Regional Economic Report
October – December 2022
Summary

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During the fourth quarter of 2022, economic activity in Mexico continued expanding, although it decelerated as compared to the first three quarters of the year. This slowdown reflected a slight loss of dynamism in secondary, and, mostly, in tertiary activities. This occurred in a context of a persistent high uncertainty about the global economic environment. In said conditions, economic activity is anticipated to have weakened in all regions during the reported quarter, except for the Southern one. Economic activity in the Northern and North-Central regions is estimated to have remained above the levels observed during the first quarter of 2020, while in the Southern region it is expected to have registered a level similar to said period. Meanwhile, economic activity in the Central region is anticipated to continue exhibiting a gap with respect to its pre-pandemic level, although such gap would continue narrowing.[1]

From a sectoral perspective, the slowdown of economic activity in the Northern and Central regions during the reported quarter derived from a lower growth rate in manufacturing, both of transport equipment and excluding said segment, as well as in mining and in the agricultural and livestock product sector, and, in the Central region, in trade and construction. Similarly, stagnation in the North-Central region was due to a contraction in trade and manufacturing. In contrast, the Southern region is anticipated to have grown at the same rate, due, to a large extent, to a significant increase in public construction, the favorable evolution of mining, and the positive performance of trade, certain services, such as tourism, and of the agricultural and livestock product sector during the fourth quarter of 2022.

To complement the analysis of regional economic activity, Box 1 presents the results of constructing drought exposure indices for certain agricultural products included in the CPI. These indices calculate the share of national production that is concentrated in the municipalities affected by drought for each analyzed product. The drought exposure indices are particularly useful in the current context of climate change, in which the probability of occurrence of extreme weather events, such as droughts, is increasing. Regarding financing at the regional level, Box 2 points to certain differences in the average interest rate offered by commercial banks to Mexican firms across different entities. However, according to the estimated econometric model, these differences can be mostly attributed to the characteristics of credit and financed companies, rather than to a geographic location. To examine wage dynamics throughout the pandemic, Box 3 estimates national and regional wage indices that control for variations in the employment composition. The box shows that, at the national level, during the initial stage of the pandemic, out of 8% of the average annual wage variation as of May 2020, 2.3 percentage points can be attributed to an employment recomposition caused by the loss of low-wage jobs. In contrast, as of December 2022, the average wage grew at a rate similar to that of the wage index, indicating that the recent increases in the former are not affected by changes in the employment composition. At the regional level, controlling for the differences in

[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.

employment composition across regions, the wage index registered the lowest growth in the Central region between December 2021 and December 2022.

Between the third and fourth quarters of 2022, headline inflation decreased in all regions as a result of a reduction in the non-core component. In February 2023, annual headline inflation in the Northern, North-Central, Central and Southern regions was 7.20, 8.21, 7.17 and 8.39%, respectively. In all of them, annual core inflation continued facing upward pressures during the fourth quarter of 2022, exceeding the levels of the previous quarter, while at the beginning of 2023, although it seems to have interrupted its upward trajectory, it is yet to show a downward trend. Within it, merchandise inflation continued to be affected by pressures related to production costs stemming from increases in input prices. Annual services inflation remained at high levels and rose at the beginning of 2023 in all regions. In a context of high demand, the prices of this component continued being subject to pressures from the increasing costs of inputs.

Based on the 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 and, except for demand expectations in the Northern region, at levels higher than those during the fourth quarter of 2019. Nevertheless, these indices exhibited mixed results at the margin among regions during 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 inflation persists at high levels; and iii) that labor costs continue rising. Among upside risks, they mentioned: 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 is strengthened.

An additional long-term risk is that the pandemic's impact on human capital formation may limit the potential growth in the regions. In this regard, a general equilibrium model is employed in Box 4 to estimate the long-term effect of higher educational levels of workers on different macroeconomic variables in the regions. Since the Southern region registers the lowest educational levels, it would benefit the most from increasing said levels. This box also presents an estimate of possible long-term effects on per capita output as a result of the adverse impact on learning derived from the lockdown during the COVID-19 pandemic. The estimates suggest that the effects on regional performance could be differentiated, with the lowest ones registered in the Central region.

Economic activity is anticipated to continue expanding in all regions over the next twelve months, although at a more moderate pace. This slowdown is likely to be more marked in export-oriented regions, such as the Northern and Central ones, given the deterioration in global economic growth expectations, particularly in the United States. In addition, a less favorable performance of the labor market in that country, which so far has remained tight, could affect both international tourism and the flow of remittances to Mexico and, therefore, the levels of consumption of households receiving remittances, mainly in some states in the Central and Southern regions. In contrast, the process of relocating companies to supply the North American market is expected to enhance investment in the Northern and Central regions, while it could be strengthened in the Southern region.

In order to take advantage of the opportunities provided by this relocation process, and, given the risks faced by the regional economies, especially that of a greater external slowdown, it is important to expand the domestic sources of growth and generate conditions that foster investment. In particular, the rule of law and public safety must be strengthened to grant certainty to firms and facilitate their operations. The construction or improvement of the infrastructure for the provision of inputs in the states could also contribute, in such a way that the companies reduce their costs and access, with more competitive costs of transportation, to both the input markets and their potential customers. In view of the challenges posed by climate change for regional

economies, it is essential to take actions to mitigate and adapt to this phenomenon, particularly in those states and sectors that are most exposed to its impact. Finally, in order to strengthen long-term growth, it is fundamental to continue supporting human capital formation by implementing policies that reverse the negative effects of the pandemic on education.