# Regional Economic Report
## April – June 2023
## Summary

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During the second quarter of 2023, economic activity in Mexico continued showing resiliency, expanding at a pace similar to that of the previous quarter. This resiliency can be associated with the good performance of domestic spending overall. Growth in the second quarter was a reflection of the positive performance of both secondary and tertiary activities.

In this context, the economy is estimated to have continued expanding in the Central and Southern regions during the analyzed period.[1] The Northern region is expected to have registered a level of economic activity similar to that of the previous quarter. Certain tertiary activities, such as trade, are anticipated to have contributed to the favorable performance of the Central regions and the Southern region. The Central region and the Southern region also registered a positive contribution of manufacturing and spending on construction, while mining and agricultural and livestock production did so in the Southern region as well. Stagnation of economic activity in the Northern region was associated with the negative performance of manufacturing, mining and tourism, which would have been offset by increases in trade, construction and the agricultural and livestock sector.

To delve into the effects of the gradual reconfiguration of global production chains on the regional economies, Box 1 includes business opinion qualitative data, which indicates that the nearshoring process has continued benefitting businesses in Mexico. Box 2 proposes an index that identifies the industry groups of manufacturing activity as well as the metropolitan areas that could most likely benefit from nearshoring. It also includes an econometric model the results of which suggest that, during the period after June 2020, the manufacturing industry groups identified as those that could show a greater tendency to nearshoring exhibit higher levels of activity and employment compared to a counterfactual scenario constructed with the industry groups that show a lesser tendency to the nearshoring process. According to the index proposed in this box, the metropolitan areas that could most likely benefit from nearshoring are located in the Northern region. This does not rule out the possibility that other regions could benefit as well. Insofar as economic activity in any region is positively affected, spillover effects could spread onto the rest of the regions in view of the economic connections among them. In this regard, Box 3 uses the Multi-State Input-Output Matrix published by INEGI to estimate the intra- and inter-regional effects of a shock on manufacturing exports.

Headline inflation decreased in all regions between the first and second quarter of 2023. This result was driven by the decrease in both core and non-core components in all regional economies. The decline in core inflation continued reflecting the easing of pressures associated with the shocks from the pandemic and the military conflict in Ukraine. However, the high levels that it continues registering indicate the persistence of these pressures. Within the core component, annual inflation of both merchandise and services was lower than those registered in the previous quarter in all regions,

[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.

although they remained at high levels. Non-core inflation exhibited atypically low levels in all regional economies. In the context of an increased occurrence of heat waves, Box 4 estimates an econometric model that shows that increases in temperature have the potential to raise fruit and vegetable prices.

Based on information gathered during the program of interviews with business agents, in all regions, the diffusion indices of expectations for the demand for products they offer, for personnel hired and for investment in fixed assets, for the next twelve months remained in the expansion zone. However, said indices showed a differentiated behavior at the margin among regions in the reported quarter.

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

In general, the interviewed business agents anticipate milder upward pressures on their selling and input prices over the next twelve months. They also continue expecting these pressures to be relatively higher on wage costs, particularly in the Northern and Central regions. Box 5 uses additional qualitative information drawn from the consultation with business agents and shows that the effects of the pandemic and the war in Ukraine on firms' profit margins have been heterogeneous. Although input price increases have been widespread, the companies' ability to pass them through to their selling prices seems to have depended on the strength of their demand, in face of a relatively inflexible supply.

Economic activity is expected to continue expanding in all regions over the next months. However, if the global economy decelerates, especially the US economy, the states more specialized in manufacturing exports, such as those in the Northern and Central regions, or those where the inflow of remittances represents a significant share of households' income, could be affected to a greater degree. The possible weakening of external demand could be compensated, at least partly, by the impact of the nearshoring process to supply the North American market. During the following months, domestic demand would also continue being supported, among other factors, by the construction of large infrastructure projects in the Central and Southern regions, and by a strong labor market.

To take advantage of the opportunities offered by the nearshoring process, and in view of the risks faced by regional economies, especially that of a greater global economic slowdown, it is crucial to continue reinforcing the domestic sources of growth and generate conditions that favor investment. Specifically, it is necessary to continue strengthening the rule of law, and to keep fighting insecurity and corruption. In addition, it is essential to support human capital formation in order to generate a labor supply that satisfies the hiring needs of firms and allows higher wages for workers, in an environment in which automation and artificial intelligence will have an increasingly greater impact on the labor market, particularly in those regions, such as the Southern one, where a higher percentage of the population tends to be employed in activities that are more likely to be automated. The construction or improvement of transportation and energy infrastructure could also contribute to regional growth, allowing companies to lower their costs, have better access to markets, and use less polluting energy sources. Finally, in view of the challenges posed by climate change for the regional economies, it is essential to implement mitigation and adaptation actions, particularly in those entities and sectors most exposed to its impact.