Regional Economic Report
January – March 2021
Summary

Economic activity in Mexico slowed its pace of recovery during the first quarter of 2021 relative to the decline observed during the second quarter of 2020 due to the initial shock generated by the COVID-19 pandemic. This was due to a number of events that took place at the beginning of the year. In particular, between late 2020 and early 2021, new cases of infections rose, which led to the implementation of new restrictions to contain the pandemic. There were also some disruptions in the supply of certain industrial inputs, particularly in the automotive sector, as well as a temporary interruption in the supply of natural gas and electricity in mid-February in the country's Northern region. These shocks led to a weak performance in January and to a fall in productive activity in February.

Subsequently, although some input supply problems persisted in the automotive industry, the sector's production rebounded in March. Lower rates of infections and advances in the vaccination process have allowed for a gradual loosening of restrictions on mobility and production. This led to a reactivation in March. It should be noted that the level of recovery of the different economic sectors was overall heterogeneous, with a relatively better performance of industrial activity as compared to services.

Given the abovementioned, all regions[1] are expected to have registered a slowdown in their rates of recovery during the first quarter of the year. However, the Northern and Central regions are anticipated to have grown at lower rates than the South. Despite the relatively better performance of the South, during the first quarter of 2021, this region, together with the Central region, would continue to show a larger gap in their levels of activity relative to those recorded during the same period of 2020 than the Northern and North-Central regions. Indeed, the levels of activity in the Northern, North-Central, Central and Southern regions during the first quarter of 2021 are estimated to have been 1.2%, 2.0%, 4.3% and 4.7% below those observed during the same period of the previous year, respectively.

This heterogeneous behavior across regions during the analyzed quarter is attributed, among other factors, to the fact that the effects of the problems in the provision of natural gas and electricity, and of other production inputs, concentrated in the Northern and Central regions, in addition to the fact that both regions were affected to a greater extent by the restrictions imposed to contain the pandemic at the beginning of the year. The slowdown in the Northern region was also attributed to a slower growth rate in mining, tourism and in retail trade, which offset the better performance in the agricultural and livestock products sector as well as in the construction sector during the reported quarter. The Central regions registered a more generalized deceleration among sectors, except for construction in the North-Central region and the agricultural and livestock sector in the Central region. In contrast, the higher growth rate estimated for the South during the reported quarter, as compared to the other regions, would be due to an important increase in public construction as well as to a better performance in oil mining, retail trade and in the agricultural and livestock sector than in the previous quarter, which offset the negative evolution of some tourism-related services.

In the context of the disruptions to the supply of natural gas and electricity that took place in February 2021, Box 1 presents an estimation of their effects on regional economic activity and shows that said effects were greater in the manufacturing sector in the Northern region. As for the evolution of regional

[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.

consumption during the health emergency, Box 2 presents evidence on how the gradual loosening of social distancing measures contributed to reactivate consumption in all regions, and how the upsurge of new infections in late 2020 and in early 2021 temporarily affected this reactivation, particularly in the Central region. Box 3 discusses the dynamics of temporary residential rental properties (Airbnb) and shows how, from a long-term perspective, they have gained market share in the accommodation market as compared to hotels, and how, form a shorter term perspective, they have recovered more rapidly than hotels, following the sharp contraction observed at the beginning of the pandemic.

During the first quarter of 2021 and in April, annual headline inflation increased in all regions of the country as compared to the average levels observed during the fourth quarter of 2020. This rise was mainly due to a significant increase in non-core inflation in all regions, although core inflation also rose, except in the Central region. In particular, the evolution of non-core inflation was largely determined by the increase in energy inflation, due to the arithmetic effect resulting from the considerable reduction in gasoline prices during the previous year, as well as to the increase in gasoline and L.P. gas prices this year. In May, headline inflation decreased in all regions, as the aforementioned arithmetic effect began to reverse and, in the Northern and Southern regions, as core inflation decreased.

Within regional annual core inflation, throughout the first quarter and so far during the second one, there has been, in general, a reduction in food merchandise inflation and increases in non-food merchandise and services inflation. However, the magnitude of these heterogeneous pressures across regions has led to certain differences in the aggregate behavior of regional core inflation, particularly in May. It is noteworthy that core inflation in the Central region remained at lower levels than in the rest of the regions. However, after following a downward trend since September 2020, in February it reached a minimum level for the year, and has increased since then, thus reversing to some extent the divergence it had shown versus the rest of the regions. In this regard, Box 4 uses an econometric model to illustrate how the dynamics of regional labor markets, the incidence of COVID-19, and the measures to contain it, help to explain part of the divergent behavior of regional core inflation in relation to national inflation in the context of the pandemic.

The results of the most recent interview program suggest that, in all regions, business agents' expectations regarding the demand for the goods and services they offer continued to improve during the reported quarter. Indeed, during the first quarter of 2021 the diffusion index of such expectations exceeded the level reported in the fourth quarter of 2019. The diffusion index of business agents' expectations regarding the number of hired employees continued to increase in all regions except for the Central one. As to business agents' expectations regarding their investments in fixed assets for the next twelve months, the results suggest that these continued to improve in all regions, except for the North-Central region, and the corresponding diffusion index remained above 50 points in all of them.

The majority of business agents surveyed in all regions, except the Central one, anticipate the sales prices of their goods and services to increase at a similar or higher rate over the next twelve months as compared to the previous twelve months. This was mainly attributed to the fact that, in all regions, there was a significant increase in the proportion of business agents who expect sales prices to increase at a higher rate over the next twelve months than in the previous twelve. Likewise, the percentage of agents who expect input prices to increase at a higher rate over the next twelve months compared to the previous year also increased significantly in all regions. The percentage of business agents anticipating a change in wage costs for the next twelve months similar to that observed last year increased in all regions, especially in the Northern one.

According to the interviewed business agents, the following risks to regional economic growth stand out. To the downside: i) delays in the distribution or application of vaccines or a worsening of the pandemic situation that imply the adoption of new containment measures; ii) that public safety indicators continue to deteriorate; and iii) that

domestic uncertainty persists, thus affecting investment. To the upside, business agents mentioned the following risks: i) that the pandemic dissipates faster, particularly due to a more rapid vaccination campaign; and ii) that growth in the United States and the stimulus programs implemented in that country result in a greater boost to the regional economies.

Looking ahead, the regional economies are expected to continue to benefit from the greater dynamism foreseen in the US economy. In particular, the Northern and Central regions would maintain the momentum generated by their exports to the United States. The regional economies are also expected to continue to benefit from a gradual dissipation of the pandemic and the consequent loosening of measures to contain it. Furthermore, progress in the vaccination campaign will continue to be a key factor in boosting regional economies over the coming quarters. This would be reflected, in turn, in a greater reactivation of the domestic market and of tourism, which could lead to a greater recovery, especially in the Central and Southern regions, which until now have registered lower levels of recovery than the rest of the regions. The states where the major public infrastructure projects that are being currently developed are located are also expected to continue to receive both direct and indirect benefits generated by such projects.

The recovery process is not risk-free and poses a great challenge, since at the present time it is difficult to anticipate with certainty which would be the more lasting consequences of the pandemic on the regional economies. In any case, it is necessary to continue strengthening the institutional framework in all regions and provide greater legal certainty for investment in order to achieve higher growth rates and well-being of the population.