

Regional Economic Report

April – June 2014

Summary

Economic activity in all regional economies significantly recovered in the second quarter of 2014, as compared to the weakness registered in the first quarter of the year. This was mainly due to a greater dynamism of external demand and to an improvement in domestic demand. Across regions, the analysis of different indicators points to a more vigorous rebound in the economic activity of the Northern region, while in the Southern region the dynamism of economic activity was relatively low.¹

From a structural point of view, regarding economic activity, it should be noted that in previous reports the role of local elements in the performance of regional economies was analyzed. Taking into account that economic literature has partly linked informality to the difficulty to set up firms due to excessive local regulations, Box 1 of this Report provides a further analysis of informality. In particular, opinions of business agents interviewed by Banco de México for this Report in the four regions are presented regarding three aspects of the informal sector: its size, its origin, and the public policies that could tackle it.

As expected, annual headline inflation increased by the end of the second quarter of 2014 as a result of the fading effect coming from a high comparison base over most of the first half of the year in the non-core component, specifically in the subindex of agricultural prices. Subsequently, in July and August annual headline inflation increased further, which was mainly due to higher prices of some livestock products. Therefore, prices of some processed foods, which use the referred livestock products as inputs, went up. Derived from the above, annual headline inflation reached levels above 4 percent in the Central and Southern regions. In the Northern and North-Central regions, although it also increased, annual headline inflation persisted below 4 percent.

The interviewed business agents generally stated that they anticipate an expansion of demand for own goods and services over the next six and twelve months. This estimation derives from the expected boost coming mainly

from external demand and, to a lesser degree, from domestic demand. In particular, the consulted business contacts associated their favorable outlook for economic growth with the expected good performance of the manufacturing industry and with greater public expenditure on infrastructure. Regarding the latter, the business contacts of the North-Central region expect that the improved connectivity in their region following the construction of the Durango-Mazatlan highway will continue generating benefits. In line with this expectation, Box 2 of this Report presents an exercise analyzing the positive impact of this infrastructure project on the North-Central region.

Although the interviewed business agents anticipate that the recovery of economic activity in their regions will continue, they also mentioned the main risks they perceive for the following six and twelve months. Among the upward risks to regional economic activity, the business contacts in all regions emphasized public investment in infrastructure and higher than expected levels of private investment. In this sense, they stressed the importance of proper implementation of structural reforms. Likewise, they pointed out as an upward risk, mainly in the Northern region, that the recovery of the U.S. economic activity might be more vigorous than anticipated. Among downward risks, business agents mentioned deterioration in the perception of public safety, and an extension, further than expected, of the effect on businesses' cash flow of the fiscal changes in force since early 2014. The business agents also noted as a downward risk a delayed execution of public expenditure at the local level.

As regards inflation expectations, and given the slack conditions expected to prevail in regional labor markets, the interviewed business contacts in all regional economies expressed that no inflation pressures on labor costs are anticipated over the following six and twelve months. Likewise, regarding input prices, they mentioned that lower annual rates of change are expected as compared to those registered over the same period of the previous year. In line with the above, the consulted contacts pointed out that lower annual growth rates of their sale prices are also anticipated for the referred horizon.

¹ Regionalization: Northern: Baja California, Sonora, Chihuahua, Coahuila, Nuevo León and Tamaulipas; North-Central: Aguascalientes, Baja California Sur, Colima, Durango, Jalisco, Michoacán, Nayarit, San Luis Potosí, Sinaloa and Zacatecas; Central: Distrito Federal, Estado de México, Guanajuato, Hidalgo, Morelos, Puebla, Querétaro and Tlaxcala; and Southern: Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.