

# Regional Economic Report

## January – March 2017

### Summary

**D**uring the first quarter of 2017, the growth rate of economic activity in Mexico was similar to that observed in the last quarter of 2016. This expansion reflected the dynamism of the services' component, while the industrial production as a whole remained stagnant. Within the industrial sector, however, manufacturing production kept expanding, even though it was offset by the stagnation observed in construction, a negative evolution of the electricity sector and a downward trend in mining.

The performance of the Mexican economy in the reference quarter was reflected across most regions. Indeed, it is estimated that economic activity in the Northern and the Central regions kept expanding, although in the latter region it occurred at a slightly lower rate as compared to the previous quarter. This expansion is mainly attributed to the favorable evolution of export-oriented manufacturing and of some services. Likewise, there was an expansion of the construction sector in the Northern and Central regions, and of non-oil mining and agricultural production in the Northern and North-Central regions. Meanwhile, economic activity in the Southern region is estimated to have continued contracting, albeit at a more moderate pace relative to the fourth quarter of 2016, which derived from a decrease across most of its sectors, except for manufacturing and, according to the consulted sources, some tertiary activities, which kept growing. To complement the analysis of the regional economic evolution presented in this Report, Box 1 delves into the process of the regional GDP per capita convergence in Mexico in the period of 1994 – 2015, whereas Box 2 analyzes the impact of international remittances on the economic activity in different regional economies of Mexico.

During the period covered by this Report, annual headline inflation maintained an upward trend, which was a result of different shocks it had been exposed to, and which temporarily affected the evolution of both its core and non-core components. In particular, the core inflation trend keeps reflecting the effects of the exchange rate depreciation accumulated since late 2014. On the other hand, the increment in energy prices in January 2017, especially gasoline and LP gas, directly affected non-core inflation, and indirectly, its core component, by raising the production costs of different goods, as well as of some services, mainly food-related ones, which use the said energy products as inputs. More recently, annual headline inflation has been further affected by increments in the prices of some agricultural products and in passenger transport services across various locations of the country, especially in Mexico City. Moreover, the increase in the minimum wage in early 2017 also contributed to higher annual headline inflation. It should be noted that even considering the simultaneity and the magnitude of inflation shocks, so far no second round effects on the price formation process in the economy have been observed, and long-term inflation expectations remain stable. The performance of regional inflation, in general, also reflects the above mentioned factors.

Business contacts interviewed for this Report anticipate demand for own goods and services to expand over the next twelve months, this signal being stronger than in the previous quarter. In line with that, the referred business agents expect a higher number of hired personnel and physical capital stock in all regions.

The consulted sources also commented on the principal upward and downward risks to the regional economic growth. Among downward risks, in all regions the referred business agents emphasized the following: i) the possibility of a deterioration in the perceived public safety; ii) that indeed certain trade and migratory policies may be implemented in the U.S., which would negatively affect regional economies; and iii) that a certain weakening of public work projects would lead to an insufficient level of regional infrastructure, especially in transportation and communications. In contrast, among upward risks, the next were mentioned: i) a probable rebound in investment levels, both domestic and foreign, that would derive from the NAFTA renegotiation, which would favor the involved parties, and ii) that the dynamism of private consumption would be greater than previously estimated.

As regards the expected evolution of prices for the next twelve months, the interviewed business agents across all regions anticipate the annual growth rate of own goods and services' sales prices to be generally lower than last year, following a period when this signal had been less favorable in most regional economies during the previous quarter. Likewise, business agents estimate a decrease in the annual change of wage costs and input prices for the next twelve months with respect to that observed in the reference quarter.

Finally, it is important to stress that in the current juncture uncertainty still prevails regarding the economic policy to be implemented by the U.S., as well as its effects on the regional economic activity. In this context, it is a priority to maintain the strength of the macroeconomic fundamentals and to proceed with the implementation of policies locally and nationwide, which would facilitate businesses' operation and would further promote the efficiency of resource allocation. In particular, it is necessary to strengthen the rule of law and to guarantee legal certainty of all economic agents.