

Regional Economic Report

July – September 2016

Summary

Economic activity in Mexico recovered moderately in the third quarter of 2016, following a period of stagnation in the previous one. This evolution is principally attributed to the expansion in the services' sector, while industrial production as a whole remained stagnant. Indeed, there was a recovery in tertiary activities, after a strong contraction in April, fundamentally due to the dynamism of the trade sector and transport services, mass media information, financial and real estate services, among others. Meanwhile, within the industrial production, a decreasing trend, which had been registered since early 2014, persisted in the mining sector, in a context in which the crude oil production platform kept declining. Similarly, the construction sector stagnated, as a consequence of a smaller volume of contracted work by the public sector, while electricity decelerated in the reported quarter. In contrast, the improvement in manufacturing, which had begun at the end of the previous quarter, persisted, which is, in part, associated to a relatively more favorable evolution of this sector's exports in the third quarter of 2016.

The recovery of the national productive activity in the analyzed quarter was perceived across most regional economies. Indeed, the Northern and the North-Central regions are estimated to have registered a greater dynamism in their economic activity, as compared to the previous quarter, while the Central region is estimated to have expanded moderately, although less than in the second one. In the south, a level of economic activity similar to that in the previous quarter was registered, which is in contrast to the contraction in the second quarter. The positive performance in the Northern and Central regions is largely attributed to the favorable evolution of manufactures more related to the external market, of trade and of services, as well as to the incipient rebound in non-oil mining in the North-Central region and in construction in the Northern one. On the other hand, stagnation in the Southern region fundamentally derived from the weakness prevailing in the oil mining sector and in manufacturing, as well as a certain slowdown in tourism, which was offset by the favorable performance of construction, particularly its private component, of retail trade and agricultural production in that region. To complement the regional economic analysis presented in this Report, Box 1 estimates the relative multiplier effects in the regional economic activity in view of a shock to manufacturing exports, while Box 2 examines the performance of the labor force participation rate (LPR) at the regional level, as well as its relation to a number of factors that affect it.

As of September 2016, annual headline inflation accumulated 17 consecutive months below the permanent 3 percent target, and later reached 3.31 percent in November. This was despite the complex external environment, which was manifested, among other things, in a considerable depreciation of the exchange rate. The conduct of monetary policy and the environment of absence of aggregate demand-related pressures onto prices, as well as low international prices of most commodities and lower prices of telecom services in Mexico, which were consequent on the structural reform in that sector, contributed to the referred result. The evolution of inflation at the regional level has been congruent with the said performance. In particular, across all regional economies, inflation was equal to or

below 3 percent in the reported quarter, even though in November it was above that figure. It should be pointed out that, unlike in other quarters, the performance of headline inflation was slightly heterogeneous across regions; in particular in the Northern region it displayed a tendency to increase more than in other regions, as a consequence of gasoline price increments, which were observed in the border area during the analyzed quarter.

Most business contacts interviewed for this Report anticipate demand for own goods and services to grow over the following twelve months. In accordance with this, the consulted business agents generally anticipate a rise in the number of hired personnel and the physical capital stock across different regions of Mexico.

Business contacts also commented on the principal upward and downward risks to regional economic growth. Among downward risks, the following were mentioned: i) possible consequences of the outcome of the U.S. elections; ii) greater volatility in international financial markets, and, in particular, that it may affect the exchange rate performance; and iii) a possible deterioration in the perception of public safety. In contrast, among upward risks, the next were listed: i) a greater than estimated increment in the levels of private investment in Mexico, especially from abroad; and ii) strengthening of external demand, related to a higher dynamism of the U.S. economy and a depreciation of the real exchange rate.

As regards inflation expectations for the next 12 months, business agents interviewed across all regional economies anticipate annual price changes of own goods and services, as well as wage costs, to be generally lower than in 2015. In contrast, in most regional economies, in line with the consulted sources, the annual growth rate of input prices is expected to be higher than or equal to that registered last year.

Finally, it should be noted that the outlook for regional economies has turned more complex, among other factors, as a consequence of the U.S. electoral process and its outcome. In particular, the referred event increased the risk of implementing policies in the U.S. that may hinder foreign trade and foreign investment. Hence, insofar as competitiveness in different regions is boosted, by means of a continuous improvement in the infrastructure, in particular in communications and transport, and by means of exploiting regional comparative advantages, not only a greater export vocation of the regional economies and a major diversification of Mexican exports' destinations can be attained, but also a relatively greater impact on the domestic market, GDP and employment can be achieved. In this respect, Box 3 shows the opinions of business agents regarding the main challenges faced by Mexico's transport infrastructure. Likewise, it is indispensable to proceed with the adequate and prompt implementation of structural reforms, as they will foster productivity across regional economies and will contribute to a better resource allocation. These reforms will boost a greater sustainable growth of the domestic market, which would allow to counteract the effects generated by the adverse external environment on the Mexican economy.