Regional Economic Report
January – March 2022
Summary

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During the first quarter of 2022, and considering seasonally adjusted figures, Mexico's economic activity registered growth, after having fallen during the third quarter of 2021 and having performed weakly in the fourth one. This occurred despite the upsurge in COVID-19 infections at the beginning of the year, persistent disruptions in global supply chains, and the uncertainty generated by the conflict in Eastern Europe. This recovery mainly reflected the dynamism of manufacturing and the moderate improvement in the services sector.

During the first quarter of 2022, economic activity is estimated to have expanded in all regions, albeit heterogeneously across sectors. Activity in the Northern region is expected to have been above the levels observed during the first quarter of 2020, while the North-Central region would be at levels similar to said reference, and the Southern region, at a level slightly below the same reference. In the Central region, activity is foreseen to continue registering a larger gap with respect to its pre-pandemic levels, and therefore it is anticipated to remain the region with the slowest recovery.[1]

In the Northern region, the expansion of economic activity during the reported quarter is expected to have reflected the favorable performance of manufacturing and mining, some tertiary activities, such as trade and tourism, and agricultural and livestock product production. The Central regions' recovery is anticipated to have been contributed to by industrial activity, particularly manufacturing, mining and construction, and some tertiary activities, such as trade and, in the Central region, tourism. The Southern region is expected to have continued recovering due to the favorable contribution of oil mining and construction, particularly public construction, as well as trade and certain services such as tourism.

The pandemic and, more recently, the conflict in Eastern Europe, have affected international commodity markets. In this context, box 1 proposes a partial equilibrium model for Mexico that allows to quantify the regional impact of an increase in natural gas prices on consumption of both natural gas and electricity, as well as the subsequent impact on manufacturing activity. The results suggest that progress in the recovery of the manufacturing sector during 2021 would have been greater in all regions, particularly in the Northern one, had the price of natural gas remained at pre-pandemic levels. Box 2 describes the extent to which regions in the country are exposed to changes in the market for nitrogen fertilizer, taking into account the specialization of the regions in the production of crops with the highest requirements for these inputs: corn, wheat, sorghum, and sugar cane. Among the findings, the North-Central region stands out as the one with the highest use of nitrogen fertilizers. It is also estimated that, following an increase in the prices of these inputs, the Southern region would have the greatest relative increase in the costs of overall production of such crops.

Delving into the evolution of regional labor markets during the pandemic, box 3 analyzes how IMSS-insured jobs reallocated in the country and across sectors between February 2020 and February 2022.

[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.

The results indicate that formal employment reallocated from the Central and Southern regions to the Northern region, partly due to the migration of workers from these regions. As to sectoral adjustments, manufacturing managed to absorb part of the workers that left the services sector, the most affected by the health crisis, particularly in the Northern region, as well as construction, in the Southern region. Box 4 estimates the probabilities of employment controlling for participation decisions. The results indicate that the probabilities of employment have recovered significantly, although they are still below estimated pre-pandemic levels for men and women at both national and regional levels, except for men in the Northern and North-Central regions, in which during the fourth quarter of 2021 said probabilities were already higher than the same reference. It is also found that the reactivation of employment probabilities is greater for men than for women in all regions, and recovery has been slower in the Central region as compared to the rest.

During the first quarter and so far in the second quarter of 2022, inflation in all regions has been under pressure due to the effects of the pandemic-related shocks, which have not been resolved yet, in addition to the most recent ones stemming from the Russia-Ukraine conflict. This has occurred in a context of low supply flexibility and a still high demand worldwide, which has led to a persistent imbalance between supply and demand in several markets. The diversity, magnitude and duration of the shocks that have affected inflation have had cross-cutting effects, exerting widespread pressure on the prices of the goods and services that make up the CPI basket. During the first quarter of 2022, annual headline inflation remained at levels above those of the previous quarter in all regions, registering 8.33, 8.04, 6.80 and 8.34% in May for the Northern, North-Central, Central and Southern regions, respectively. During the reference quarter, annual core inflation in all regions continued increasing and in May it reached levels above those of the referred quarter, driven by the increase in both merchandise and services inflation. Meanwhile, annual core inflation remains at high levels in all regions driven mainly by the high annual inflation of agricultural and livestock products.

The results of the most recent program of interviews to business agents suggest that, in all regions, the diffusion index of expectations of demand for the goods and services they offer continued in the expansion zone. Although the index declined slightly in all regions in relation to the previous quarter, it remained at levels above those of the fourth quarter of 2019. Meanwhile, the diffusion index of expectations for the number of workers employed in companies also continued in the expansion zone in all regions, although it declined in the Central region for the second consecutive quarter. Regarding the diffusion index of fixed asset investment expectations for the next twelve months, it continued in the expansion zone in all regions during the first quarter of 2022. Said indicator continued trending upwards in the North-Central region, remained stable in the Northern region with respect to the previous quarter, while contracting in the Central and Southern regions.

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 domestic uncertainty persists and affects investment. On the upside: i) that public spending, particularly investment in infrastructure, is higher than expected; ii) that more favorable conditions are observed both domestically and internationally thus promoting greater private investment; and iii) that a greater control of the pandemic enables a greater-than-expected impulse for economic recovery.

Economic activity in all regions is expected to continue growing gradually over the next twelve months. Insofar as external demand continues to expand, especially that from the United States, the recovery of states such as those in the Northern region, which are more export-oriented, will be more robust. A greater control of the pandemic is also expected to drive the performance of tertiary activities, particularly trade and services in the Central region, where these sectors have been lagging the most, as well as tourism in the North-Central and Southern regions.

This recovery, however, is not exempt from risks that could affect its progress. Although the regional economies showed some resilience during the upsurge in COVID-19 cases in early 2022, uncertainty remains as to the global evolution of the health emergency, particularly in regards to the possible emergence of new variants and the need for additional vaccine booster shots. The pandemic also continues to affect global supply chains, which have also been affected by the Russia-Ukraine conflict. Given the significant share of these countries in commodity markets, particularly in those of grains and energy, and of some inputs such as fertilizers, this conflict has led to additional inflationary pressures and could affect all regional economies. In particular, it could have a greater impact on primary activity in those regions that specialize in the production of crops that are more exposed to fluctuations in the nitrogen fertilizer market, such as the North-Central and Southern regions, or whose manufacturing is more use-intensive of natural gas, such as the Northern region. In addition to this complex external environment, if the weakness of certain services persists regionally, particularly in the country's Central region, employment growth could slow down. A deterioration in public safety conditions could also limit the recovery of the states, particularly those that specialize in activities that are more sensitive to changes in the perception of insecurity, such as tourism. In any case, in order to address all of the above, it is necessary to fight insecurity in all regions, continue strengthening the institutional framework, and provide greater legal certainty for investment. This would also help to mitigate inflationary pressures from sectors with limited productive capacity. Likewise, it is key to implement measures that, as a whole, would contribute to increase productivity in the different regions of the country. All of the aforementioned, with the aim to achieve higher rates of growth and wellbeing of the population.