

Regional Economic Report

January – March 2016

Summary

In the first quarter of 2016, economic activity in Mexico presented a growth rate greater than in the previous one. This was largely due to the dynamism of the services sector and, to a lesser extent, due to the favorable evolution of the agriculture and livestock industry, as well as to an incipient improvement in the construction sector. In contrast, the rest of industrial sector activities remained weak. Indeed, manufacturing production presented a low dynamism, fundamentally, as a reflection of the unfavorable evolution of this sector's exports. Similarly, mining maintained a negative trend, while the electricity sector remained stagnated.

In this context, the performance of the economic activity was heterogeneous across regions in the reported quarter.¹ In particular, it is estimated that the increment in the growth rate of the Mexican economy was principally attributed to the rebounds in the levels of economic activity registered in the North-Central and Southern regions, following the contraction of activity in these regions in the previous quarter. Indeed, in both regions construction, retail trade, the agriculture and livestock industry and manufacturing more related to the domestic market performed better than in the fourth quarter of 2015. Meanwhile, in the Northern region the economic activity slightly decelerated, principally, due to the unfavorable performance in the construction sector and the manufacturing production for exports carried out in this region, although it was partially offset by the good performance of manufactures channeled, to a larger extent, to the domestic market, as well as retail trade. Likewise, in the Central region the pace of economic growth decreased relative to last quarter, even though it is estimated that it remained above the national average. The decline in this region's growth rate is fundamentally attributed to the less favorable performance of some manufacturing activities more oriented to meet external demand. In contrast, a high dynamism persisted in those sectors that destine a large share of their production to the national market.

To complement the structural analysis of the regional economic activity, Box 1 of this Report analyzes the evolution of manufacturing industries' location and of the degree of specialization of different Mexican regions over the period 1993-2013. This allows to pinpoint some of the key changes in the patterns of geographic concentration and of regional diversification of the manufacturing activity that were observed considering the country's commercial openness and higher levels of competition at the external market. In particular, the Box presents the analysis of the regional patterns of the Mexican economy, after the implementation of the North American Free Trade Agreement (NAFTA) and the entry of China into the World Trade Organization (WTO).

Headline inflation performed favorably in spite of the complex global environment faced by the economy. In particular, annual headline inflation has remained below the permanent target for 13 consecutive months, despite a slight upward shift in this indicator in early 2016, which was related to different factors that temporarily affected it and that, in some cases, had been anticipated. The good performance of inflation was a result of an adequate monetary policy stance, slack conditions prevailing in the economy, direct and indirect effects of price drops in some generalized-use inputs onto inflation (largely a result of the implemented structural reforms), as well as the environment of low international prices of most primary goods. The low exchange rate pass-through onto prices during 2015 and in 2016 so far should be mentioned, which, in part, is also the effect of the above mentioned factors, but above all it reflects the structural change that has been taking shape for years regarding a more effective anchoring of inflation expectations. Inflation performance at the regional level has been congruent with these dynamics, and, in particular, across all regional economies inflation remained under 3 percent in the reported quarter.

Most business contacts interviewed in four regions considered for this Report estimate demand for own goods and services to expand during the following twelve months. Consistent with this, the consulted business agents, in general, expect a rise in the number of hired personnel and in the physical capital stock across different regions of the country, and, in particular, they were optimistic considering the investment flow expected in the automotive sector. In this respect, Box 2 studies the impact of investment in this sector on the regional economic activity, based on the use of regional input-output matrices (RIOM).

As regards the main risks to the regional economic growth, business contacts noted the following among the upward ones: i) a greater than expected growth of private investment in the manufacturing sector and tourism; and ii) the strengthening of external demand. On the other hand, among downward risks, the next were mentioned: i) higher volatility in international financial markets; and ii) a possibility of the deterioration in the perception of public safety.

Business agents also commented on the inflation expectations for the next twelve months. In this regard, the interviewed business contacts generally anticipate lower annual growth rates in the prices of own goods and services, as well as the prices of inputs used in the production process, as compared to last year. Likewise, in all regional economies of Mexico business agents indicated that they expect wage increments lower or equal to those of last year.

¹ Regionalization: **Northern**: Baja California, Sonora, Chihuahua, Coahuila, Nuevo León and Tamaulipas; **North-Central**: Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; **Central**: Ciudad de México, Estado de México, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and **Southern**: Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.