

Regional Economic Report

April – June 2016

Summary

Economic activity in Mexico contracted in the second quarter of 2016, after it had expanded in the first one. This evolution reflects the fact that the expansion of the tertiary activities practically came to a halt in the reported quarter, in a context in which the stagnation, presented by the secondary activities since mid-2014, persisted. Within the industrial production, the manufacturing activity contracted, while the mining maintained a downward trend. In contrast, construction somewhat improved, with respect to the stagnation in 2015, and the electricity sector recovered, following a period of lower dynamism it presented in late 2015 and over the first months of 2016. Meanwhile, the noticeable slowdown of the tertiary activities is partly associated to the loss of dynamism in the manufacturing production, which led to a less favorable evolution of trade and the transport services, among others. In this regard, Box 1 elaborates on the effect generated by the weak manufacturing sector on the tertiary sector at the regional level, based on the analysis of productive chains in both groups of economic activity. Nonetheless, it should be pointed out that the services more related to domestic demand also weakened, which was congruent with the loss of dynamism in the private consumption in the quarter analyzed in this Report.

Weakness in the Mexican productive activity in the reported quarter was perceived across most regional economies. Indeed, in the Northern and Southern regions, a drop in production levels is estimated, following the expansion of the activity in the referred regions in the previous quarter, while stagnation was registered in the Central one. Likewise, in the North-Central region the timely indicators point to a noticeable deceleration as compared to the growth in the previous quarter. In the Northern region, this evolution fundamentally reflected the unfavorable performance of the manufacturing industry, more associated to the external sector, and the construction industry, while the growth rate of retail trade declined. Similarly, in the Southern region a lower level of economic activity relative to the last quarter stands out in the majority of productive sectors, even though tourism recovered incipiently. On the other hand, the slowdown in the North-Central region is principally attributed to a lower level of activity in the construction and mining industries, as well as to a loss of dynamism in trade, although manufacturing and tourism kept observing a relatively more favorable performance. Likewise, the stagnation of the economic activity in the Central region was related to the weak manufacturing industry, which was triggered by temporary closures of some automotive plants, as well as the loss of dynamism in the mining industry and in some tertiary activities, such as retail sales and certain services, for example tourism.

As of August 2016, headline inflation accumulated 16 consecutive months below the permanent 3 percent target. The good performance of inflation is consequent on the fact that the conduct of monetary policy prevented the evolution of the national currency's value from negatively affecting the anchoring of inflation expectations. In this way, the depreciation of the national currency did not lead to greater and more widespread price adjustments. The evolution of inflation was also contributed to by the absence of aggregate demand-related pressures onto prices, as well as by the low international prices of most commodities, which resulted from the weak dynamism of their demand at the global level. In general, the evolution of inflation at the regional level has been congruent with this performance. Particularly, across all regional economies inflation persisted below 3 percent in the analyzed period.

Most business contacts interviewed for this Report anticipate demand for own goods and services to expand over the next twelve months. Consistent with that, business agents generally expect an increment in hired personnel and in the physical capital stock in different regions of Mexico. To complement the analysis of business contacts' expectations given in this Report, Box 2 presents the analysis of their opinions on the factors affecting the investment climate experienced by businesses across different regions of Mexico. In connection with this, Box 3 delves in the determinants of attracting foreign direct investment (FDI) to the regional manufacturing industry.

Likewise, business agents mentioned the major upward and downward risks to the regional economic growth. Among upward risks, the next were stated: i) a greater than expected growth of private investment in Mexico; and ii) the strengthening of external demand, related to a higher dynamism of the U.S. economy. By contrast, among downward risks, the following were mentioned: i) higher volatility in international financial markets and, particularly, its possible impact on the exchange rate; and ii) a possibility of the deterioration in the perception of public safety.

As regards inflation expectations for the next twelve months, the interviewed business contacts generally anticipate lower annual growth rates in the prices of own goods and services, as compared to last year. Meanwhile, in most regional economies of Mexico business agents estimate a lower annual change in the prices of own inputs and wages for the next twelve months relative to last year, even though in some regions these signals weakened with respect to the previous quarter.