Regional Economic Report
October – December 2017
Summary

During the fourth quarter of 2017, the Mexican economy expanded significantly, which stands in contrast with the contraction in the previous one, in the wake of the September earthquakes and a major decline in the oil production platform during that month. The recovery in economic activity in the fourth quarter mainly derived from the dynamism of services, despite the persistently weak performance of the industrial production. This occurred in spite of a rebound in December, which was attributed to growth in the construction industry, in part, possibly associated with the reconstruction efforts following the September twin earthquakes.

The performance of economic activity in the reference quarter has improved across all Mexican regions. Indeed, the productive activity is estimated to have rebounded in the Central and Southern regions, in part reflecting the reestablished higher activity levels in the aftermath of the September earthquakes, and, in the South, the drop in crude oil production during that month. The North-Central and Northern regions expanded after a decline exhibited in the latter region in the previous quarter. Economic growth in the Central and Southern regions was fomented by greater construction activity and trade, as well as manufactures and the mining industry in the former region. Meanwhile, in the North-Central region, trade, agricultural production and tourism also expanded, while in the North there were increments in the mining production and trade. To complement the analysis of the regional economic evolution presented in this Report, Box 1 delves into the determinants of Mexican workers' remittances abroad, while Box 2 estimates the degree of synchronization of the manufacturing production cycles among the Mexican states and that corresponding to the U.S.

Between the third and the fourth quarters of 2017, average annual headline inflation rose from 6.48 to 6.59 percent, and closed the year at 6.77 percent. This evolution reflected a number of different shocks at the end of the year: higher energy prices, mainly LP gas, and higher prices of certain fruits and vegetables; a further depreciation of the Mexican peso; and the effect of the change in the calendar of the minimum wage increase effective in December rather than in January. These shocks took place in an environment of tightening slack conditions in the economy, which could be reducing the economy's ability to absorb them, and could be affecting the pace of the core inflation decline. In January 2018, as anticipated, annual headline inflation decreased, marked 5.55 percent and, subsequently, 5.34 percent in February. This resulted from the arithmetic effect associated with the fact that in 2018 energy price increases were not as intense as those registered at the beginning of the previous year. The said effect is also associated with the core inflation decline. Despite the considerable inflation decrease in early 2018, it was limited given that the price increases of some non-core components observed at the end of the previous year persisted. These factors affected the evolution of regional inflation, which generally followed a similar trajectory. However, the situation in the North was different from the rest of the regions, as inflation went down in the fourth quarter with respect to the third one, and inflation levels in the North were lower relative to the remaining regions during the first months of 2018. This mainly derived from increases in energy prices that were smaller as compared to last year. This is due to the fact that in the border cities of this region the determination of gasoline prices was already based on international references prior to 2017. Another factor that contributed to that were lower increases in merchandise prices caused by the partial fading of the shocks that had affected them in 2017. Inflation was lower in the Southern region relative to other regions in 2017, although at the end of the year this difference was narrowing, when the growth rates of merchandise prices and of some products comprising the non-core component increased in that region.

Across all regions, business contacts interviewed for this Report expect demand for own goods and services to grow during the next twelve months. In line with that, the consulted contacts also anticipate a greater volume of hired personnel and the physical capital stock. The referred business agents commented on the main upward and downward risks to regional economic growth. The downward risks are: i) a deterioration in public safety; ii) that the uncertainty related to the 2018 electoral process could detonate volatility episodes in financial markets, which could curb private spending on investment; and iii) an unfavorable outcome of the NAFTA renegotiations for Mexico. In contrast, among upward risks, the consulted sources stressed the following: i) a favorable outcome in NAFTA negotiations; and ii) a greater-than-expected increase in private investment levels (both domestic and foreign), especially in the energy and automotive sectors.

Regarding the estimated performance of prices over the next twelve months, most interviewed contacts expect the annual growth rates of own goods and services sales' prices, of input prices and of the cost of the labor factor to be generally lower or equal to the previous year. However, a larger share of the consulted business agents currently expects a greater growth rate. With respect to input prices, Box 3 gives an analysis of the impact of logistics costs and a number of variables associated with the market concentration on the regional price of low octane gasoline.

One of the important findings of this Report is the presence of heterogeneity in the degree of synchronization among the four considered regions and the U.S. manufacturing cycle. Indeed, the Northern region and some states of the Central regions are more synchronized with the U.S. manufacturing cycle, which could, in part, be reflecting their infrastructure provision, and in some cases their proximity to the U.S. This has fostered greater productivity and value added generation, as these regions are more integrated into the global value chains. In this context, it is necessary to continue fomenting the needed infrastructure and human capital across all regions, along with safety conditions, the rule of law and the institutional framework. This is required to better benefit from the comparative advantages of other regions, to achieve higher production levels, a more dynamic domestic market, and to be more closely integrated with foreign markets.