Regional Economic Report
January – March 2024
Summary

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The weakness of Mexico's economic activity observed during the last quarter of 2023 extended into the first quarter of 2024. A mixed behavior was observed among economic activity sectors throughout the quarter. In January, primary and tertiary activities decreased significantly, leading to a sharp economic contraction that month. Subsequently, in February and March both sectors performed better. In contrast, industrial activity remained weak throughout the reference quarter.

At the regional level, economic activity is estimated to have remained weak in all regions during the first quarter of 2024, except in the Southern one.[1] In the Northern and central regions, this performance is expected to have been due to the evolution of certain industrial activities. Specifically, it would have reflected a significant decline in construction and the continued sluggishness in manufacturing in these regions. Likewise, agricultural and livestock goods' production in the Northern and central regions contracted significantly, partly due to the droughts that affected some of the country's main producing states of primary goods. These regions also registered a weakening in certain tertiary activities, such as trade. In contrast, the Southern region exhibited an expansion in economic activity, after having contracted in the previous quarter. This growth is estimated to have been attributed to an increase in tourism, manufacturing and construction. The latter activity remains at high levels in view of the progress that various public infrastructure projects have continued showing.

To complement the analysis of regional economic activity, Box 1 shows Beveridge curves at the regional level, which capture the typically negative relationship between the unemployment rate and the job vacancy rate. The estimated Beveridge curves suggest that the evolution of economic activity in different regions contributed to lower unemployment rates and higher job vacancy rates. However, in 2023, vacancy rates decreased in all regions except the Northern one, although there was no increase in unemployment rates, as compared to 2022. Box 2 shows that income inequality declined in all regions during the 2018-2022 period. The analysis indicates that this would have responded mainly to a lower contribution of households' subordinate labor income to income inequality. The drop in the contribution of this source of income to inequality was more significant in the south than in the central regions, and it was even more marked compared to the north.

In all regions, core inflation, which better reflects the medium-term trend in inflation, continued declining between the fourth quarter of 2023 and the first quarter of 2024, while non-core inflation increased. Between these quarters, annual headline inflation in the Northern, Central and Southern regions increased as higher non-core inflation offset lower core inflation. The opposite occurred in the North-Central region. So far in the second quarter of 2024, headline inflation increased in all regions, while non-core inflation continued rising. As for the components of core inflation in all regions, annual merchandise inflation continued trending downwards, while

[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.

services inflation remained at elevated levels without showing a clear downward inflection point.

In recent years, processed foods have gained share in the consumption basket of Mexicans. Box 3 analyzes the structure and trend of household food consumption according to the degree of processing. There is an upward trend in the consumption of ultra-processed foods, as a share of total caloric intake throughout the country, to the detriment of unprocessed or minimally processed foods. In 2022, the North-Central region attained the highest proportion of ultra-processed food consumption among all regions. However, the most significant upward trend from 2016 to 2022 in consumption of this type of food was observed in the Southern region.

According to data collected during interviews with business agents in the different regions, the diffusion indices, which measure expectations for demand for products they offer, for personnel hired and for investment in fixed assets for the next twelve months, continued anticipating growth in these variables. In the reported quarter, in the case of expectations regarding demand and hired personnel, the indicators corresponding to the central regions and the south decreased with respect to the previous quarter. In contrast, in the Northern region, both indices increased. Regarding expectations for fixed assets investment for the next twelve months, the indices remained relatively stable in all regions, except for the Southern region, where the indicator continued decreasing.

The interviewed business agents pointed out the following risks that could affect regional economic growth over the next twelve months. On the downside: i) that public safety indicators deteriorate; ii) that uncertainty generated by the 2024 elections, common in this type of processes, is higher than expected; iii) that severe weather phenomena adversely impact regional economic activity; and iv) that inflation and interest rates persist at high levels. Among upside risks, they mentioned: i) that public spending, particularly investment in infrastructure projects, is higher than expected; ii) that public safety conditions improve; iii) that more favorable conditions are observed, both domestically and internationally, thus promoting higher levels of private investment; and iv) that leisure and business tourism continues to be reactivated.

Related to the risks faced by regional economies, Box 4 reports the results of interviews with business agents on the consequences of climate change on business operations. Overall business perception indicates that over the last five years, a number of extreme climate-related events impacted companies in Mexico, which began to determine adaptation strategies given the risk that these events represent. The consulted sources perceive a certain risk of facing further consequences associated with this type of phenomena in the next five years.

In the Northern and Central regions, the percentage of responses from interviewed business agents anticipating the selling prices of the goods and services they offer to grow at a similar or higher rate in the next twelve months compared to the previous twelve months continued to increase. In contrast, this percentage decreased in the North-Central and Southern regions. Regarding input prices, the proportion of business agents expecting them to grow at a similar or higher rate increased in all regions. As for wage cost expectations, in all regions there was a reduction in the proportion of surveyed business agents who expect wage costs to increase at a higher rate in the next twelve months compared to the previous twelve months.

Looking ahead, regional economies are anticipated to expand, despite facing a complex and uncertain environment that poses significant challenges to their growth. One of these challenges is the possibility of a decline in external demand, especially from the United States, where an economic slowdown could occur. This could particularly affect states in the north and central regions that are highly dependent on exports, as well as those that receive significant inflows of remittances or tourists from the United States, as is the case of some states in the North-Central and Southern regions. Another challenge are public insecurity issues, as business agents continue to note their effects on their business operations in certain areas of the country. Another challenge is the occurrence of adverse climate-related events that pose a risk to regional economic activity, as was

recently the case with the intensification of drought conditions in various agricultural areas of Mexico.

Given the challenges faced by regional economies, it is important to continue strengthening domestic sources of growth, generate conditions that foster investment and leverage the opportunities presented by nearshoring. Specifically, it is necessary to continue promoting the construction of transportation, water and energy infrastructure projects, as well as human capital formation. It is also necessary to continue strengthening public safety and the rule of law. Considering the risks posed by climate change to regional economies, it is essential to implement mitigation and adaptation policies in the most vulnerable areas. These measures would not only help the regions to face current challenges successfully, but would also promote more inclusive and sustainable growth in the long term, thus improving the living conditions of their population.