

# Regional Economic Report

## April – June 2017

### Summary

**D**uring the second quarter of 2017, the Mexican economy continued expanding, although at a slightly lower rate as compared to the previous one. This growth kept reflecting the dynamism of the tertiary sector, while stagnation in the industrial activity, which had been observed since mid-2014, persisted. At the same time, the primary activities contracted. Within the industrial activity, the manufacturing sector lost dynamism with respect to the second half of 2016, while the performance of construction remained weak and mining maintained an unfavorable trajectory.

The expansion of Mexico's productive activity in the reference quarter was perceived across most regions of the country. Indeed, in the Northern and Central regions the economic activity is estimated to have continued growing, largely as a result of the positive performance of manufactures with stronger links to the external market and of certain tertiary activities, in particular retail trade. Furthermore, tourism contributed to the positive evolution of the economic activity in the Northern and North-Central regions, while an increase in agricultural production in the Northern and Central regions was also beneficial to the economic activity levels. In contrast, in the South a contraction is estimated to have been recorded, as a consequence of a drop in most activities, except for tourism, and, in accordance with interviewed business agents, some services. To complement the regional economic analysis given in this Report, Box 1 delves in the main retail trade determinants at the regional level, while Box 2 presents some stylized facts of the so-called Millennial generation. In the same vein, Box 2 explores the main causes that, in line with business contacts, account for the said generation's main trend of the separation from employment, along with the strategies implemented by businesses to tackle this situation and to achieve a greater level of worker retention.

In the analyzed period, headline inflation displayed an upward trend, although its growth rate seemed to have started to decelerate. Among the shocks that have affected it, the following are noteworthy: the depreciation of the exchange rate that has been accumulated since late 2014, the effects of the liberalization process of energy prices, mainly gasoline and LP gas prices, and the increase in the minimum wage, which took place in January 2017. In recent months, headline inflation experienced further upward pressures, which derived from higher passenger transport fares that had been registered in a number of cities in Mexico, as well as from higher prices of some agricultural products. However, some items that have been previously affected by the initial shocks, as is the case of energy products and non-food merchandise, already present a turning point in their annual changes. It

should be noted that even considering the simultaneity and the magnitude of shocks on inflation, so far no second round effects on the price formation process of the economy have been perceived. The evolution of the regional economy, in general, reflects the mentioned factors, despite a certain heterogeneity in their growth rates.

Business agents interviewed for this Report anticipate the demand for own goods and services to expand over the next twelve months across all regions. Consistent with the above, the said business agents also expect an increase in the number of hired personnel and the physical capital stock.

In addition, business contacts commented on the principal upward and downward risks to the regional economic growth. Among downward risks, they highlighted the following in all regions: i) a possible deterioration in public safety; ii) that uncertainty related to the upcoming electoral process in 2018 adversely affects private spending, especially investment; and iii) that the renegotiation of NAFTA (the North American Free Trade Agreement) turns out unfavorable for Mexico. On the contrary, among upward risks, the next were listed: i) the greater-than-expected flow of investment (both domestic and foreign); ii) the NAFTA renegotiation that turns out favorable for Mexico; and iii) the higher-than-estimated level of activity in the energy sector.

As regards the expected evolution of prices for the next twelve months, business contacts interviewed in all regions estimate the annual changes of the sales' prices of own goods and services to be generally below those of last year. It should be noted that this signal kept gaining strength across the four regional economies, after it had been less favorable at the beginning of the year. In line with the above, business agents also anticipate a decrease in annual growth rates of wage costs and input prices for the next twelve months with respect to the reference quarter.

Finally, it is important to keep in mind that regional economies are still facing a highly complex environment, despite the resilience shown in most regions in view of the shocks that had affected them. In this context, the priority is to maintain the soundness of the macroeconomic fundamentals and to continue strengthening the rule of law, legal certainty and public safety at all levels. In this way, regional economies could achieve a greater potential growth, and higher competitiveness that would lead to a more rapid expansion of employment and labor-related remunerations.