

## Regional Economic Report

### July – September 2017

### Summary

**D**uring the third quarter of 2017, economic activity in Mexico contracted. This performance reflects the fact that the slowdown that had been observed in a number of components of aggregate demand was complemented by adverse, although transitory, effects generated by the earthquakes and by the plunge in crude oil production that took place in September. Indeed, over the reported period, the weak performance of industrial activity, registered since mid-2014, became more pronounced, while the tertiary activities declined. Within the industrial production, mining accentuated its unfavorable trend in the third quarter, while the construction sector persisted weak. In contrast, the manufacturing activity maintained a positive trend.

Consistent with the above, it is estimated that while in the Northern and North-Central regions the growth rate of the economic activity somewhat decelerated, the regions affected by the referred temporary shocks contracted. In particular, it is estimated that the Southern region registered a drop as a result of both the decrease in crude oil production and telluric movements, the latter factor lowering the economic activity level in the Center, especially in trade and services. Indeed, this regional performance reflects the fact that in the Northern and North-Central regions manufactures kept performing favorably, while in the Central and Southern regions the tertiary activities were particularly affected by the earthquakes in September, and in the South the oil mining accentuated its fall as a consequence of the temporary reduction in the crude oil production platform. In this regard, Box 1 specifies the main impacts and difficulties faced by businesses, as a result of the referred seismic shifts, while Box 2 estimates their impact on the regional economic activity.

Annual headline inflation attained 6.66 percent in August 2017, and went down over the following two months. However, as a result of new shocks, in November annual headline inflation increased with respect to September from 6.35 to 6.63 percent. In particular, the annual change of the non-core subindex went up, fundamentally derived from higher energy prices, especially LP gas, as well as from higher prices of certain fruit and vegetables. Meanwhile, annual core inflation also increased, which was related to the growth of non-food merchandise prices and a rebound in services' prices. The evolution of inflation across all regions was affected by the above indicated factors and generally followed a similar trajectory.

Business agents interviewed for this Report across all regions expect demand for own goods and services to expand during the following twelve months. In this context, the consulted contacts also anticipate an increase in the number of hired personnel and the physical capital stock. The referred business agents mentioned the main upward and downward risks for regional economic growth. Among downward risks, the following were highlighted: i) a possible deterioration in public safety; ii) that uncertainty related to the upcoming electoral process in 2018 inhibits private spending on investment; and iii) that the renegotiation of NAFTA (the North American Free Trade Agreement) turns out unfavorable for Mexico, or even leads to the U.S. withdrawal from the said agreement. In contrast, among upward risks, the next were mentioned by business agents: i) the greater-than-expected flow of investment (both domestic and foreign); and ii) that NAFTA renegotiation turns out favorable for the Mexican productive sector. To measure the relevance of NAFTA for different Mexican regions, Box 3 delves in the importance of Mexico – U.S. trade to generate the value added in the regions, especially the one derived from integrating different regions in Global Value Chains (GVC).

As regards the expected evolution of prices for the next twelve months, business contacts interviewed in all regions anticipate the annual growth rates of the sales' prices of own goods and services to be generally lower as compared to last year. In line with the above, business agents also expect a decrease in the annual growth rates of input prices for the next twelve months with respect to 2016, and, in the balance, in most regions they anticipate, on average, similar changes in the cost of the labor factor.

Finally, the structural reforms that are being implemented, along with the economic policy seeking to maintain an environment of sound macroeconomic conditions, allowed regional economies to show resilience in view of the adverse shocks they had faced. Nonetheless, an environment of public insecurity and a lack of the full observance of the rule of law have prevented the strength of macroeconomic fundamentals from being fully reflected in higher productivity levels, which is a fundamental factor to obtain a sustainable greater expansion of the economy and, therefore, to increase labor incomes and population welfare across different regions of Mexico.