



Regional Economic Report

October – December 2014



BANCO DE MÉXICO

March 12, 2015

Outline

- I. Regional Economic Report**
- II. Results October – December 2014**
 - A. Economic Activity**
 - B. Inflation**
 - C. Economic Outlook**
- III. Final Remarks**

Regional Economic Report

- The Regional Economic Report is a quarterly publication on the recent trends in economic activity, inflation and business agents' expectations in the Mexican regions.¹
- This information is taken into account by Banco de México's Board of Governors when evaluating the economic situation and the forecast for the Mexican economy.
- The economic performance of the regions in 4Q 2014 and the prospects for regional economic activity and inflation over the following 6 and 12 months are analyzed herein.

1/ For the purposes of this Report, the states of Mexico are grouped into the following regions: Northern: Baja California, Chihuahua, Coahuila, Nuevo León, Sonora 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. Southern: Campeche, Chiapas, Guerrero, Oaxaca, Quintana Roo, Tabasco, Veracruz and Yucatán.

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Economic Activity

- In 4Q 2014 regional economies continued recovering moderately.
- This recovery was supported by a favorable performance of industrial activity in most regions.
 - ✓ Within the industrial activity, manufacturing presented a relatively greater dynamism in four regions.
 - ✓ Likewise, private construction rebounded in all regions, while public construction presented a mixed performance across the regions.

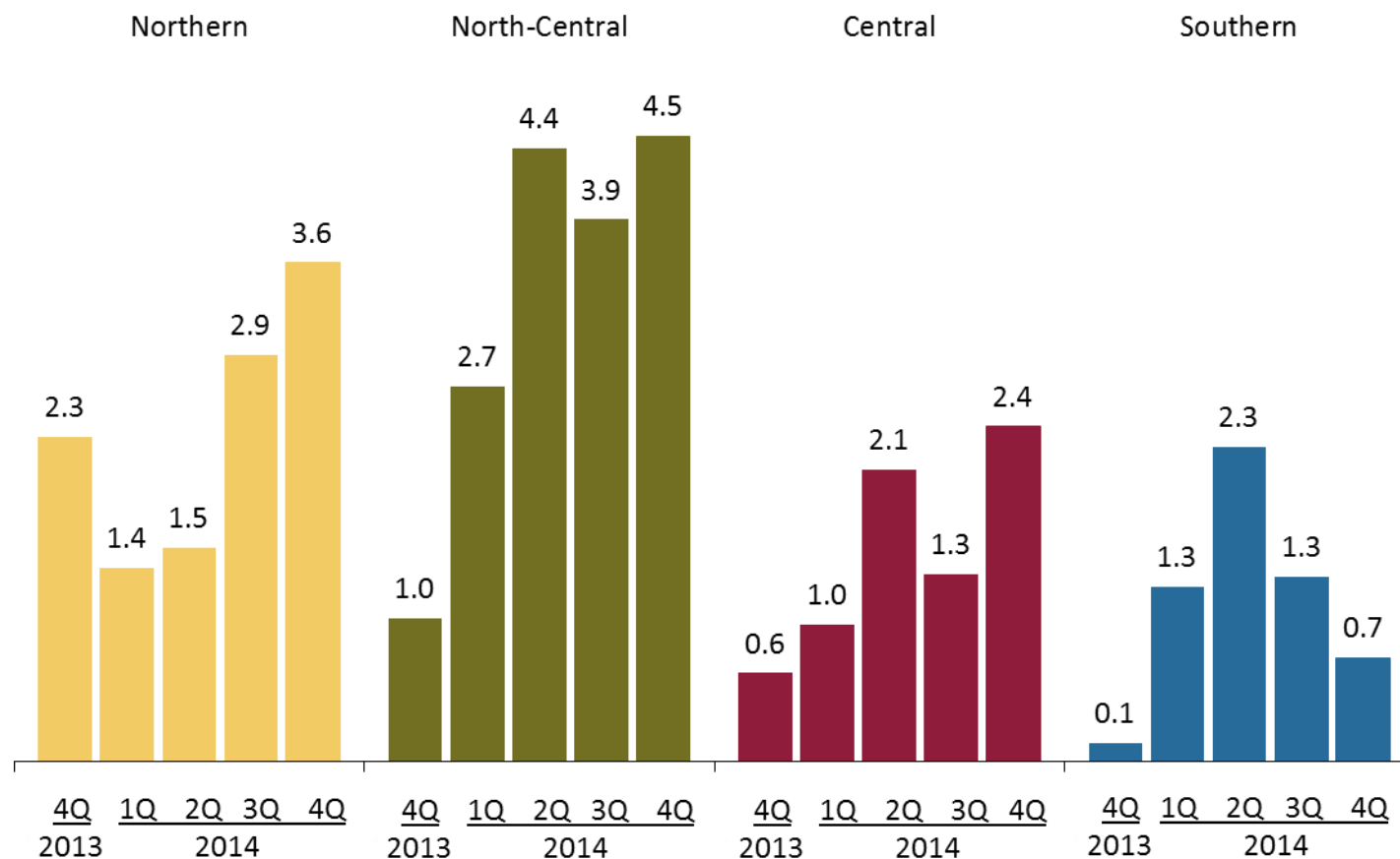
Economic Activity

- As regards the services' sector in the reference quarter:
 - ✓ The dynamism of tourism was notable in most regions.
 - ✓ Retail trade expanded in 4Q 2014 with respect to the same period of last year, although at a lower rate than in the previous quarter.
- Agricultural production observed positive annual changes in 4Q 2014 in most cases, although at lower rates as compared to 3Q 2014.
- Finally, in the analyzed quarter the number of IMSS-insured workers continued accelerating in most regions of Mexico.

In 4Q 2014, the growth rate of economic activity strengthened in the Northern, North-Central and Central regions. In turn, although economic activity in the South registered growth as well, it presented a lower dynamism.

Quarterly Indicator of Regional Economic Activity ^{1/}

Annual change in percent

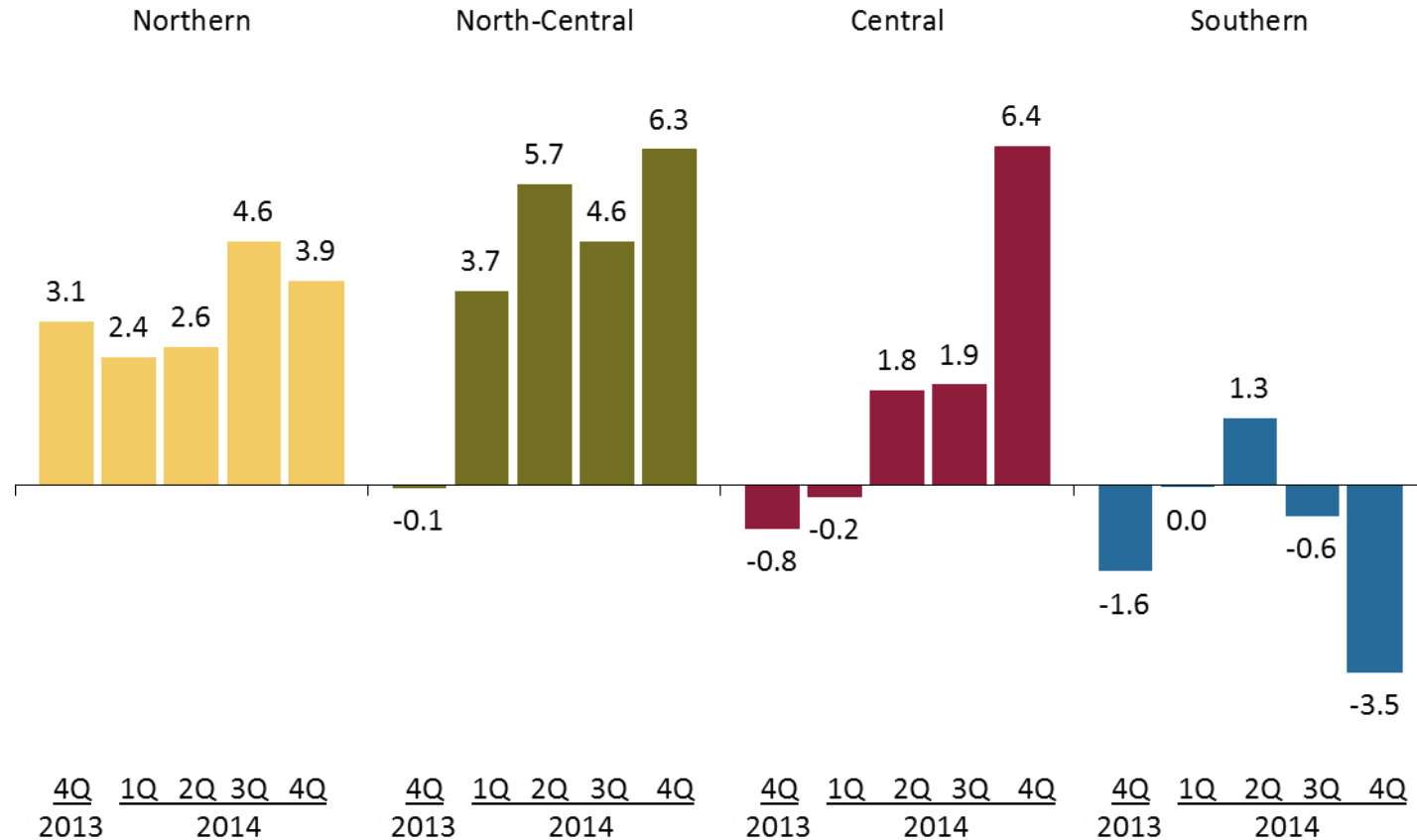


^{1/} This indicator's values in the fourth quarter of 2014 are preliminary.

Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Across all regions, industrial activity was driven by manufacturing and private construction. Still, in the South industrial activity kept weakening, which is principally associated to the performance of oil mining.

Regional Indicator of Industrial Activity ^{1/} Annual change in percent

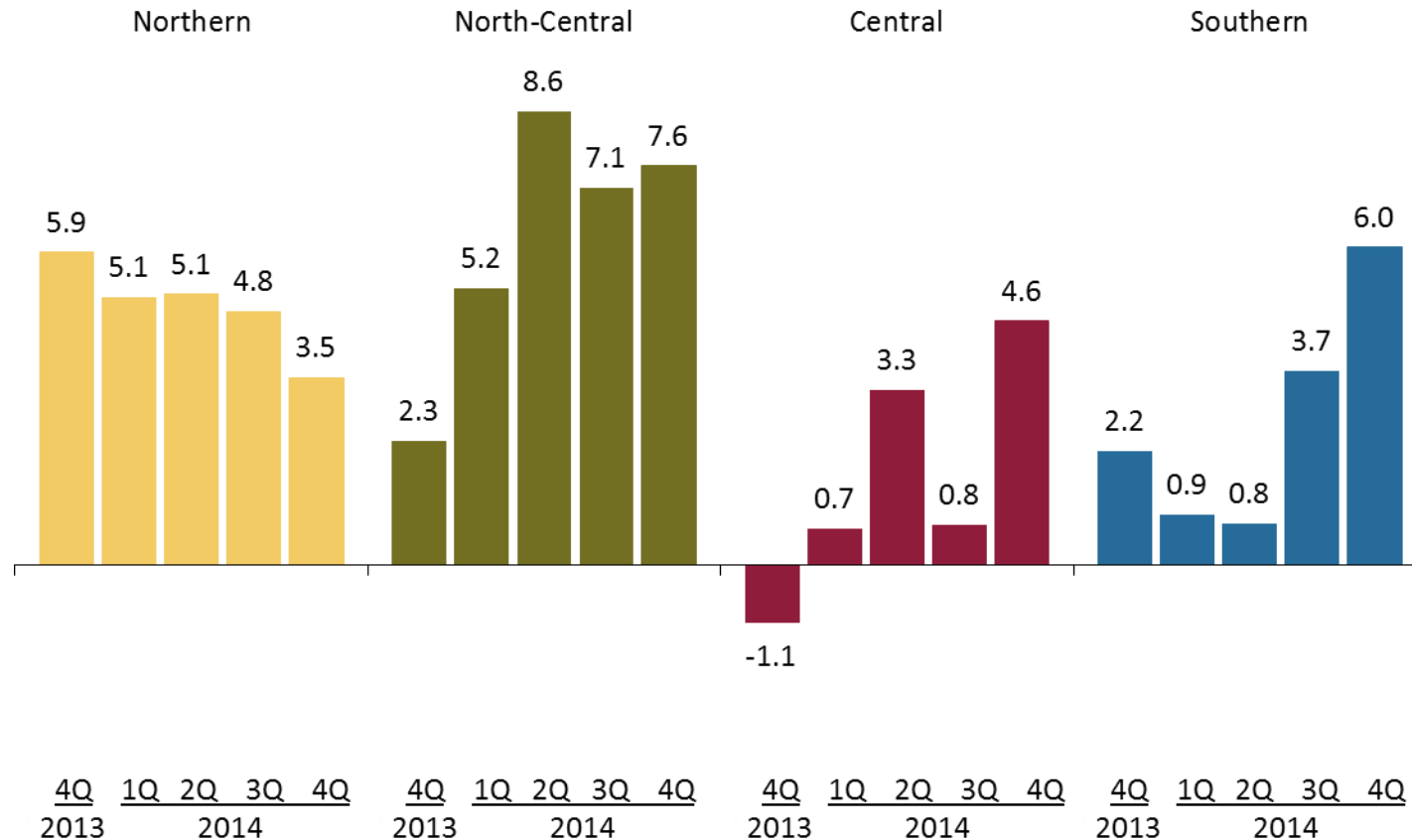


^{1/} This indicator's values in the fourth quarter of 2014 are preliminary.

Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Within the manufacturing sector, the dynamism of exports was noteworthy, just as the dynamism of the automobile and electronics industries, as well as that in the areas of production related to them, in four regions.

Regional Manufacturing Indicator ^{1/} Annual change in percent



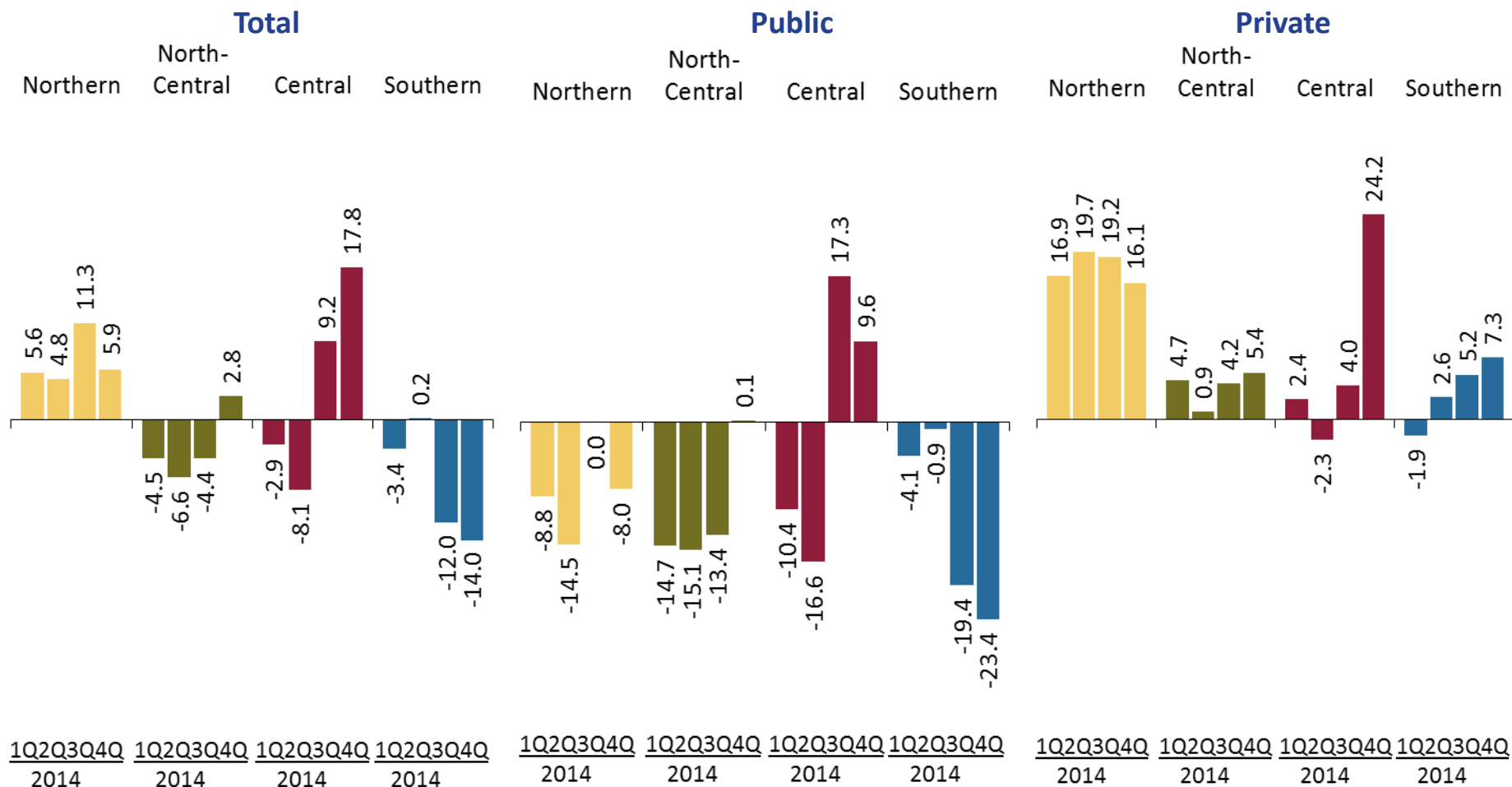
1/ This indicator's values in the fourth quarter of 2014 are preliminary.

Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Private construction presented positive annual growth rates in all regional economies, while public construction observed a mixed performance across regions.

Real Value of Production in the Construction Industry by Region

Annual change in percent



Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Box:

Recovery of Residential Construction in Mexico by Region

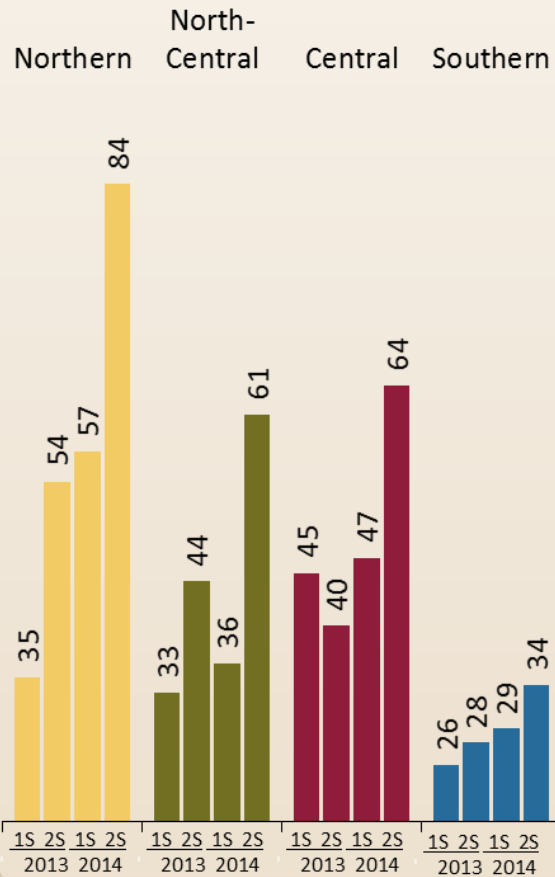
- During 2014, private construction recovered with respect to last year. In particular, different indicators suggest that the residential segment has strengthened in various regions of Mexico.
- The indicators of housing permits and housing startups point to a reactivation in residential construction in four regional economies of Mexico.
 - ✓ This reactivation was more evident in the second half of 2014 and in the Northern region.
- In turn, total financing to housing in 2014 recovered, especially in the Northern and Central regions.¹

1/ It includes financing granted by INFONAVIT, FOVISSSTE, SHF, commercial banks, FONHAPO and other entities (ISSFAM, Orevis, Hábitat de México, Banjercito, CFE and PEMEX).

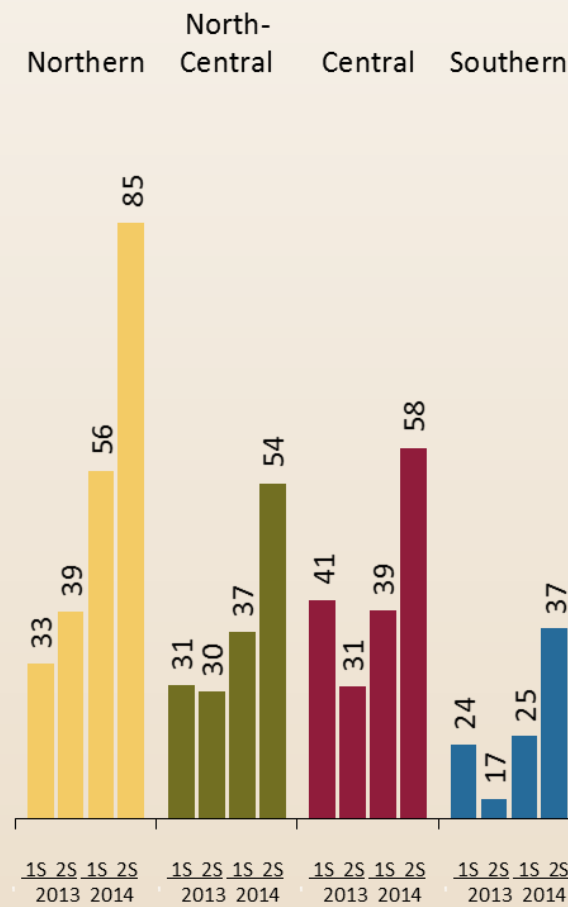
Box:

Recovery of Residential Construction in Mexico by Region

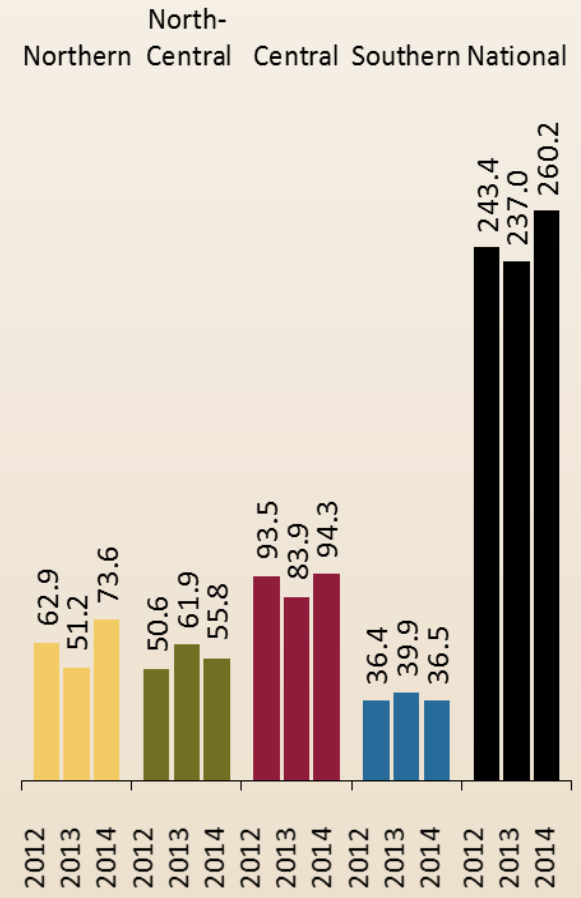
Housing Permits
Thousands



Housing Startups
Thousands



Total Financing of Housing Entities
MXN billions at prices as of 2F of December 2010



Source: Estimated by Banco de México with data from the National Register of Housing.

Source: Estimated by Banco de México with data from the National Register of Housing.

Source: CONAVI.

Box:

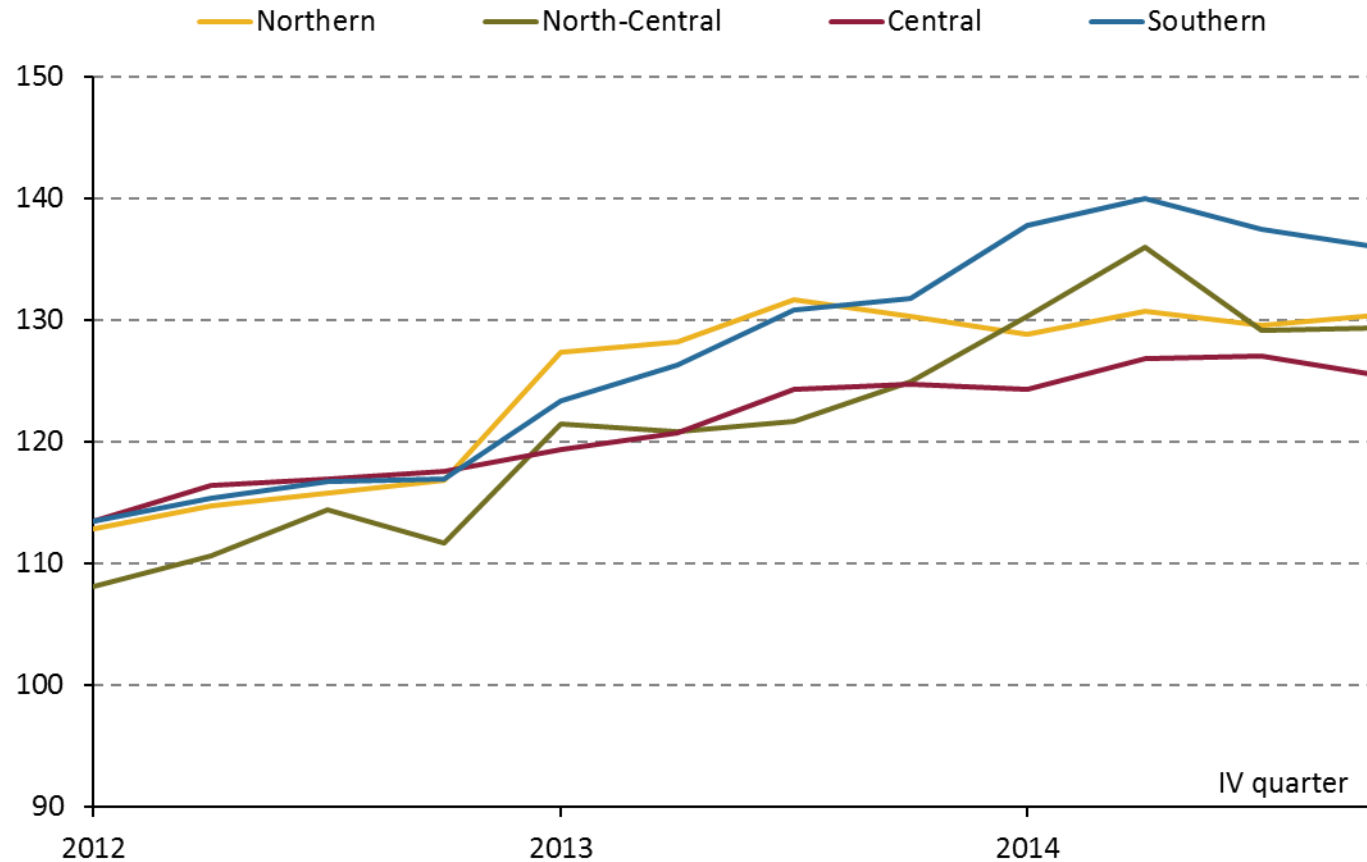
Recovery of Residential Construction in Mexico by Region

- Business contacts interviewed by Banco de México for this Report confirmed the referred trends.
 - ✓ Specifically, it was stressed that the recovery of the sector in 2014 took place in a context of greater ease to obtain credits for housing acquisition and improvement, as well as direct subsidies for this item.
- Thus, different indicators point to a recovery in private residential construction in all regions, principally in the second half of 2014.

Retail trade expanded in 4Q 2014, as compared to the same period of last year, although at a lower rate with respect to 3Q 2014.

Regional Indicator of Retail Trade

Index 2008=100, quarterly average

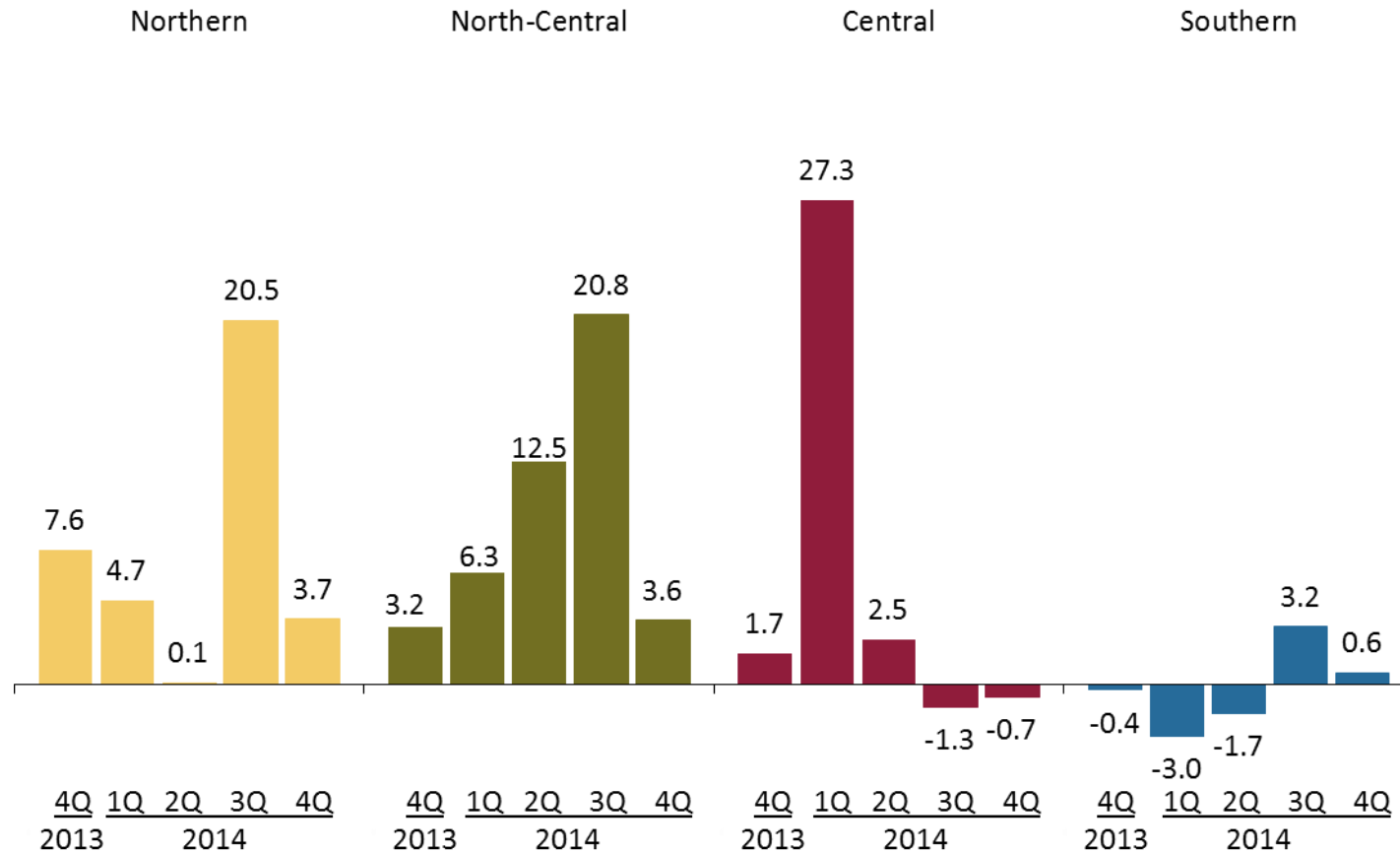


Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Agricultural production registered positive annual changes in 4Q 2014 in most cases, although at lower rates as compared to the previous quarter.

Index of Regional Agricultural Production

Annual change in percent



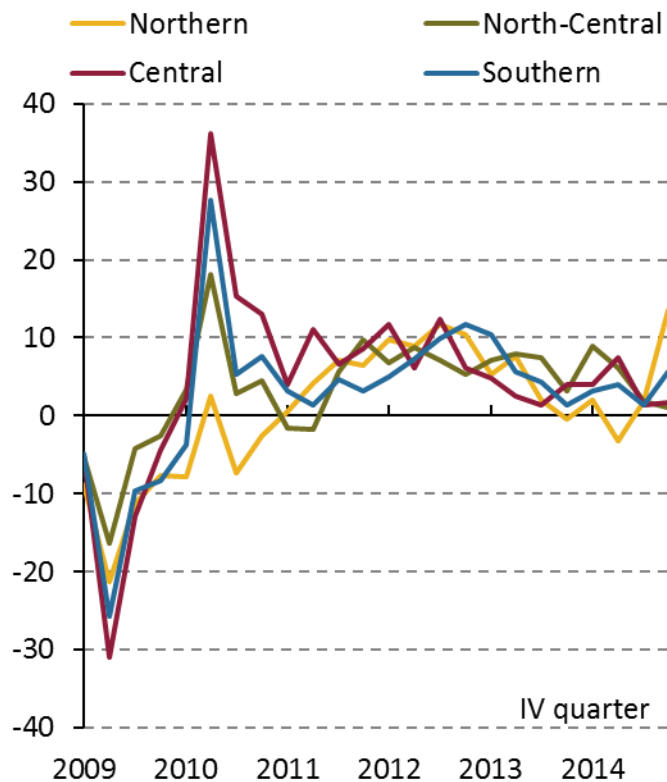
Source: Estimated by Banco de México based on data from SAGARPA.

As regards the services' sector, the expansion rate of tourism rebounded in 4Q 2014 in all regions, except for the North-Central region, where the loss of dynamism is associated with the impact caused by the hurricane "Odile" in Los Cabos.

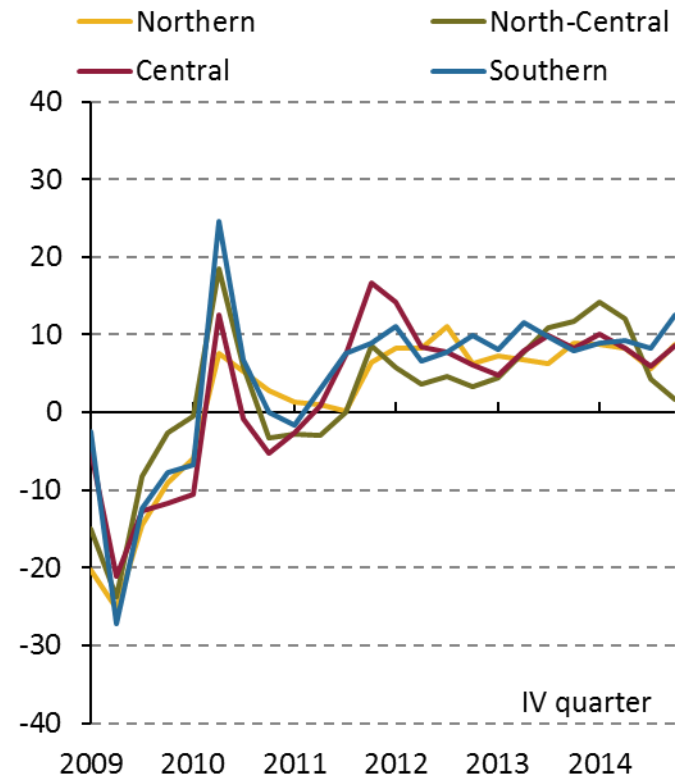
Regional Indicators of Activity in Tourism

Annual change in percent

Hotel Occupancy



Inflow of Passengers to Airports



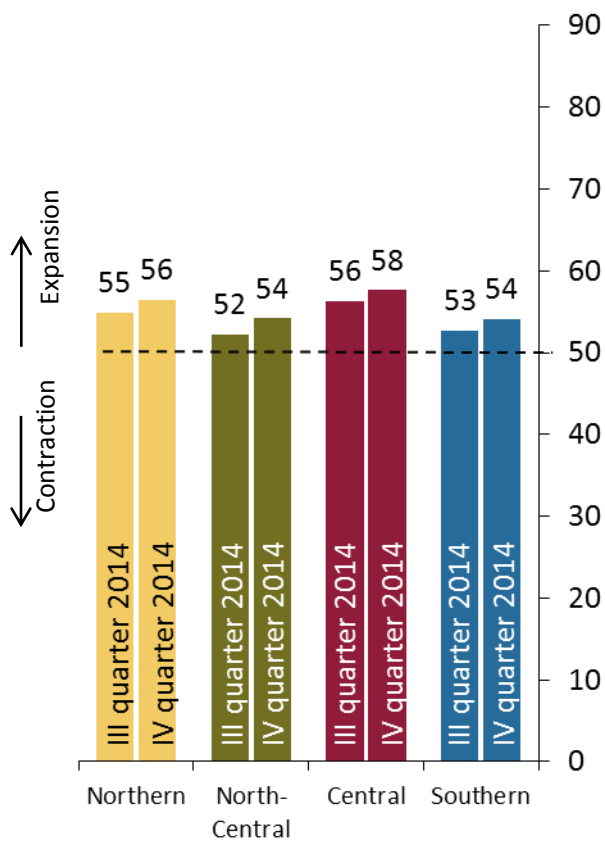
Source: Estimated by Banco de México with seasonally adjusted data from the Mexican Secretariat of Tourism and from Airports and Auxiliary Services (ASA, for its Spanish acronym).

In four regional economies, firms generally reported an increase in the use of financing. However, the sign of expansion of financing granted by commercial banks weakened in most regions with respect to 3Q 2014.

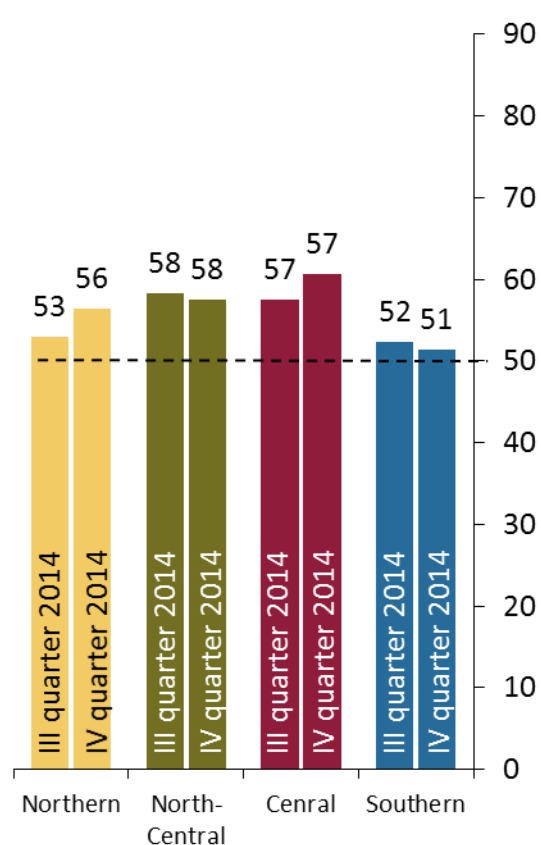
Main Sources of Financing to Firms

Diffusion index

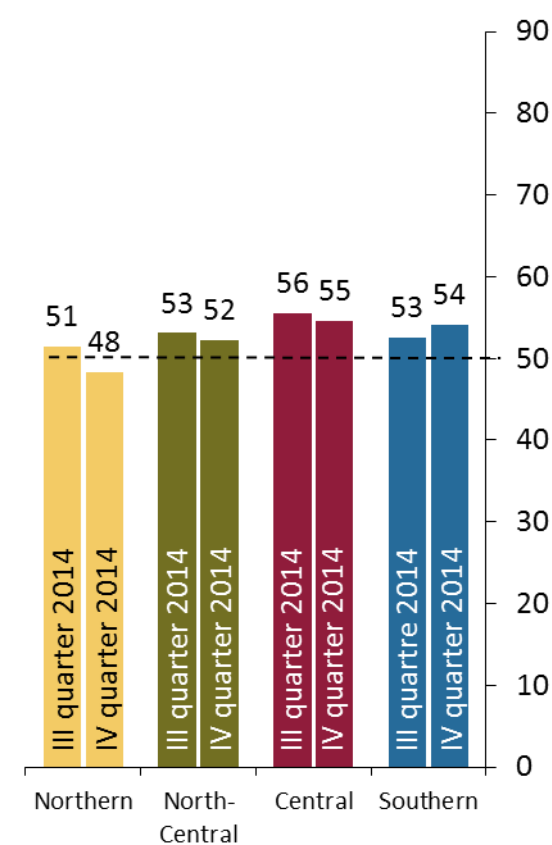
Own Resources



Suppliers



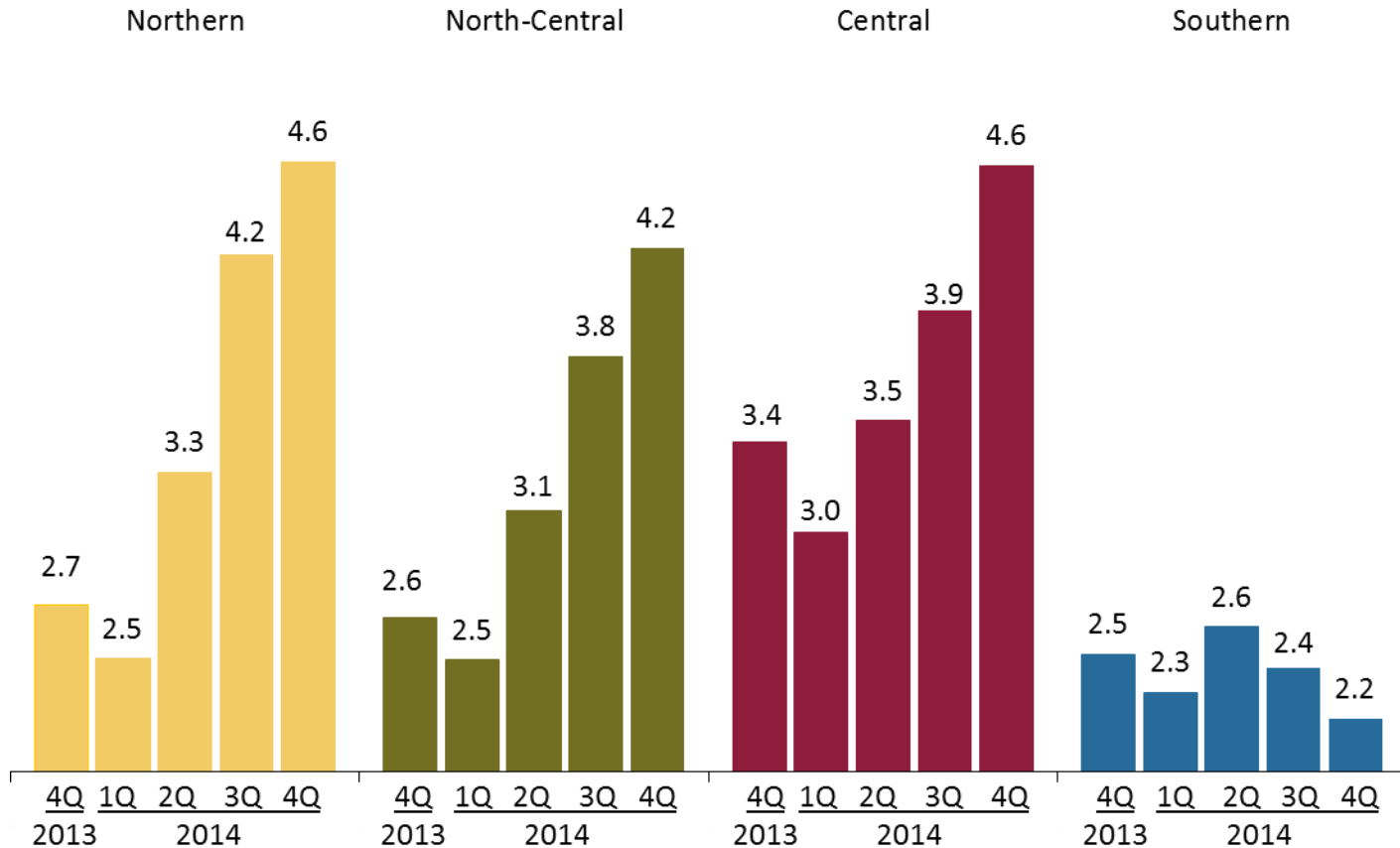
Commercial Banks



Source: Banco de México.

In the Northern, North-Central and Central regions, the number of IMSS-insured workers kept accelerating. In turn, although in the Southern region it grew as well, it kept showing a lower dynamism.

Number of IMSS-insured Workers Annual change in percent



Source: Estimated by Banco de México with seasonally adjusted data from IMSS.

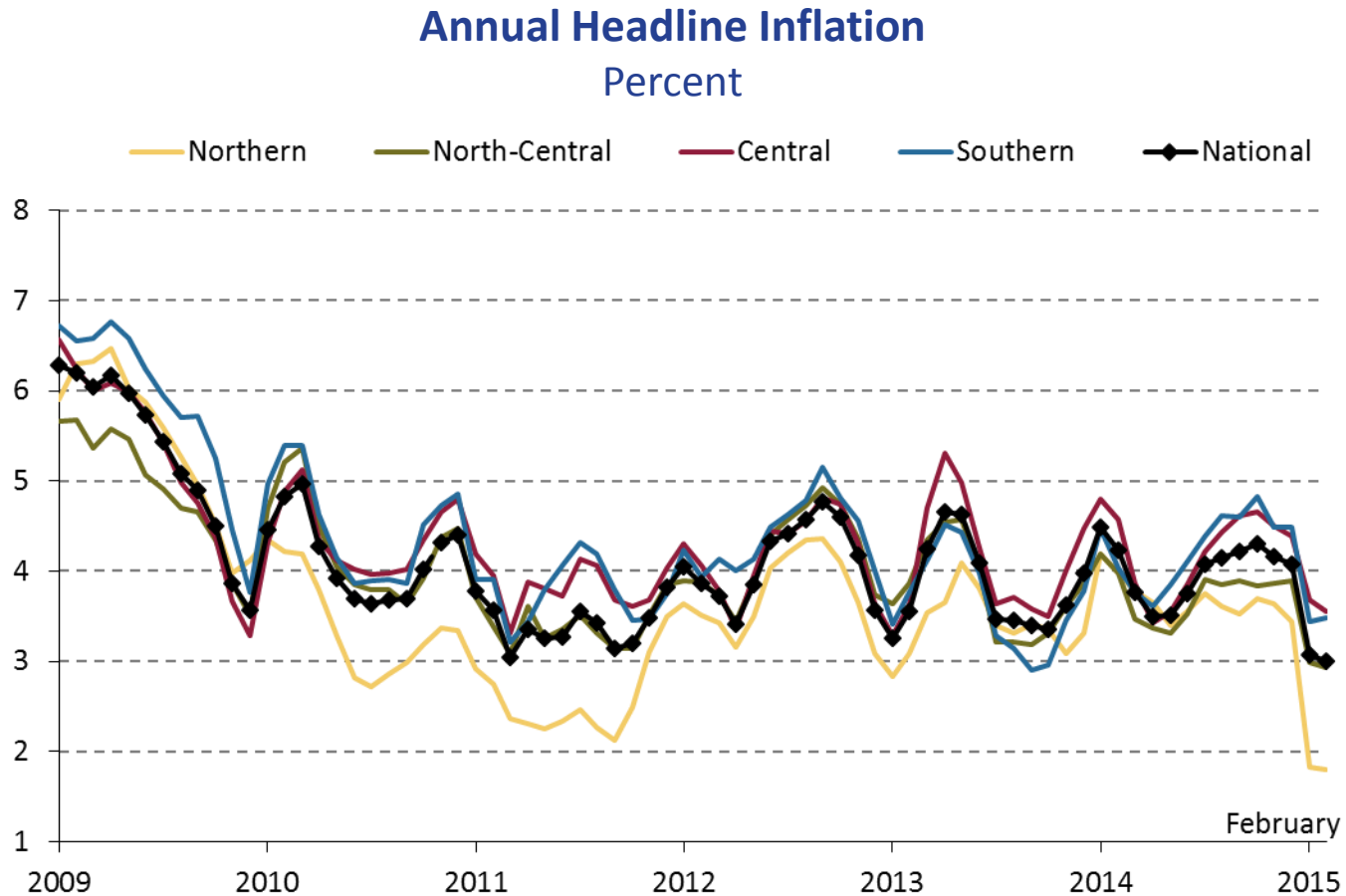
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Inflation

- Annual headline inflation reached its recent maximum level in most regions of Mexico in October 2014. This was due to the effects of the fiscal modifications in force since the beginning of the year, and due to the transitory shocks that affected the non-core component.
- Subsequently, from November 2014 onwards, annual headline inflation started to present a downward trend, which intensified after an additional considerable decrease in January 2015.
 - ✓ This reduction partly derived from the fact that the increments in prices generated last year by fiscal modifications did not present again, as well as from lower prices in telecommunication services and from smaller increments in energy prices.
 - ✓ Additionally, increments in prices of merchandise and services were, in general, smaller than observed last year.

From November 2014, annual headline inflation commenced a downward trend. It was more noticeable in the Northern region, due to the favorable performance of gasoline prices in the border cities.



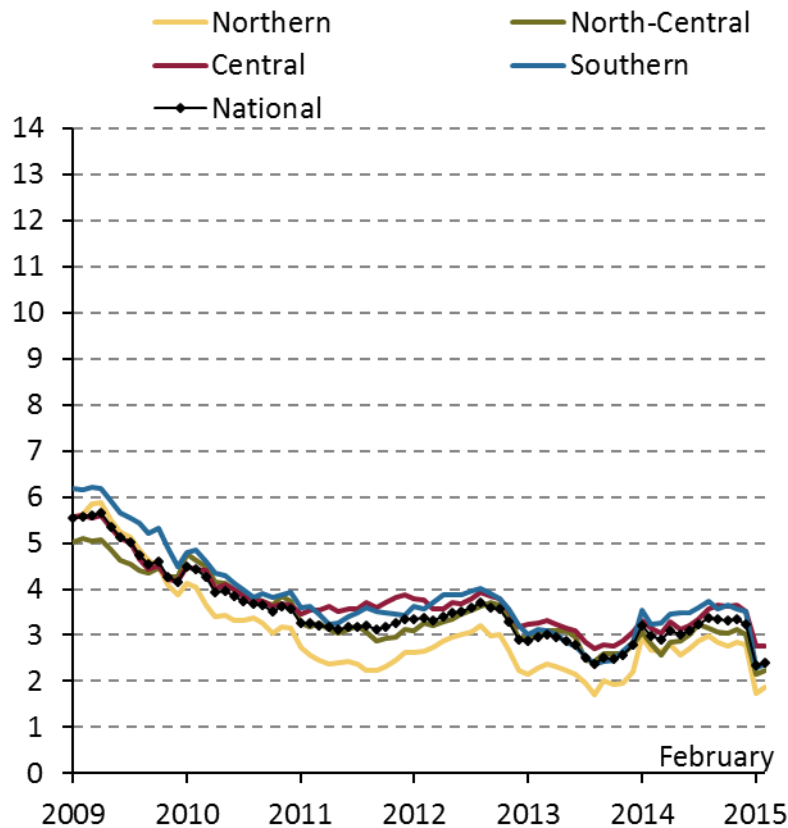
Source: Estimated by Banco de México with data from INEGI and Banco de México.

Annual core inflation in four regions of Mexico decreased in 4Q 2014 and located below 3 percent in recent months. In turn, annual non-core inflation presented a downward trend.

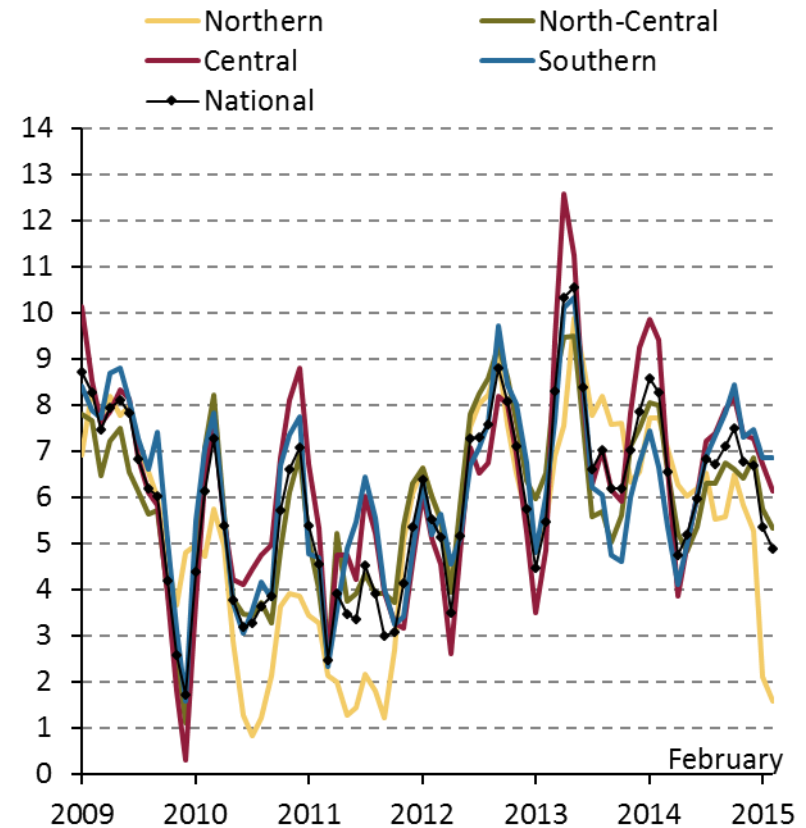
Components of Annual Headline Inflation

Percent

Core



Non-core



Source: Estimated by Banco de México with data from INEGI and Banco de México.

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Economic Outlook

- Business contacts' expectations are, in general, moderately optimistic and indicate that the economic recovery in their regions will continue over the following 12 months.
- The interviewed business agents sustained that their expectations are principally based on the favorable outlook for the U.S. economy.
- Additionally, a greater dynamism of private investment, as compared to 2014, is expected in all regional economies.
 - ✓ Investments estimated in the manufacturing sector, construction and the services related to exports and tourism were noted.
 - ✓ It was also mentioned that considerable investment in the agricultural sector is anticipated.

For the following 12 months, the interviewed business contacts anticipate an expansion of demand for own goods and services, as well as of hired personnel and of the physical capital stock in own firms.

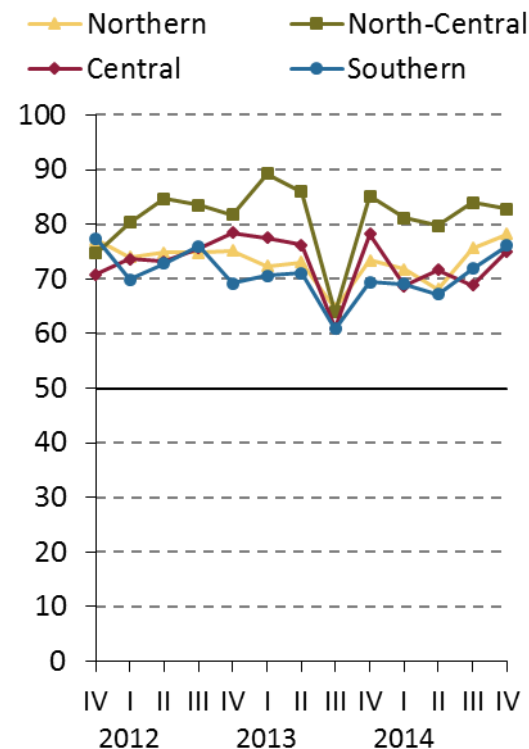
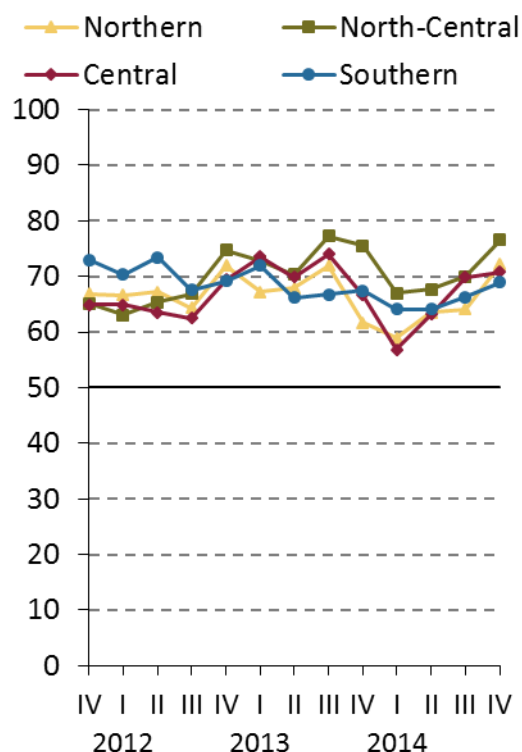
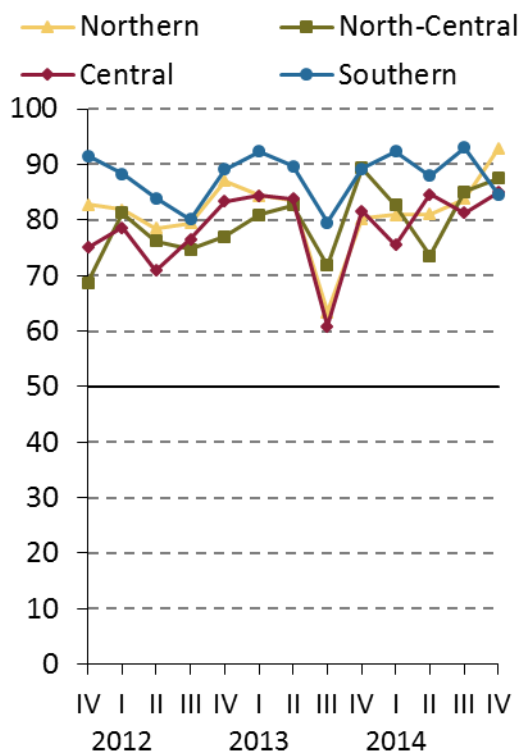
Business Agents' Expectations: Demand, Personnel Hired and Physical Capital Stock, Next 12 Months ^{1/}

Diffusion indices

Demand

Personnel Hired

Physical Capital Stock



1/ Results obtained from responses to the questions: "With respect to the situation in 4Q 2014, how do you expect demand for own goods or services to change over the next 12 months?", "How do you expect personnel hired by your firm to modify over the next 12 months?" and "How do you expect your firm's physical capital stock to change over the next 12 months?", from the interviews conducted by Banco de México.

Economic Outlook

- Among upward risks to the regional economic activity, business agents in all regions mentioned:
 - ✓ The performance of external demand, especially in the U.S.
 - ✓ The dynamism of domestic demand, particularly private investment. The latter refers to investment in automobile and energy sectors.
- Across regions, business agents emphasized the following as upward risks:
 - ✓ In the Northern and Southern regions, the implementation of the recently approved structural reforms.
 - ✓ In the North-Central and Southern regions, the rate of expansion of tourism.

Economic Outlook

- Among downward risks to regional economic activity, business agents indicated the following across four regions:
 - ✓ The possibility of a further deterioration in the perception of public safety.
 - ✓ An increment in some input prices, derived from a recent exchange rate depreciation.
- In the South, an eventual exacerbation of social conflicts was also mentioned as a downward risk to economic activity.

Box:

Resolution Time of Commercial Disputes and Regional Economic Performance

- Business contacts interviewed for previous Reports stressed the importance of administering justice, in general, for the economic development of the regions.
- This Box analyzes the statistical relation between economic growth and an indicator of administering justice.
- In particular, the information concerning the time taken for court decisions of commercial disputes is used, and its relation to the regional economic growth is analyzed.
- In principle, as might be expected, shorter resolution times of commercial disputes is associated with greater average economic growth of the regions.

Box:

Resolution Time of Commercial Disputes and Regional Economic Performance

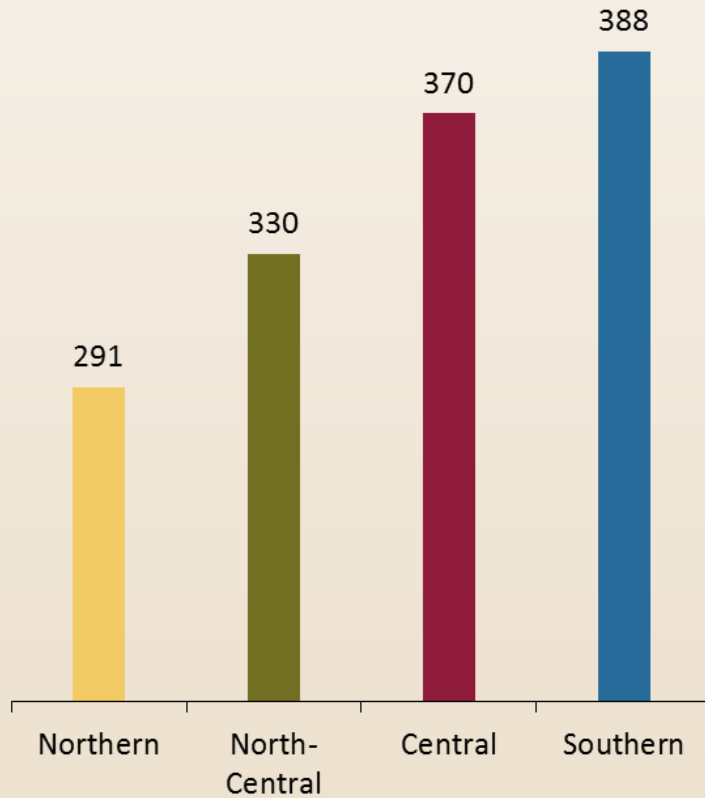
- In particular, the exercise consists in estimating a statistical relation between:
 - ✓ The economic growth: the average of the annual percentage change of per capita GDP by federal entity in the period of 2006-2013; and
 - ✓ An indicator of administering justice: the number of days taken by local courts, on average, to resolve a commercial dispute between two local businesses in each state. This variable is obtained from the reports “Doing Business”, released by the World Bank for all federal entities of Mexico in 2007, 2009, 2012 and 2014.¹

1/ The estimation is controlled by per capita GDP of the federal entity at the beginning of the analyzed period (2006), as well as by an index that captures the level of development of the entity in terms of different social indicators and infrastructure.

Box:

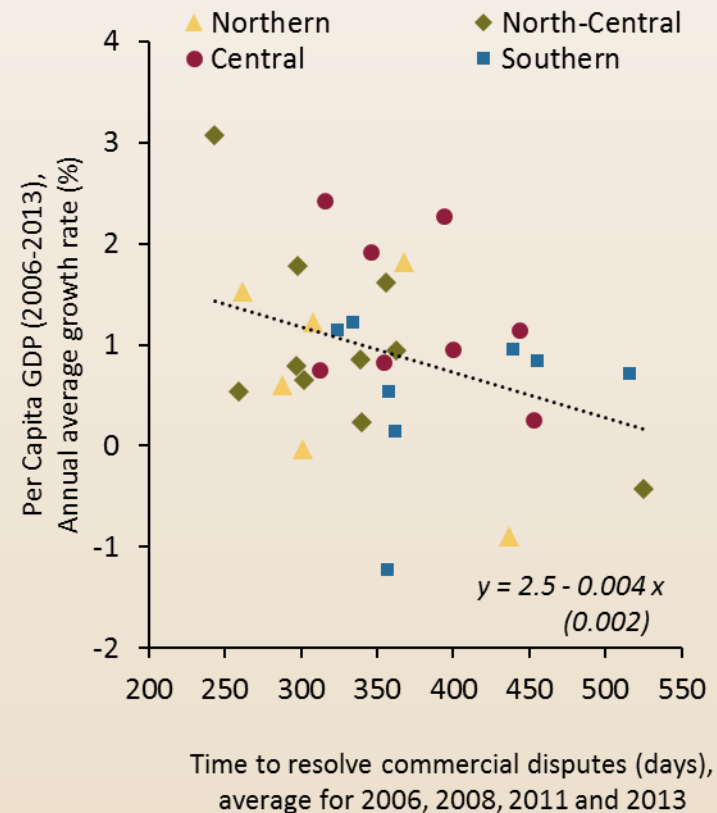
Resolution Time of Commercial Disputes and Regional Economic Performance

Average Time to Resolve a Commercial Dispute by Region ^{1/}
Days, 2013



1/ Average values by federal entity weighted by the entity participation in regional GDP.
Source: Estimated by Banco de México with data from the World Bank and INEGI.

Growth Rate of Per Capita GDP and Average Time to Resolve a Commercial Dispute
Federal entity



Box:

Resolution Time of Commercial Disputes and Regional Economic Performance

- The results of the analysis indicate that:
 - ✓ The average time (in days) it takes to resolve a commercial dispute is shorter in the North and longer in the South. Central regions present intermediate values.
 - ✓ Shorter resolution times are associated to higher rates of average growth.
- These results illustrate the importance of institutions for the economic development of the regions, in particular the strengthening of the rule of law.

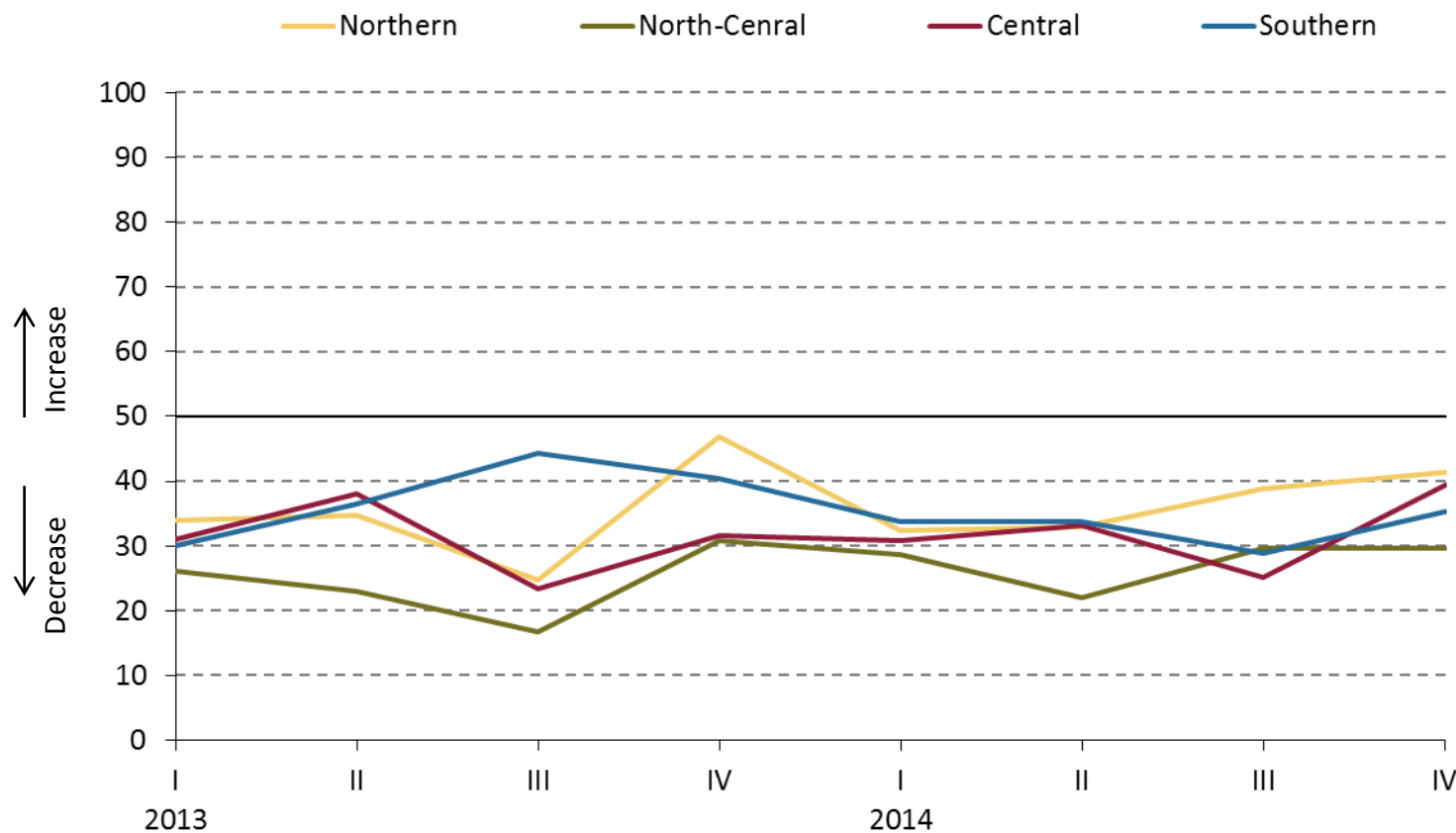
Economic Outlook

- As regards inflation expectations for the following 12 months, most interviewed business agents in four regions of Mexico anticipate the sales prices of own goods and services to register lower annual percentage changes as compared to last year.
- Additionally, according to the expectations for the annual percentage growth rates of input prices and salary costs, these are below the levels registered in 2013, although lying close to them.

Across all regions, business contacts generally anticipate lower annual percentage changes in their sales' prices as compared to last year.

Business Agents' Inflation Expectations of Sales' Prices, Next 12 Months ^{1/}

Diffusion index

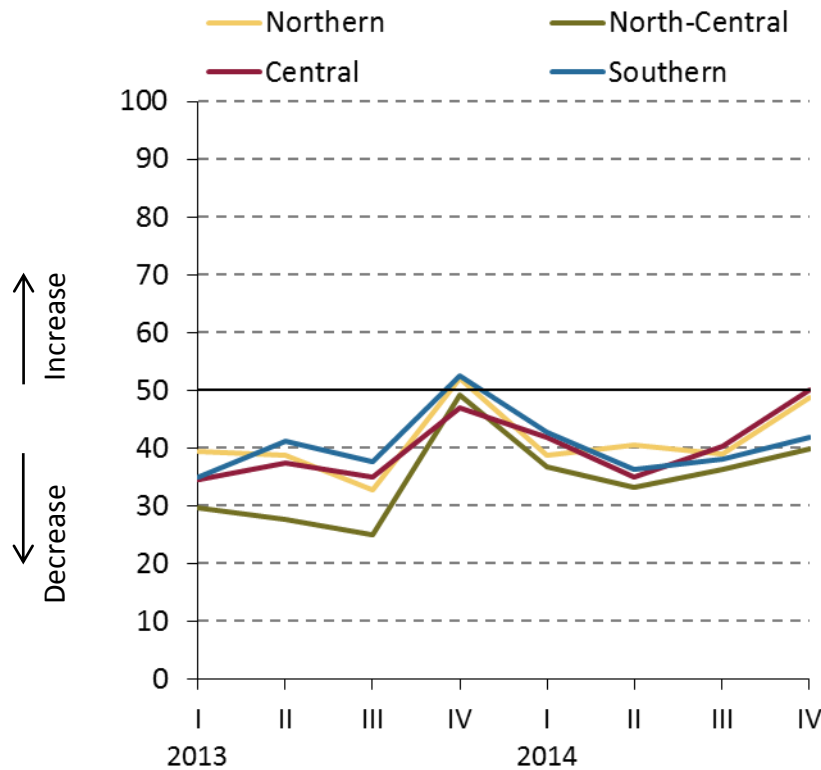


1/ Results obtained from responses to the question: "With respect to the situation in 4Q 2014, do you expect any adjustments in sales prices of own goods and services over the next 12 months?" and "As compared to the same period of last year, what magnitude of adjustment do you expect: greater, same or lower?", from the interviews conducted by Banco de México.

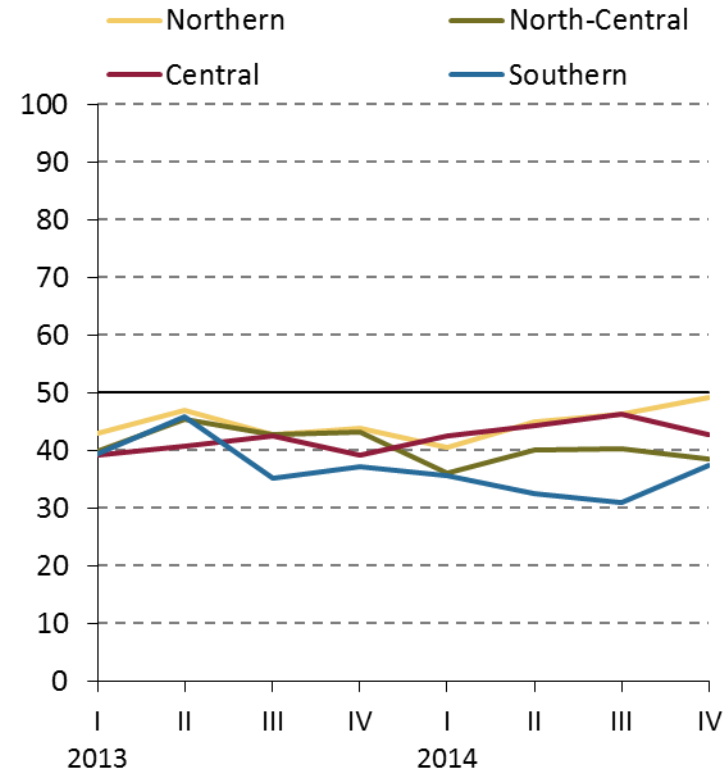
Most interviewed business agents expect slightly lower annual percentage changes in their input prices and labor costs, as compared to last year.

Business Agents' Inflation Expectations, Next 12 Months ^{1/} Diffusion index

Input Prices



Wage Costs

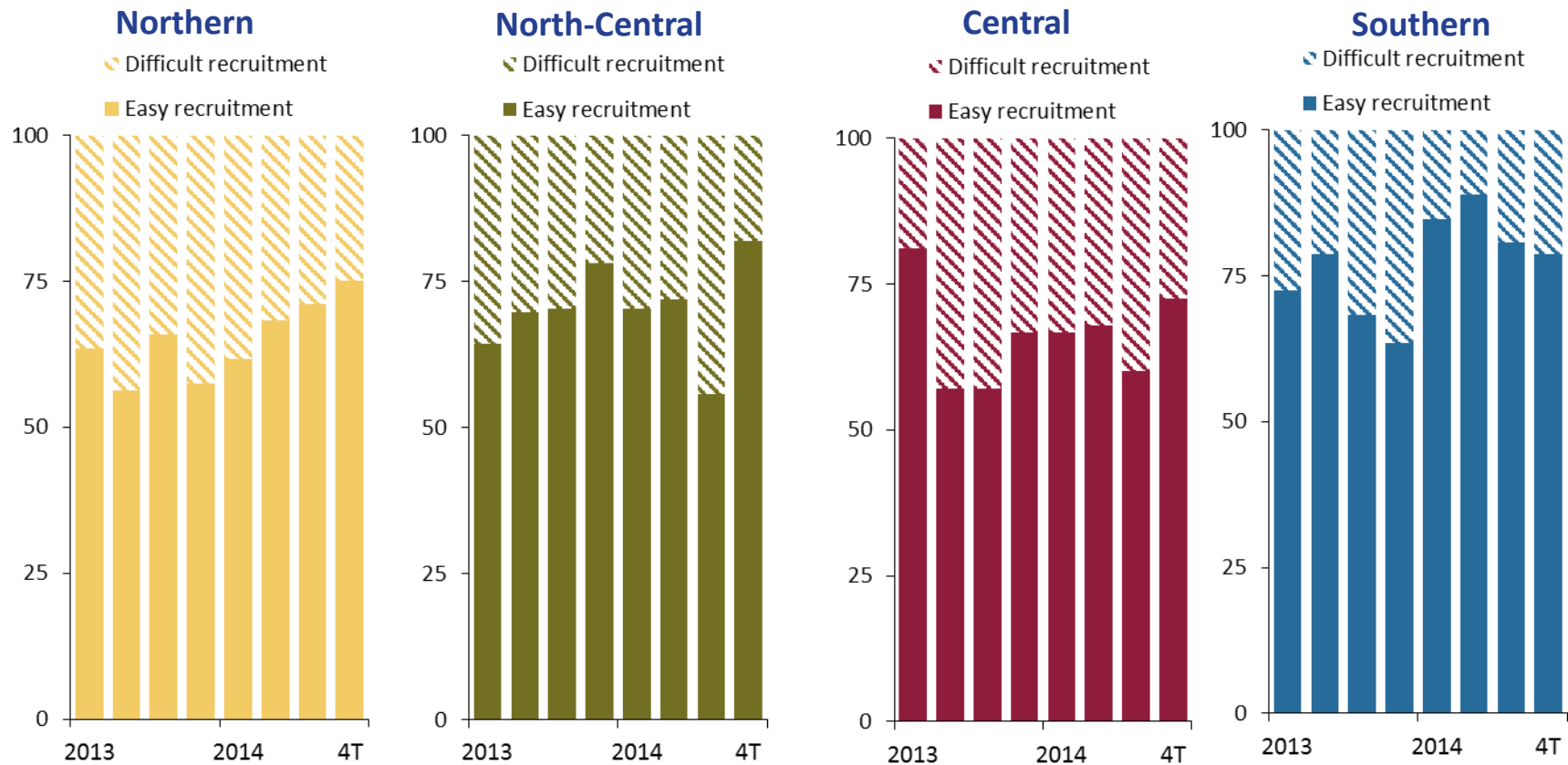


^{1/} Results obtained from responses to the question: "With respect to the situation in 4Q 2014, do you expect any adjustments in sales prices of own goods and services over the next 12 months?" and "As compared to the same period of last year, what magnitude of adjustment do you expect: greater, same or lower?", from the interviews conducted by Banco de México.

With regard to labor costs, most business contacts noted that no difficulties in hiring personnel are anticipated.

Difficulty to Hire Personnel, as Expected by Business Agents, Next 6 Months ^{1/}

Percentage distribution of responses



^{1/} Results obtained from responses to the questions: "Recruitment in your firm will be (according to the number of posts available or the required degree of specialization): difficult, easy", from the interviews conducted by Banco de México.

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Final Remarks

- ① In 4Q 2014, regional economies continued to recover moderately.
- ② Annual headline inflation started to show a downward trend from November 2014. It intensified following an additional considerable decrease in January 2015, to later remain close to 3 percent in all regions in February.
- ③ Business contacts interviewed by Banco de México expect the economic activity in four regions of Mexico to be moderately optimistic, during the following 12 months. In particular, the impulse of external demand and a greater dynamism of private investment were stressed as factors that will support the economic growth in the regions.
- ④ As regards inflation, business agents anticipate smaller increments in their prices, with respect to those observed last year.



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