Regional Economic Report

April – June 2021

Summary

During the second quarter of 2021, economic activity in Mexico continued to recover gradually, although heterogeneously across sectors. In particular, services continued to reactivate, in a context in which progress in the vaccination process made it possible to relax the restrictions associated with the health emergency, particularly in service areas with greater face-to-face interaction. However, in view of the recent increase in the number of infections, uncertainty prevails regarding the evolution of this sector. Industrial production exhibited low dynamism in all the sectors that comprise it, especially in the cases of construction and manufacturing. Within the latter, the difficulties caused by the shortage of certain inputs and other logistical problems, mostly in the transportation equipment sector, stand out. Primary activities exhibited a volatile behavior.

In this context, economic activity in all regions[1] is estimated to have continued recovering during the reported quarter. However, the Central and Southern regions would still exhibit a larger gap from pre-pandemic levels of activity as compared to the North and North-Central regions, whose economic activity may have already attained the levels of the first quarter of 2020.

The more favorable evolution of tertiary activities is expected to have contributed to a greater extent to the regional economic recovery during the second quarter of 2021, given that secondary activities are expected to have continued to decelerate, although with heterogeneity across regions and sectors. Indeed, in all regions, the reactivation of retail trade and services, particularly tourism, is estimated to have contributed to the recovery, partly as a result of fewer restrictions on mobility in the context of the pandemic. The recovery in the Northern region is expected to have continued to be supported by the performance of manufacturing excluding transportation equipment in that region, while growth in the central regions is expected to have been favored by the positive evolution of agricultural and livestock production. This behavior offset the negative evolution of non-oil mining and, in the case of the North-Central region, of manufacturing, in an environment where the scarcity of inputs and logistical problems affected both industrial activities, especially the automotive industry. The expansion estimated in the reported quarter for the Southern region would also reflect the continuing favorable behavior public construction has been exhibiting for several quarters and, to a lower degree, the increase in mining, which would have contributed to compensate the fall in agricultural and livestock production.

Regarding progress in the vaccination campaign against COVID-19 in the country, Box 1 describes the recent developments in the regions and shows that, in the third wave of pandemic infections, the age groups with higher vaccination rates have shown smaller increases in new cases compared to other age groups, as well as significant reductions in the probability of death given a positive test result. As to the heterogeneous effects of the health emergency on regional activity, the results in Box 2 suggest that the output gap remains negative in all regions, although the widest gap is in the Central region.

During the reported quarter, the labor market continued to recover, albeit unevenly across regions. In this regard, Box 3 shows that the heterogeneity in the recovery of employment, in which the Central region has shown a greater lag, would seem to respond to differences in the economic performance of sectors in different regions, as well as to their sectoral composition. The results of Box 4 suggest that a hypothetical decrease in the rate of labor informality in the regions would result in significant

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

increases in average establishment size and per capita GDP, mainly in the Southern region.

Between the first and second quarters of 2021, average annual headline inflation increased in all regions. This behavior was associated with the increase in core inflation in all regions, except in the Southern one, as well as with the sharp rise in non-core inflation. Core inflation in all regions was subject to upward pressures from the shocks that the pandemic continued to cause, which in some cases were offset by the base effects derived from the pandemic's adverse effects registered last year. The notable increase in non-core inflation in April in all regions was largely the result of the arithmetic effect associated with the low gasoline prices last year. Subsequently, this effect has been fading, and in August it was reinforced by the decrease in the price of L.P. gas. However, the impact of energy products on the reduction of non-core inflation has been partially offset by the increase in the inflation of agricultural and livestock products. In this regard, Box 5 shows that episodes of low rainfall in the main producing states generate upward pressures on white corn and bean prices, which suggests that these types of events could continue to be an upward risk for agricultural and livestock product prices in the future, since the frequency of these events has increased in the last decade. So far in the third quarter, pressures on core inflation continued to offset the gradual reduction in non-core inflation, so that headline inflation in all regions remains high.

The results from the recent survey among business agents suggest that, in all regions, the diffusion index of expectations for demand for the goods and services they offer remained in the expansion zone, improving in the central regions in relation to the previous quarter, while the Northern and Southern regions recorded a slight reduction. Thus, in all regions, the level of the diffusion index kept exceeding that reported in the fourth quarter of 2019. The diffusion index of expectations regarding the number of workers employed in companies also remained in the expansion zone in all regions, as these registered an increase during the reported quarter. As for expectations for investment in fixed assets for the next twelve months, the results suggest that these continued to improve in the Central and Southern regions, and the corresponding diffusion index remained above 50 points in all regions.

Most business agents interviewed in different regions anticipate that, in the next twelve months, their sales prices of goods and services will increase at a rate similar or higher than that in the previous twelve months. Most business contacts also expect input prices to increase at the same or higher rate over the next twelve months, as compared to the previous twelve months, although this percentage decreased in all regions compared to the previous quarter. In this context, Box 6 presents the opinion of business contacts regarding the changes they have had to implement in the composition of their inputs due to the effects of the pandemic. The share of interviewed business agents who expect a variation in wage costs for the next twelve months similar to or greater than that of the previous year increased in all regions.

Business agents mentioned the following risks to growth. To the downside: i) that there are delays in the distribution or application of vaccines or a new outbreak of the pandemic, which would imply the adoption of new measures to contain it; ii) that public safety indicators continue to deteriorate; and iii) that internal uncertainty persists, thus affecting investment. To the upside: i) that the pandemic dissipates more rapidly, particularly through a faster vaccination campaign; ii) that tourism activity recovers at a faster pace than anticipated; and iii) that growth in the United States and the stimulus programs implemented in that country lead to a greater boost to the regional economies.

Looking ahead, although economic recovery is expected to continue in all regions, uncertainty prevails as to the course of the pandemic and the extent to which the external and internal factors that have supported the regional recovery will maintain their momentum. Indeed, the emergence of more contagious variants of the SARS-CoV-2 virus poses a significant risk to the recovery of the regional economies, especially those like the Central region, which are more specialized in services. Likewise, the persistence of some disruptions in global supply chains could limit the effect of global demand on regional economic activity, especially in those entities in the Northern and Central regions that are more oriented to manufacturing exports.

It is difficult to anticipate the most permanent consequences the pandemic will have on the regional economies, particularly in terms of human capital formation. In any case, it is necessary that all regions continue strengthening their institutional framework and provide greater legal certainty for investment. Likewise, it is imperative to implement measures that, as a whole, contribute to reduce informality in order to increase per capita GDP and the size of businesses in the different regions of Mexico. All of this in order to ensure higher growth rates and well-being for the population.