Regional Economic Report
January – March 2018
Summary

During the first quarter of 2018, the Mexican economy continued recovering, and even presented a growth rate higher than that in the previous one, which stands in contrast with the deceleration in the first three quarters of 2017 and with the weakness of some aggregate demand components, especially, investment, displayed up to the third quarter of that year. The growth of production fundamentally reflected the positive performance of the tertiary activities, the recovery of the industrial production, and the fact that production in the agricultural sector maintained a growing trajectory that had been exhibited since the second half of 2017. Within the industrial sector, both the significant reactivation of the construction activity and the recovery of manufacturing are noteworthy, which compares to their weak performance during most of 2017. In contrast, the negative trend in mining persisted, mainly due to the decline in the crude oil production platform, and thus it maintained particularly low levels.

The Mexican economic activity expanded across all regions in the first quarter of 2018. Indeed, the productive activity in the Northern and the Central regions is estimated to have continued expanding and displayed an even higher dynamism as compared to the referred regions in the previous quarter. Meanwhile, in the wake of the stagnation during the previous quarter, in the first three months of 2018 the Southern region observed a rebound, which was in contrast with the negative trend registered since early 2016. The performance of the regional economies is essentially attributed to the positive evolution of the tertiary activities, and, especially, trade across most regions, as well as to the rebound in the construction sector, manufacturing and the agricultural activities in all regions, except for the Central one. Within the tertiary activities, the positive performance of tourism stands out, which contrasts with the deterioration observed over the previous two quarters in most regions, partly as a result of the September twin earthquakes and the perceived insecurity in certain tourist destinations. In this respect, and to complement the analysis of the regional economic evolution presented in this Report, Box 1 estimates the economic growth of the main beach tourist areas in Mexico over the period of 1993 – 2017, via the use of satellite images.

Between the fourth quarter of 2017 and the first one of 2018, average annual headline inflation subsided from 6.59% to 5.31%, and later went further down to 4.51% in May. This evolution reflected an array of factors. First, the implemented monetary policy actions contributed to prevent the generation of second-round effects on the price formation process of the economy, as a result of inflationary shocks. Secondly, they contributed to the orderly adjustment in the Mexican financial markets, in an environment of uncertainty. In addition, the fading of the shocks on annual headline inflation in 2017, derived from higher energy prices at the beginning of that year, in particular of gasoline and LP gas prices, contributed to its decrease starting in January 2018.

The decline in headline inflation in Mexico since the beginning of 2018 was observed across all regions. It should be noted that the Northern region displayed the inflation reduction of a greater magnitude at the beginning of 2018, which is mostly associated to lower annual growth rates of gasoline prices in that region. In that respect, it should be noted that in the Northern region gasoline prices increased more in early 2017 than in the rest of regions, as they had been liberalized earlier. Therefore, in early 2018 this region observed the impact of the high base of comparison. The Central region registered a higher annual headline inflation relative to the rest of regions. This is in part attributed to the fact that this region has been characterized by higher levels of the services inflation, largely given that the growth rate of the housing prices tends to be higher than in other regions. This, in line with the interviewed business agents, is due to the higher demand for housing in certain parts of this region, such as the Mexico City metropolitan area and the Bajío. Relative to the factors that determine the regional differences at the inflation level, Box 2 delves in the heterogeneous nature of the pass-through of the exchange rate on prices across the four Mexican regions.

Business agents consulted in different regions anticipate the demand for own goods and services to increase over the next twelve months. Consistent with the above, they also expect an increase in the number of hired personnel and the physical capital stock. In this context, the consulted sources mentioned the main upward and downward risks to the regional economic growth. The downward risks are: i) a deterioration in public safety; ii) that the uncertainty related to the 2018 electoral process negatively affects businesses' investment levels; and iii) an unfavorable outcome of the NAFTA renegotiations to the Mexican productive sector. In contrast, among upward risks, the consulted business agents stressed the following: i) a favorable outcome for Mexico in the NAFTA renegotiations; and ii) a higher-than-expected increase in investment levels. In this regard, Box 3 delves in the functioning and the progress of Special Economic Zones (SEZ), whose operational start-ups could invigorate investment across certain states of Mexico, which had previously displayed a lower dynamism of investment, exports and the value added generation.

Relative to the expected evolution of prices for the next twelve months, most business agents in all regions generally anticipate the annual growth rates of own goods and services' sales prices, of input prices and of the cost of the labor factor to be lower or equal to those in the previous year.

In addition to the strengthening of the macroeconomic framework, to take on the challenges that may arise and to enhance the regional economies' ability to tackle negative shocks, actions should be taken to improve the competitiveness and to foment higher productivity. Thus, priority should be given to the efforts aimed to increase the infrastructure development, to foment the human capital and to generate the necessary conditions to increase the investment flows. To attain it, better public safety conditions are required, along with the legal certainty and the economic competition in all regional economies. This will not only allow attaining favorable investment conditions, but also more balanced regional expansion.