although they continue to show a loss of dynamism. Within industrial activity, the downward trajectory of construction observed since the early part of 2018 intensified further, while mining continued trending downwards. In contrast, manufacturing exhibited certain recovery vis-à-vis the weakness it had registered during the second half of 2018.

Economic activity exhibited a mixed behavior in the different regions of the country.[1] Indeed, in the North region, economic activity is expected to have continued following an upward path, while in the Central region it is estimated to have partly recovered from the fall observed in the previous quarter. In contrast, in the North-Central region economic activity remained at a standstill, while in the South it continued its negative trend. Factors that are foreseen to have contributed to the estimated expansion of economic activity in the North region during the second quarter of 2019 are the increase in manufacturing production, retail trade, and in mining and construction, while certain tertiary activities, in particular, tourism, might have contributed to the recovery of the Central region. The mining sector and the agriculture and livestock products sector are foreseen to have contributed to the weak performance of the North-Central and South regions, while construction is anticipated to have contributed to the decline in the former region and manufacturing to the latter's.

Between the first and second quarters, annual headline inflation increased from an average of 4.10 to 4.21%, although lately it has followed a downward trend, reaching 3.16% in August. The decrease of headline inflation has been mainly due to the fall of annual non-core inflation, which went down from an average of 5.84 to 5.35% in the same quarters, to 1.28% in August. As for the non-core inflation components, lower increases were observed mainly in energy prices, as well as in fruits and vegetables prices, while the growth rate of livestock product prices has increased. In contrast, average annual core inflation went up from 3.56 to 3.83% between the first and second quarters, ending at 3.78% in August. As such, core inflation has continued to show persistence.

The evolution of headline inflation at the national level permeated through most Mexican states. Indeed, between the first and second quarters of 2019, average annual inflation increased in all regions, except the Central one, where it remained unchanged. Recently, the decline exhibited by headline inflation across all regions is associated mainly with the behavior of non-core inflation, given that annual core inflation in all of them remains at high levels and continues showing persistence.

[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.

Business agents interviewed in the four regions for this Report anticipate the demand for own goods and services to grow in the following twelve months. Nevertheless, this signal was weaker than in the previous report in the North and North-Central regions, while it strengthened slightly in the Central and Southern regions. In line with such developments, an expansion of hired personnel and physical capital are also anticipated, although for these two indicators the signal weakened with respect to the previous quarter in all regions.

Business agents interviewed also 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 both domestic and external uncertainty that firms are facing continues and that this is reflected in lower investment; and iii) that the United States imposes tariffs on Mexican export products. Regarding upward risks, business agents highlighted: i) the possibility of a recovery of both public and private investment; and, ii) that the United States-Mexico-Canada Agreement is ratified.

As for expected sales' prices of their own goods and services for the next twelve months, most interviewed business agents anticipate similar or lower annual changes as compared to last year. In line with that, most business agents interviewed in all regions expect wage costs and input prices to grow at an annual rate similar or lower to that registered in the previous twelve months.

To complement the analysis of regional economic activity, three analytical boxes are included in this Report. Box 1 delves into the effect of institutional quality on firms' size and export vocation in regional economies, finding that, indeed, an improvement in institutional quality fosters both a larger size and a greater export vocation of firms, making them benefit from the economies of scale and thus promoting the productivity of the economic units. Box 2 shows that the positive effects of a specific cluster are not limited only to its own activity, taking advantage, for example, of agglomeration economies and knowledge sharing, but also to other activities through the interaction generated by the purchase and sale of production inputs. Finally, given the risk that the United States may impose tariffs on Mexican exports, and on the basis of the subjective probability measures elicited from the business agents interviewed for this Report, Box 3 shows that in the Northern region and, to a lesser extent, in the Central ones, a higher risk of a negative impact on business activity for the next twelve months is perceived, which is consistent with their greater export orientation to the United States.

The Mexican economy is facing a complex environment due to both global and other factors more associated to the domestic scenario that involve significant medium- and long-term risks, which may affect the performance of regional economies. Given this context, maintaining a solid macroeconomic framework, in addition to fostering the adoption of measures that generate confidence and certainty for investment and greater productivity, is essential. Strengthening the rule of law, tackling corruption, and fighting insecurity in all regions is equally imperative.