Regional Economic Report
April – June 2022
Summary

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During the second quarter of 2022, based on seasonally adjusted figures, economic activity in Mexico continued to recover, driven by the rebound observed in April, although showing some weakness in May and June. This occurred in a complex global economic environment and a renewed increase in uncertainty regarding the evolution of the pandemic in the country due to an increase in the number of COVID-19 infections since the middle of the period. The growth of economic activity during the quarter was mainly due to an expansion of tertiary and manufacturing activities.

In this context, during the second quarter of 2022, economic activity is estimated to have continued to expand in all regions, although heterogeneously as to its pace and level of recovery. Activity in the Northern and North-Central regions is expected to have been above the levels observed during the first quarter of 2020, while the Southern region is estimated to have attained levels similar to said reference. Economic activity in the Central region is anticipated to continue exhibiting a gap relative to its pre-pandemic level, and it is thus foreseen to remain the region recovering at the slowest pace.[1]

The growth of economic activity in all regions during the reported quarter reflects the favorable performance of manufacturing and tertiary activities, specifically in trade and tourism. Progress in the recovery of the Central and Southern regions is expected to have also been attributed to agricultural and livestock production; mining in the center; as well as construction in the south, where public construction continued trending upwards.

To complement the analysis of the recent evolution of regional economic activity, Box 1 estimates the contributions of the states and regions to the probability of the Mexican economy transitioning to periods of lower growth. In the context of a possibly lower external demand, the Box also presents an analysis of the cyclical synchronization between the Mexican regions and those of the United States. The results suggest that the regional economic cycles of the United States show greater concordance with Mexico's Northern and Central regions, and, to a lower degree, with its Southern region. Meanwhile, Box 2 delves into the impact that the relocation of businesses to Mexico to bring production closer to the United States (nearshoring) has had on foreign direct investment and on the demand for goods and services offered by the companies interviewed by Banco de México. The analysis of business opinion data hints that said phenomenon is taking place in Mexico, albeit heterogeneously across sectors and regions. Businesses in the Northern region and in manufacturing sectors that are most integrated in global value chains seem to be the most favored by the juncture.

As a result of the complex economic environment in which the cumulative effects of the shocks of the COVID-19 pandemic concur with those of the military conflict between Russia and Ukraine, in all the regions, inflation continued increasing during the second quarter of 2022 and in the third one so far.

[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.

Specifically, in August, annual inflation in the Northern, North-Central, Central and Southern regions reached 9.33, 8.96, 8.09 and 9.02%, respectively. The Central region registered the lowest levels of all regions, largely because core inflation was at levels below those of the rest of the regions. During the reference quarter and in the third quarter so far, core inflation continued trending upwards in all regions, strongly driven by food merchandise inflation, although non-food and services inflation has also increased. In all regions, annual non-core inflation remained at high levels, as a result of the high annual rates of change in agricultural and livestock products' prices, while energy inflation remained contained by the Federal Government policies.

Delving into the behavior of consumer prices, Box 3 presents evidence that inflation in the Mexican states is correlated with inflation of those states that are geographically nearest, controlling for the behavior of inflation at the national level. This positive spatial correlation is observed in headline inflation, in its core component, and, above all, in its non-core component. Similarly, Box 4 analyzes the regional differences of merchandise of the CPI core component price levels. To compare these prices, a regional premium is estimated, which is interpreted as how much more (or less) a consumer would pay on average to purchase a good in a certain region relative to what they would pay on average nationally. The Northern region is found to be the one with the highest premium, and the Central region, the one with the lowest. Differences in prices across different types of stores are also analyzed.

The results of the most recent series of interviews of business agents suggest that, in all regions, the diffusion index of expectations for the demand for goods and services offered remained in expansionary territory, at levels higher than those reported in the fourth quarter of 2019. Nevertheless, in all regions, except for the Central one, the index continued declining slightly. The diffusion index of expectations for the number of workers employed in companies remained in expansionary territory in all regions as well, despite registering a heterogeneous behavior among them: it declined in the Northern and North-Central regions, remained stable in the Southern region, and increased in the Central one. As for the diffusion index of expectations of fixed asset investment for the next twelve months, it increased in the four regions during the second quarter of 2022, thus remaining in expansionary territory.

The interviewed business agents highlighted the following risks to regional economic growth. On the downside: i) that public safety indicators deteriorate; ii) that inflation persists at high levels, and iii) that both public and private investment remain at low levels. On the upside: i) that public spending, particularly investment in infrastructure projects, is higher than expected; ii) that more favorable conditions are observed both domestically and internationally thus promoting greater private investment; and iii) that public safety levels strengthen.

Economic activity in all regions is anticipated to continue recovering gradually in the next twelve months. The expansion of exports of both transport equipment and other types of manufactures, particularly in the Northern and Central regions, is expected to contribute to said recovery. Meanwhile, in the south, oil exports could remain supported by the relatively high prices of crude oil. In the context of a global reconfiguration of production, the process of businesses' relocation to supply the North American market (nearshoring) is foreseen to continue contributing to investment in the Northern and Central regions, and it could strengthen in the south. Tertiary activities are also expected to continue recovering insofar as the effects of the pandemic dissipate and a greater control of the pandemic is attained, especially in the center, where trade and services show a greater setback with respect to the rest of the regions. Finally, the construction of large infrastructure projects is expected to continue supporting growth in the south.

However, looking forward, the recovery of regional economic activity is not exempt from risks. In view of a possible deceleration of external demand, specifically from the United States, growth in regions with stronger links to international markets could moderate. In a related manner, uncertainty generated by dispute settlement consultations within the USMCA could temper the relocation process. Similarly, a less favorable performance of the labor

market in the United States could diminish the current dynamism of remittances to Mexico, thus affecting consumption of the recipient households, mainly in certain states of the Central and Southern regions. Although the regional economies remained somewhat resilient during the resurgence of a large number of COVID-19 infections at the beginning and in mid-2022, uncertainty persists regarding the evolution of the health emergency worldwide, especially as to the emergence of new variants and the need for additional booster shots. Similarly, certain regions that specialize in manufacturing production, such as the Northern and Central regions, or in the agricultural and livestock product sector, such as the North-Central and Southern regions, are likely to continue facing disruptions in input supply, given that the pandemic or the geopolitical conflicts could continue causing problems in global supply chains. A deterioration in public safety conditions could also limit the recovery of the states, especially those that specialize on activities more sensitive to changes in the perception of insecurity, such as tourism, or where a higher incidence of crimes that affect market functioning is observed, such as extorsion and theft. Finally, there is a risk that adverse weather events, such as droughts and high temperatures, materialize or persist, affecting economic activity in those states that are more exposed to said phenomena, as it has recently happened in the Northern region.