



Regional Economic Report
October- December 2013



BANCO DE MÉXICO

March 6, 2014

Outline

- I. Introduction**
- II. Results October – December 2013**
 - A. Economic Activity**
 - B. Inflation**
 - C. Economic Outlook**
- III. Final Remarks**

Outline

I. Introduction

II. Results October – December 2013

A. Economic Activity

B. Inflation

C. Economic Outlook

III. Final Remarks

Introduction

- 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 2013 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.

Outline

- I. Introduction
- II. Results October – December 2013**
 - A. Economic Activity**
 - B. Inflation**
 - C. Economic Outlook**
- III. Final Remarks

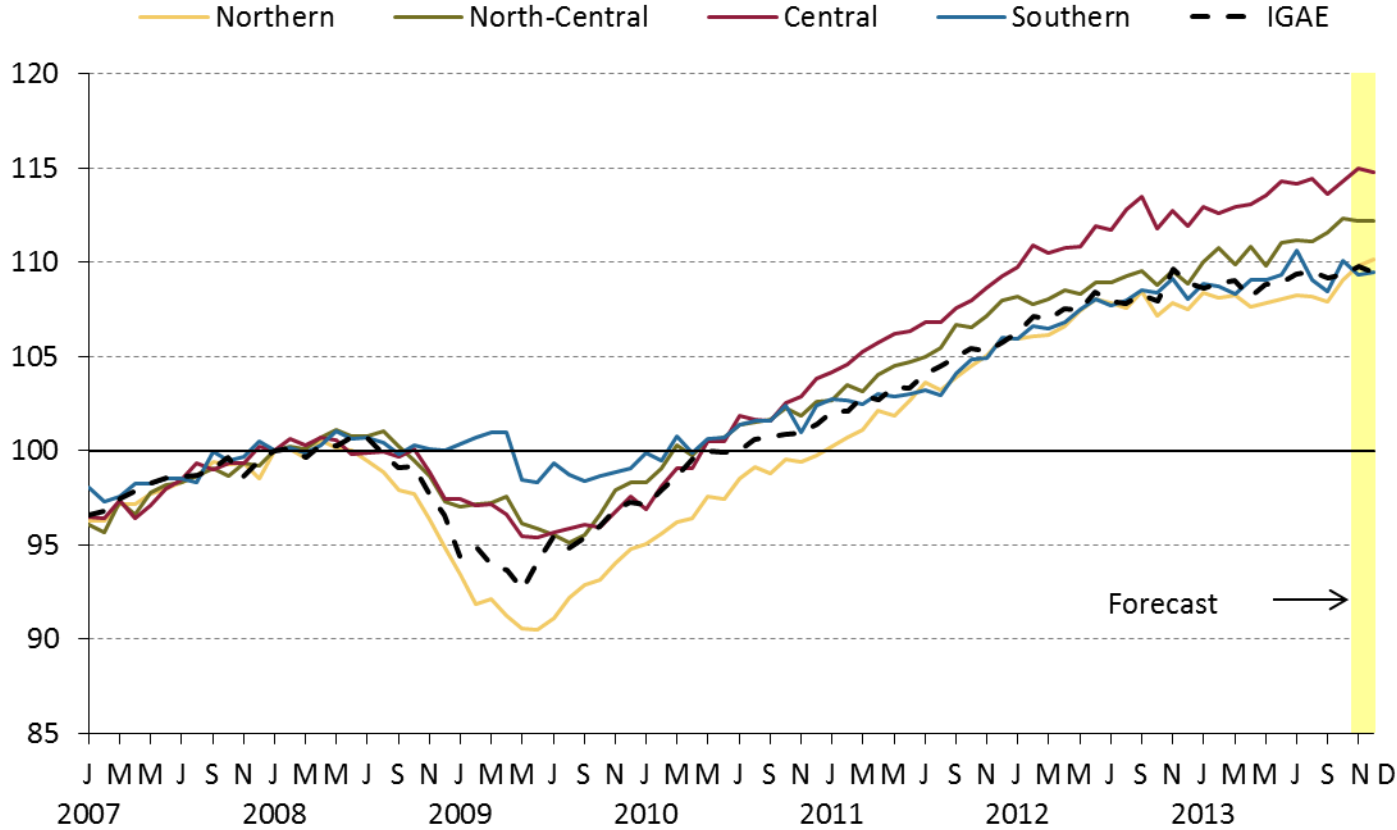
Economic Activity

- Economic activity in all regions observed an expansion in 4Q 2013, although at a lower rate than in 3Q 2013. The growth rate varied across regions.
 - ✓ The economy of the Northern region registered greater dynamism, while the rest of regional economies presented signs of weaker growth.
 - ✓ With the exception of the Northern region, the indices of activity by region in the manufacturing, construction and agricultural sectors, as well as the number of IMSS-insured workers presented in most cases lower annual growth rates as compared to those in 3Q 2013.
- According to contacts interviewed by Banco de México for this Report, regional economies were driven by the expansion of external demand, mainly of the U.S., and by a slight improvement in some sectors of domestic demand.

Economic Activity

Regional Coincident Index ^{1/}

Base January 2008 = 100

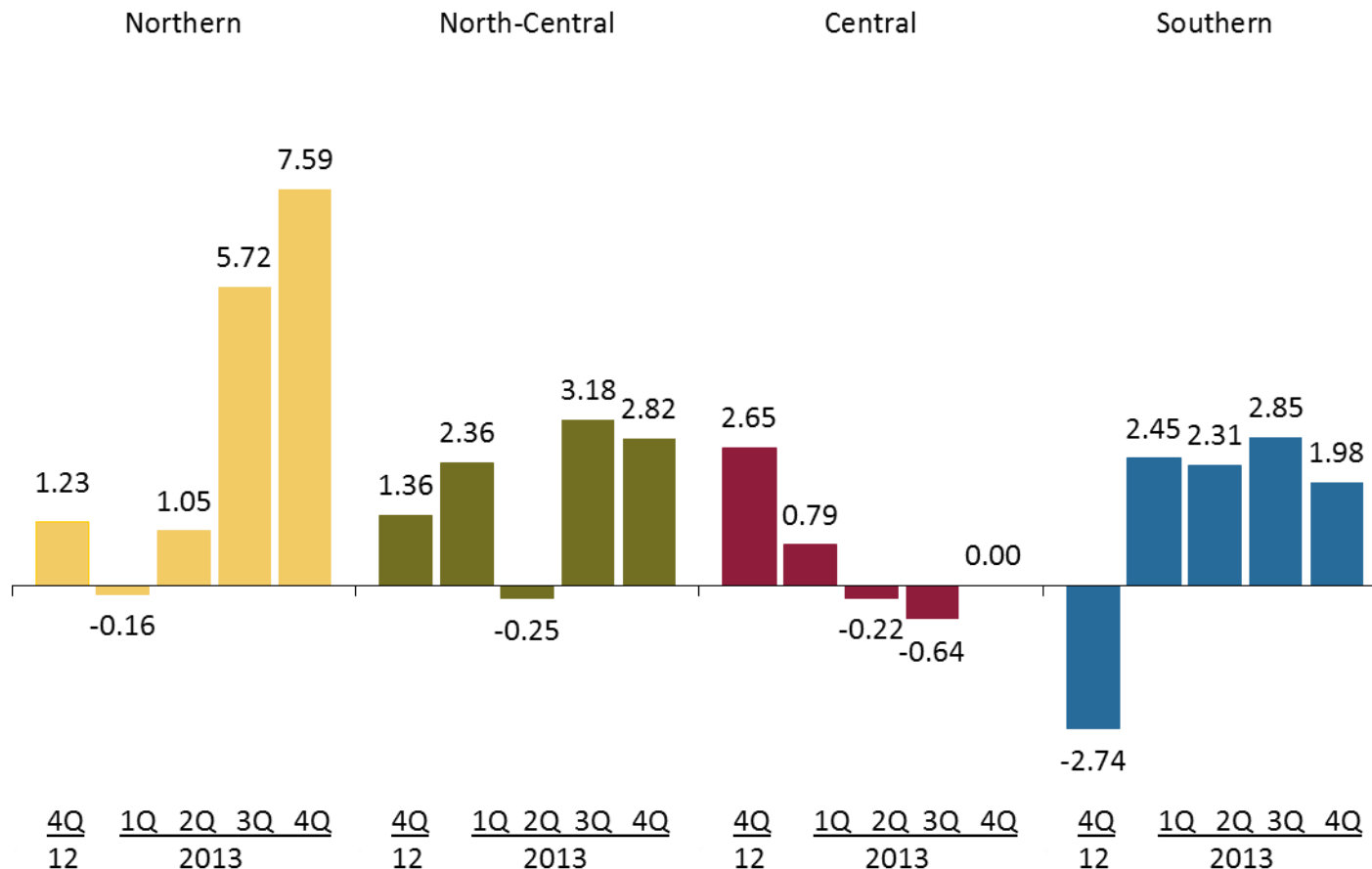


1/ This indicator's values in November and December 2013 are a forecast.
 Source: Estimated by Banco de México with seasonally adjusted data from IMSS and INEGI.

Economic Activity

Regional Manufacturing Indicator ^{1/}

Annual change in percent



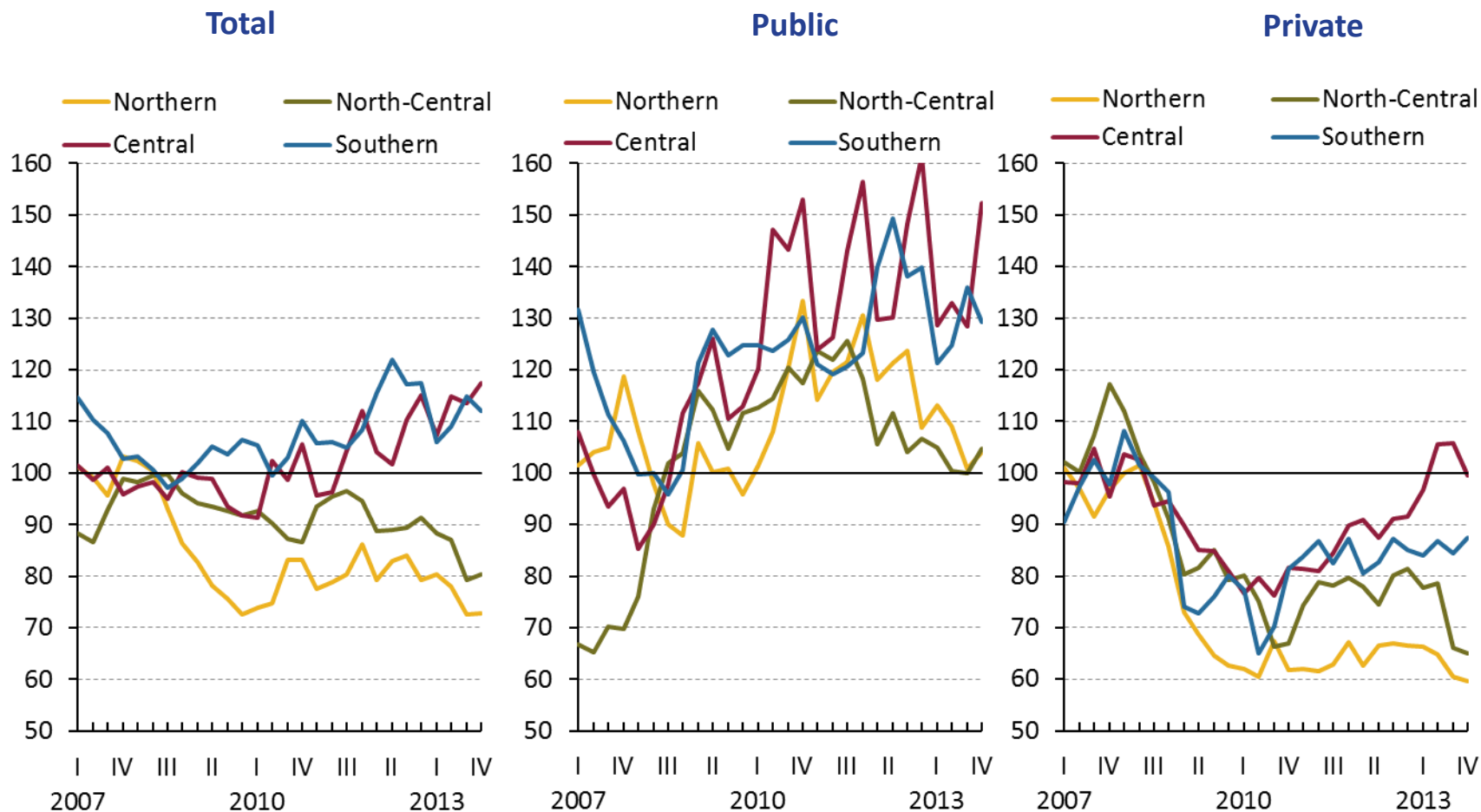
1/ This indicator's values in 4Q 2013 are a forecast.

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

Economic Activity

Real Value of Production in the Construction Industry by Region ^{1/}

Index, base 2Q 2008 = 100, quarterly average

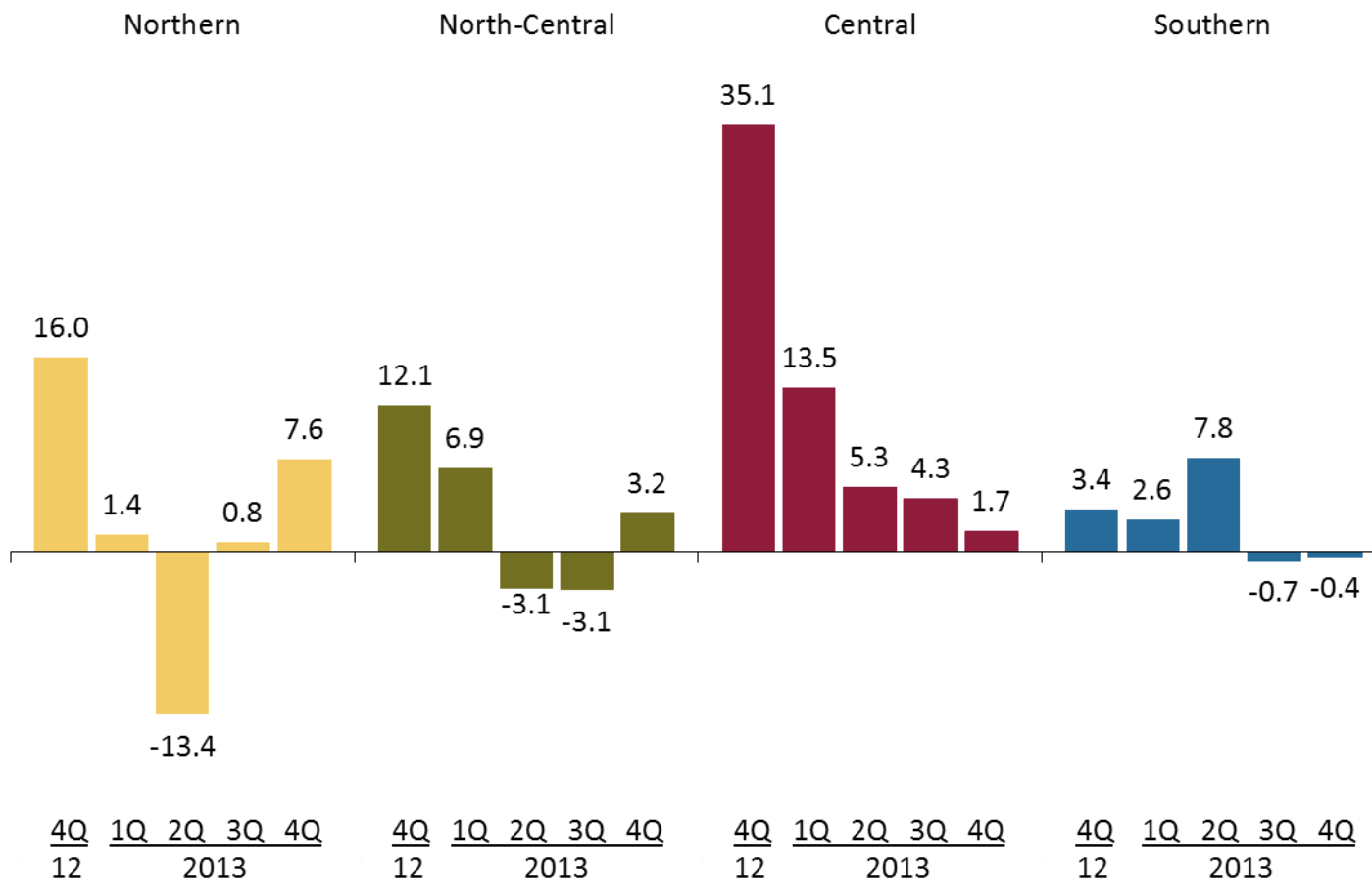


Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Economic Activity

Regional Agricultural Production Index

Annual change in percent



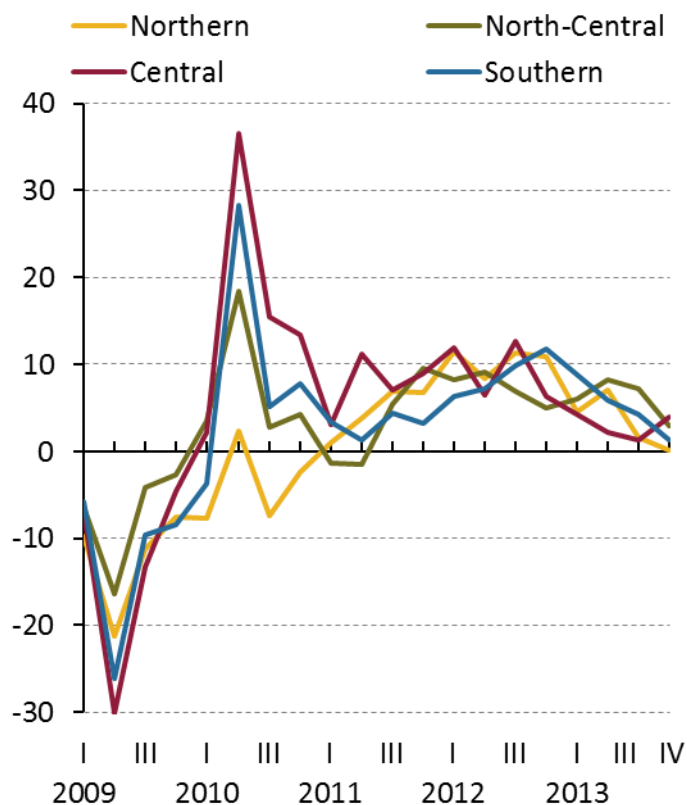
Source: Estimated by Banco de México with data from SAGARPA.

Economic Activity

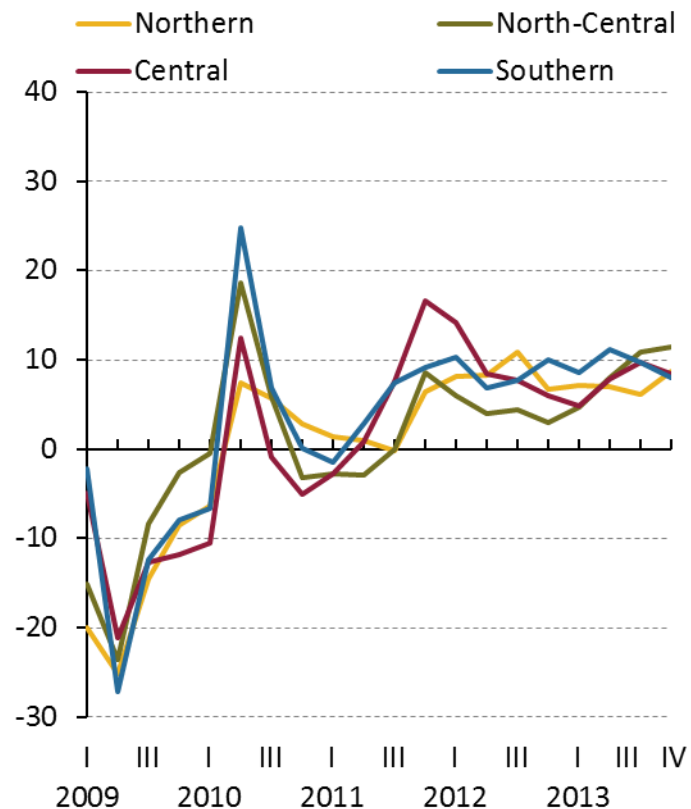
Regional Indicators of Activity in Tourism

Annual change in percent

Hotel Occupancy



Inflow of Passengers to Airports

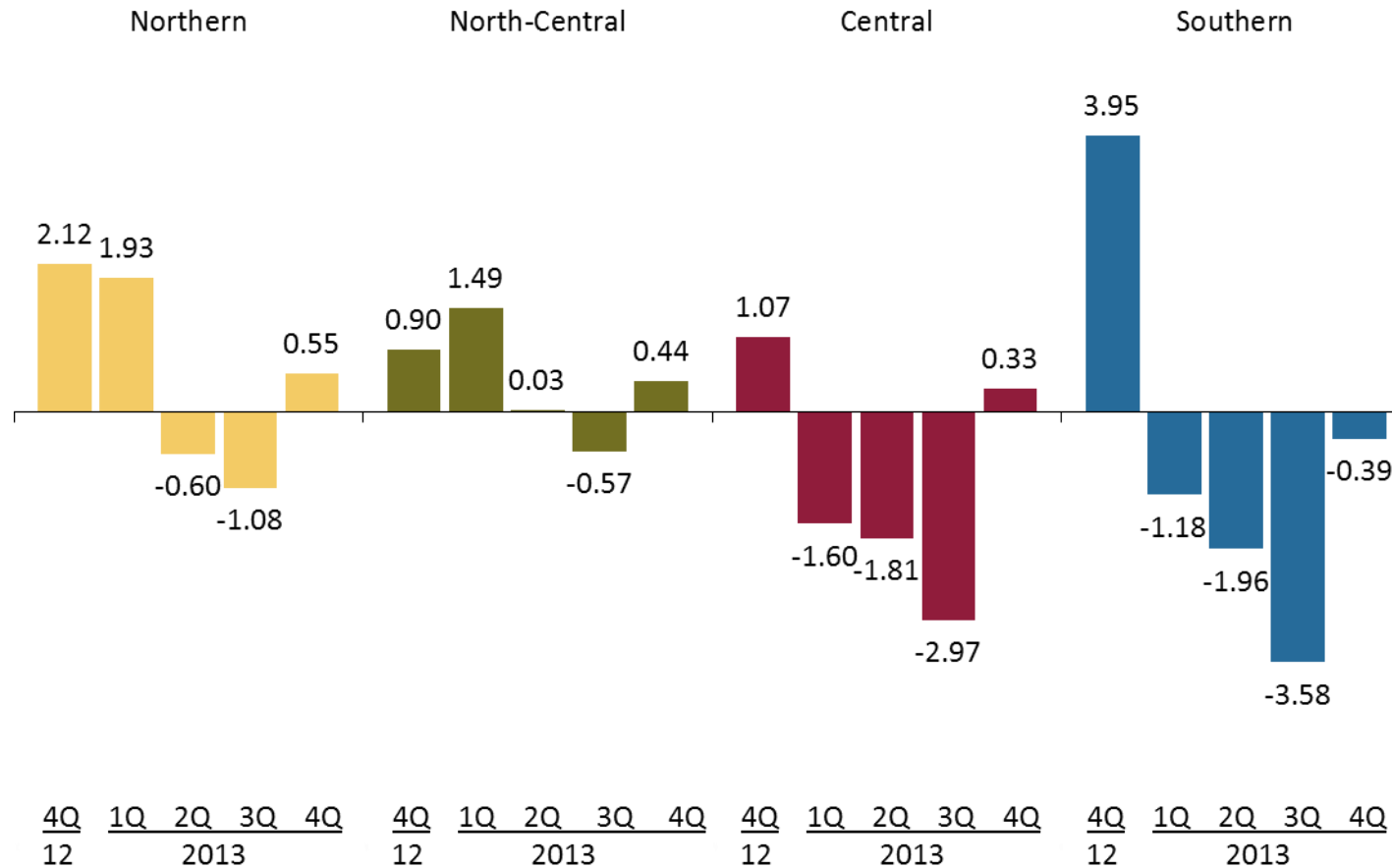


Source: Estimated by Banco de México with seasonally adjusted data from the Mexican Secretariat of Tourism and from Airports and Auxiliary Services (ASA, for its acronym in Spanish).

Economic Activity

Regional Retail Sales Indicator

Annual change in percent

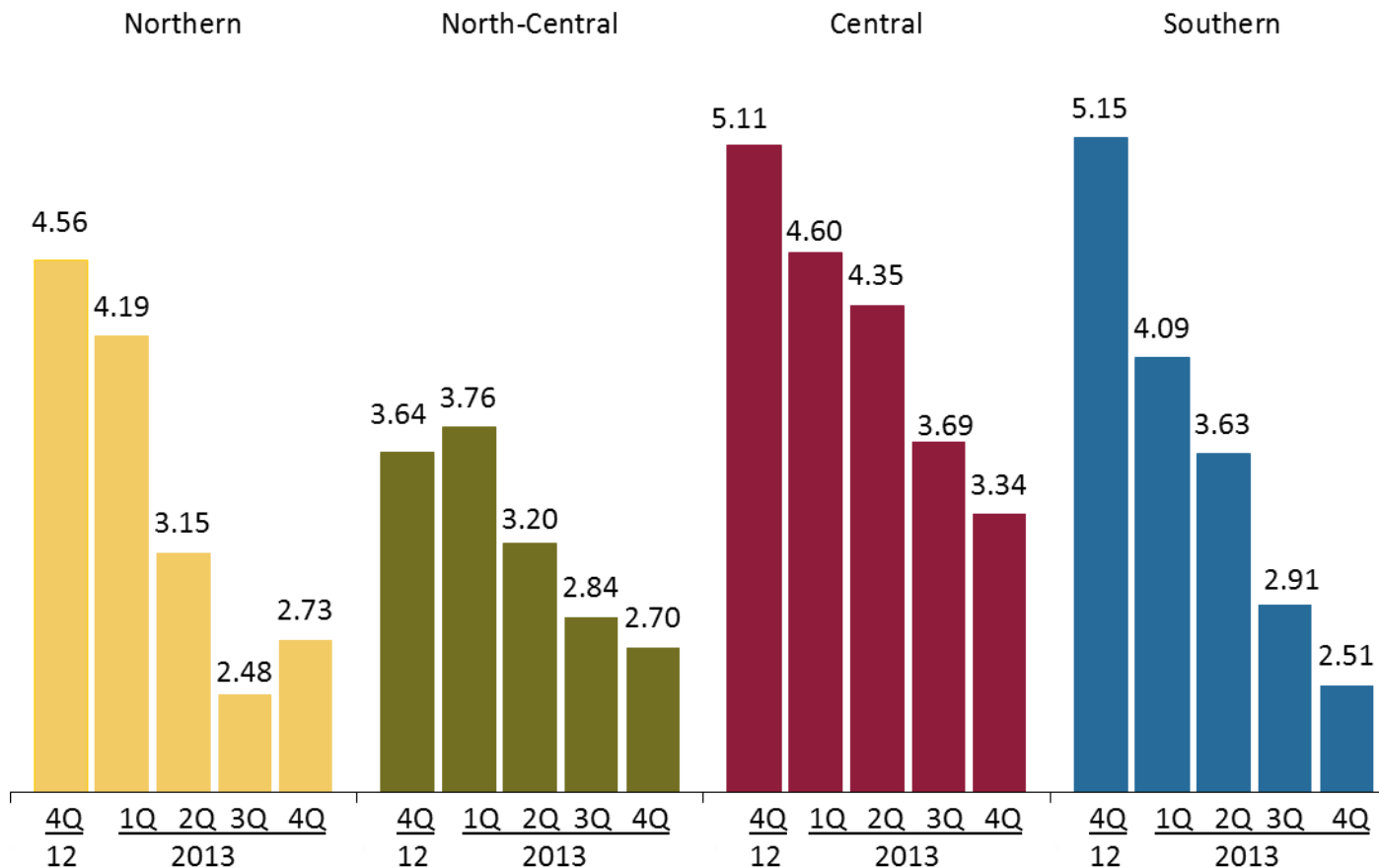


Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Economic Activity

Number of IMSS-insured Workers

Annual change in percent



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

Inflation

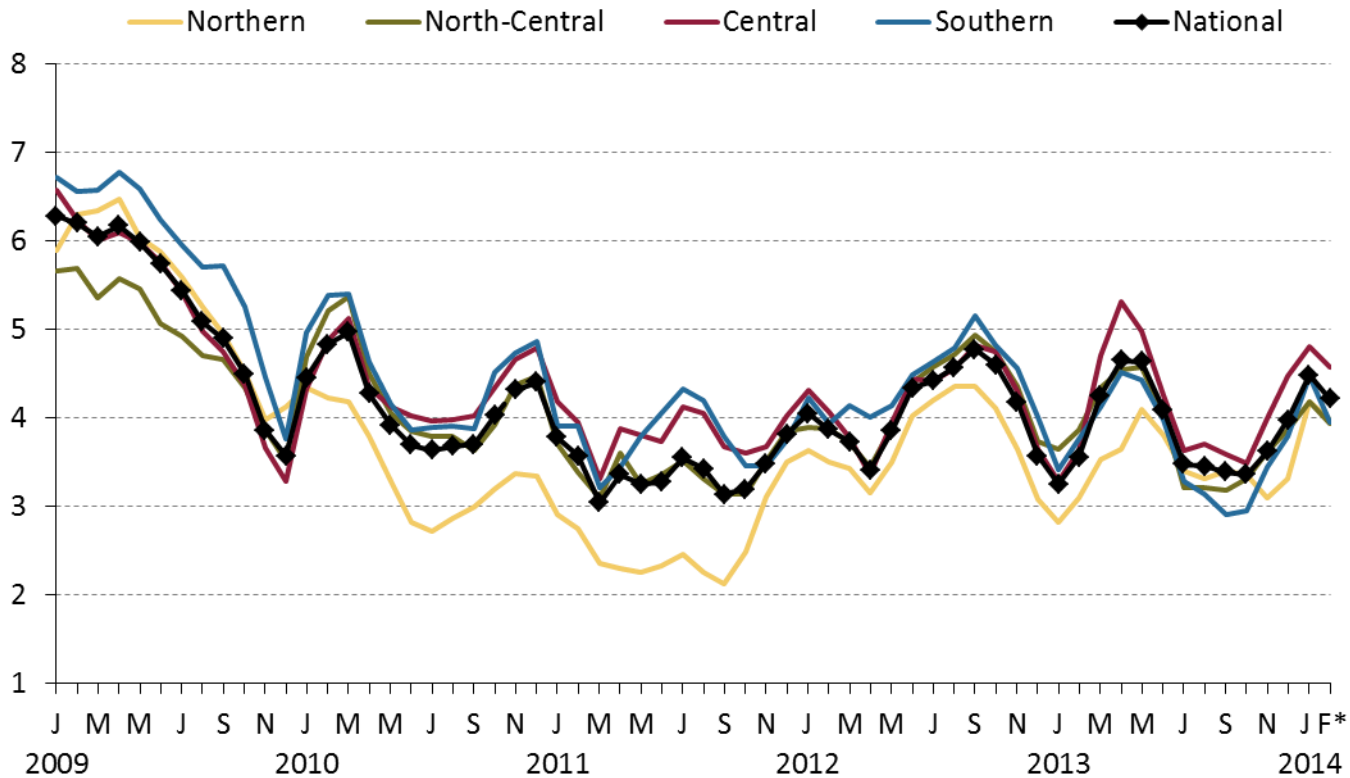
- In 4Q 2013, annual headline inflation increased in all regional economies. This was mainly contributed to by a higher growth rate of the non-core component related to:
 - ✓ Unanticipated adjustments in public transport fares in some cities of the country.
 - ✓ Higher prices of few agricultural products, caused by changes in weather conditions that had affected their production over the previous months.
- Annual core inflation remained on average below 3 percent and close to its historical minimum levels in all regional economies in 4Q 2013.

Inflation

- In January 2014, as anticipated by Banco de México, annual headline inflation in the four regional economies increased, consequent on adjustments in public prices and the fiscal measures that came into force at the beginning of 2014.
 - ✓ The referred increment was slightly more marked in the border cities of the Northern and Southern regions, due to the equalization of the VAT in the border region to the rate prevailing in the rest of the country.
- Still, from the second fortnight of January onwards, annual headline inflation began observing a downward trajectory.
 - ✓ This reflects, as anticipated, that the impact of adjustments in public prices and new fiscal measures on inflation will be temporary, and that, so far, there is no evidence of contamination of the price formation process.

Inflation

Annual Headline Inflation Percent



*/ Values of February 2014 correspond to the first fortnight.

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

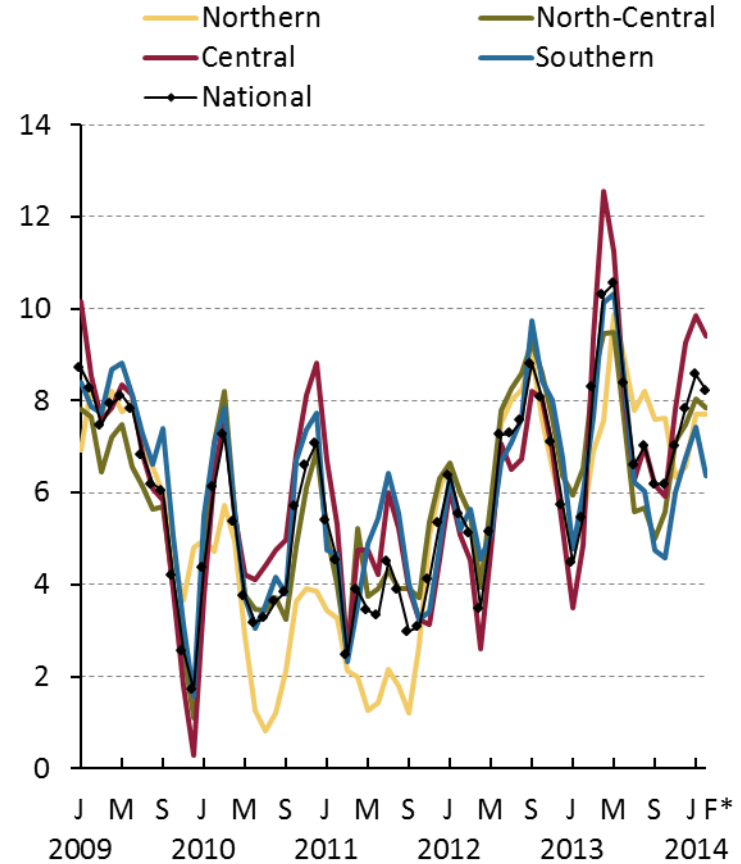
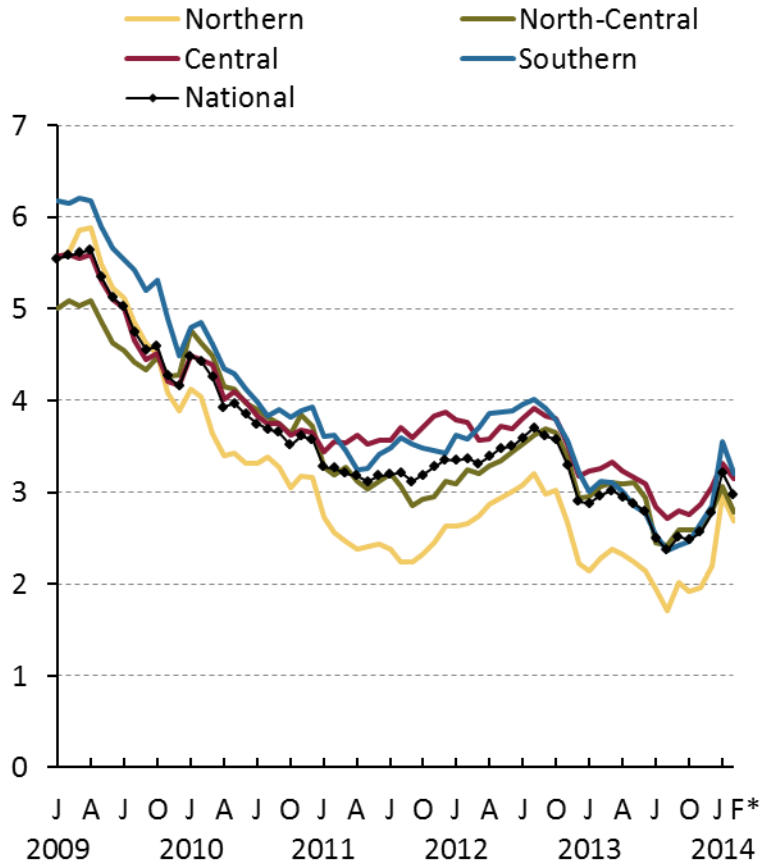
Inflation

Components of Annual Headline Inflation

Percent

Core

Non-core



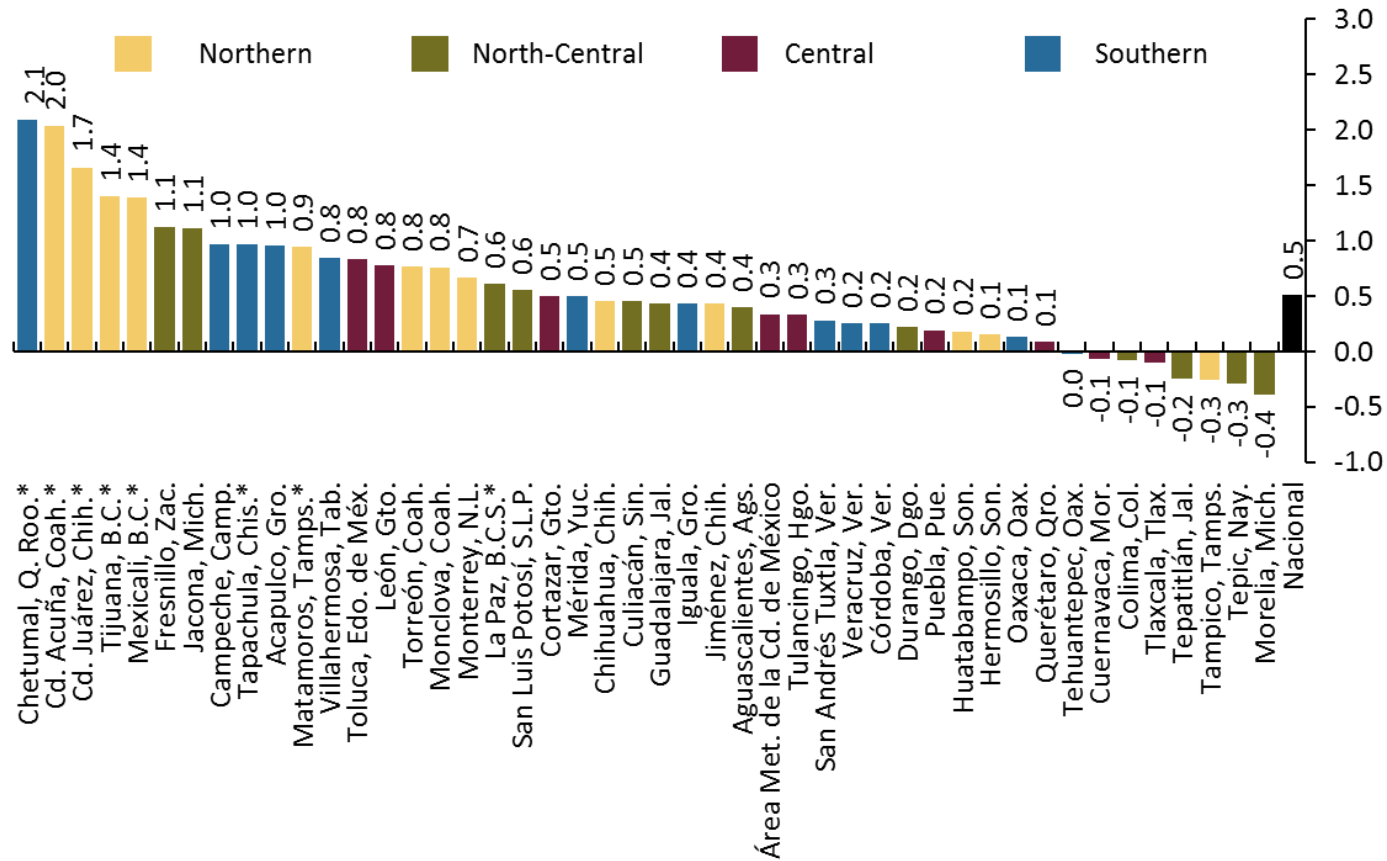
*/ Values of February 2014 correspond to the first fortnight.

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

Inflation

Change in Annual Headline Inflation by City

January 2014 with respect to December 2013, percentage points



*/ Border cities.

Source: INEGI.

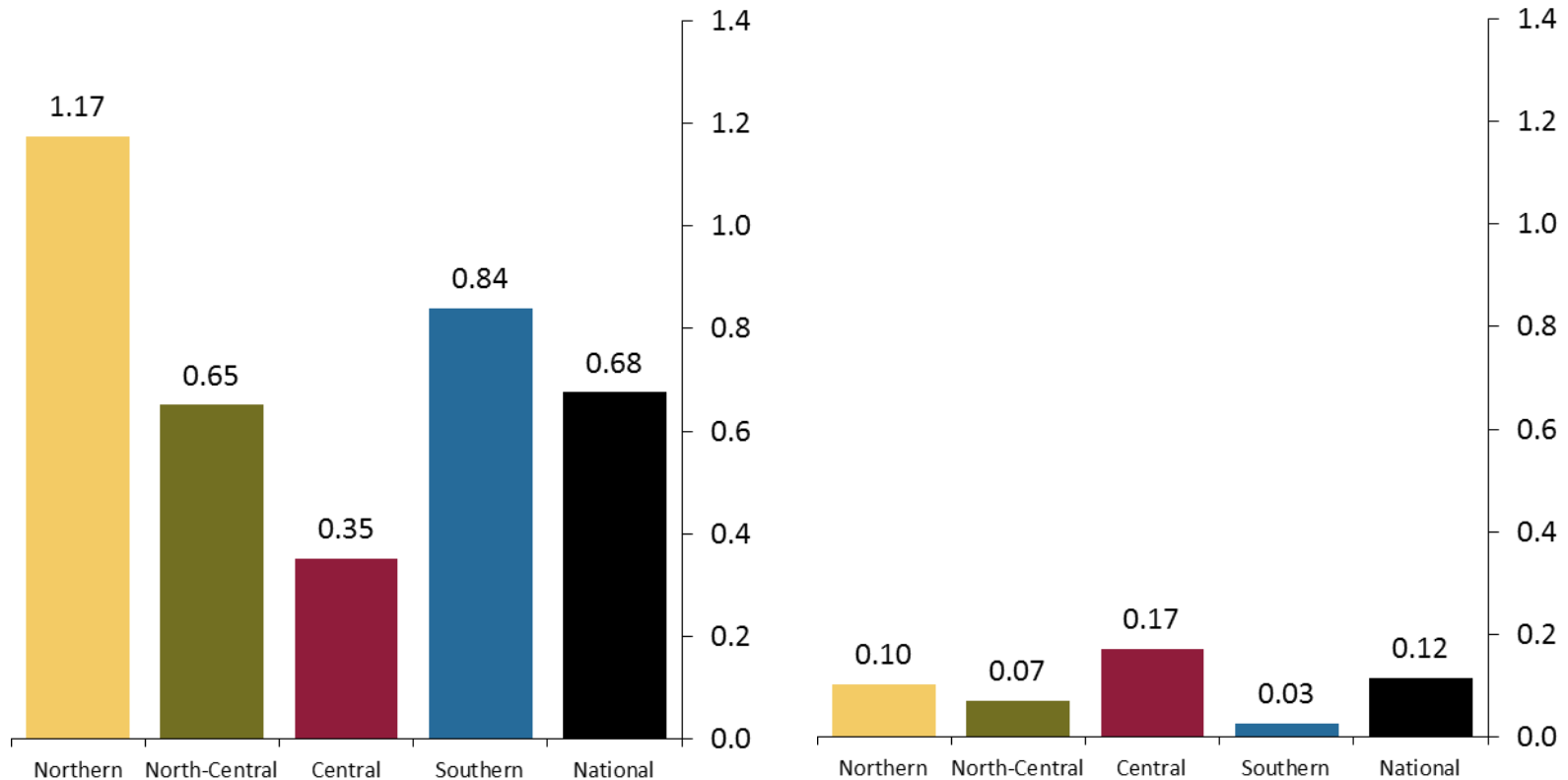
Inflation

Biweekly Inflation of the CPI in January 2014 by Region

Percent

First Fortnight

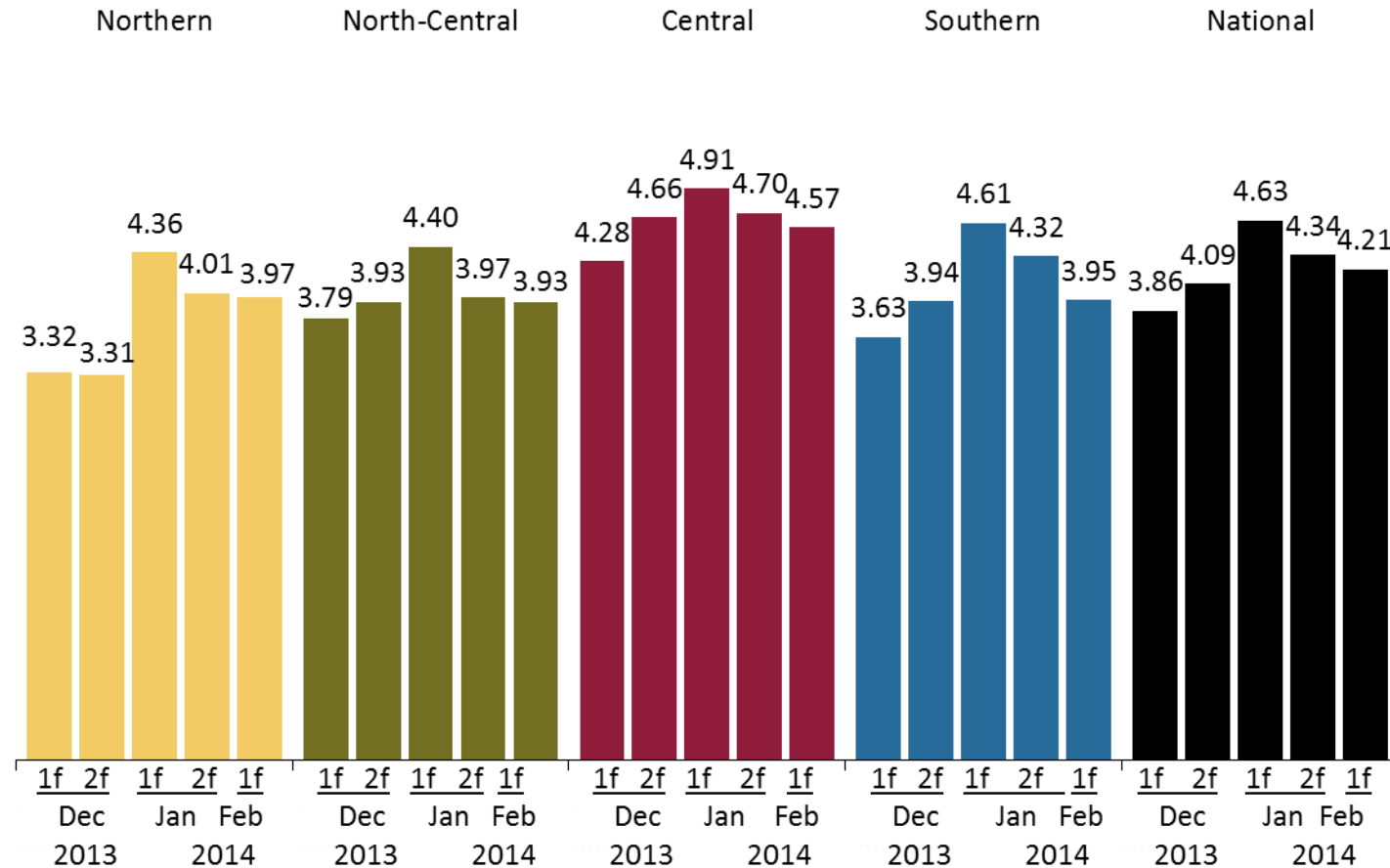
Second Fortnight



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

Inflation

Annual Headline Inflation at a Biweekly Frequency by Region Data in percent



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

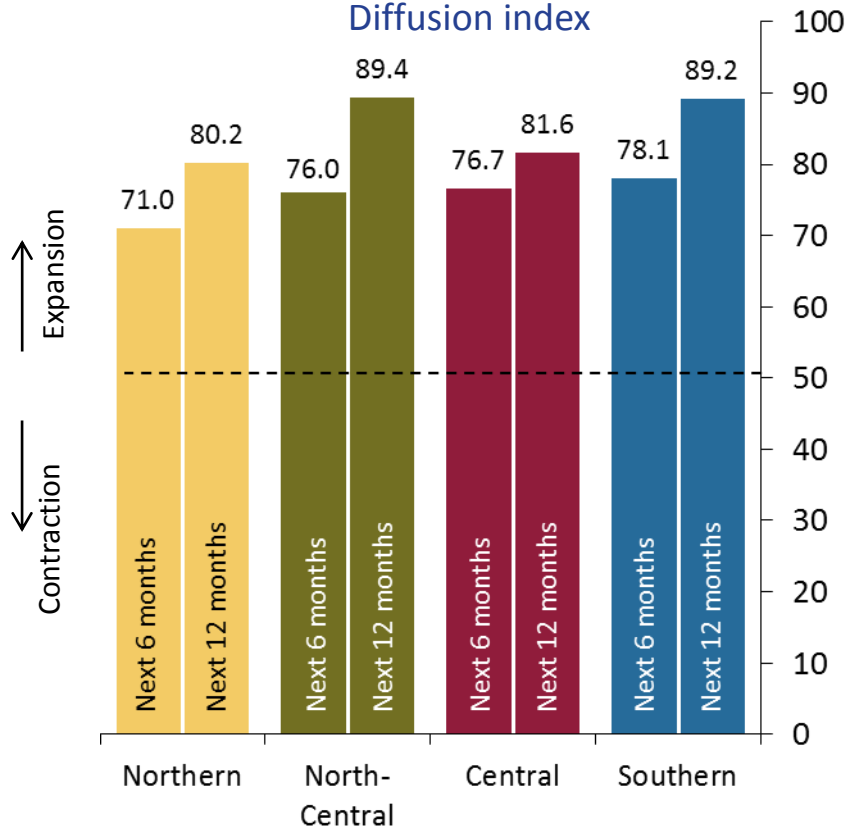
Economic Outlook

- Interviewed business agents anticipate that demand for own goods and services will continue growing in all regional economies in the next 6 and 12 months. This expectation is mainly associated to the following:
 - ✓ A greater reactivation of domestic demand, particularly of public investment in infrastructure.
 - ✓ A moderate growth of external demand.
- Despite the abovesaid, some contacts were cautious regarding the rate of economic growth in the first months of the year.

Economic Outlook

Demand as Expected by Business Agents ^{1/}

Diffusion index

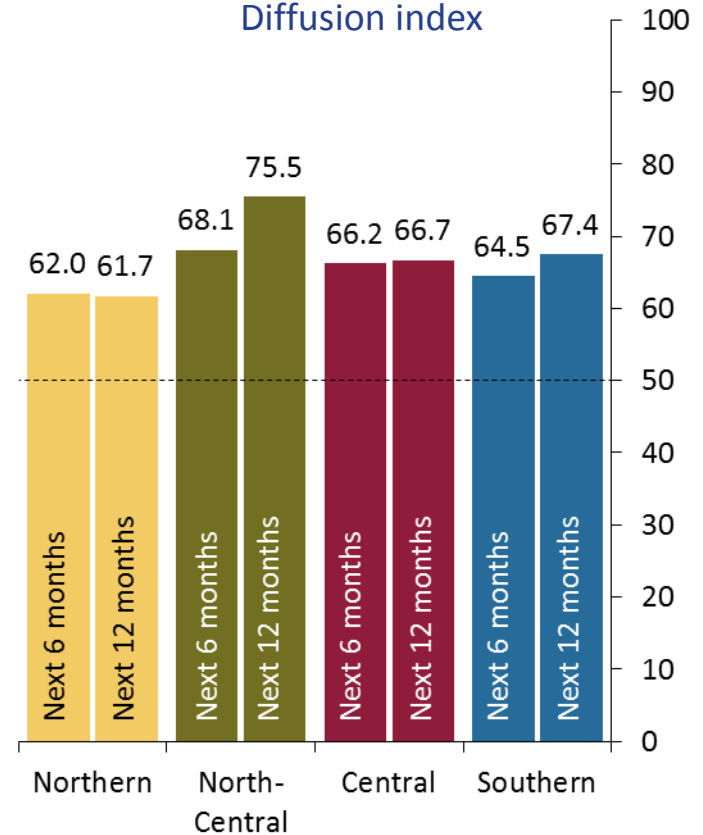


1/ Results obtained from responses to the question: “With respect to the situation in 4Q 2013, how do you expect demand for your own products and services to change over the next 6 and 12 months?”, from the interviews conducted by Banco de México in the period of January 6-31, 2014.

Source: Banco de México.

Personnel Hired as Expected by Business Agents ^{2/}

Diffusion index

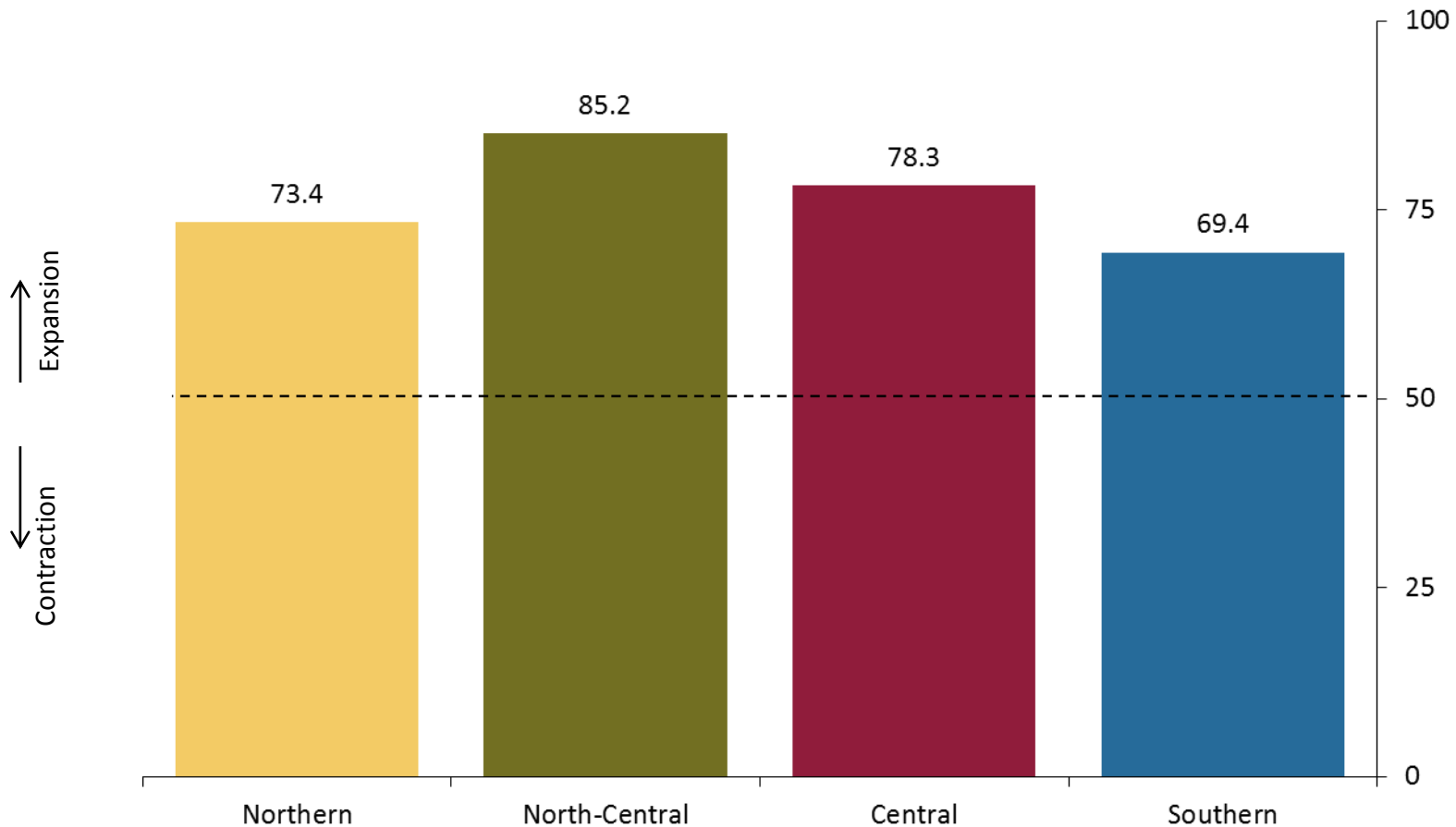


2/ Results obtained from responses to the question: “With respect to the situation in 4Q 2013, how do you expect the personnel hired by your firm to modify over the next 6 and 12 months?”, from the interviews conducted by Banco de México in the period of January 6-31, 2014.

Source: Banco de México.

Economic Outlook

Physical Capital Stock as Expected by Business Agents for the Next 12 Months ^{1/} Diffusion index



1/ Results obtained from responses to the question: "With respect to the situation in 4Q 2013, 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 in the period of January 6-31, 2014.
Source: Banco de México.

Economic Outlook

- According to interviewed contacts, among the main risk factors that could affect the expected growth rate of regional economies, if they happen to occur, are the following:

External factors

- ✓ New volatility episodes in international financial markets.

Domestic factors

- ✓ Deterioration in perceived public safety.
- ✓ Smaller than foreseen extent of structural reforms.
- ✓ Greater than expected impact of fiscal measures on consumer purchasing power.
- ✓ In some regions business agents also expressed concern over the dynamism of public expenditure on infrastructure and the occurrence of adverse weather phenomena.

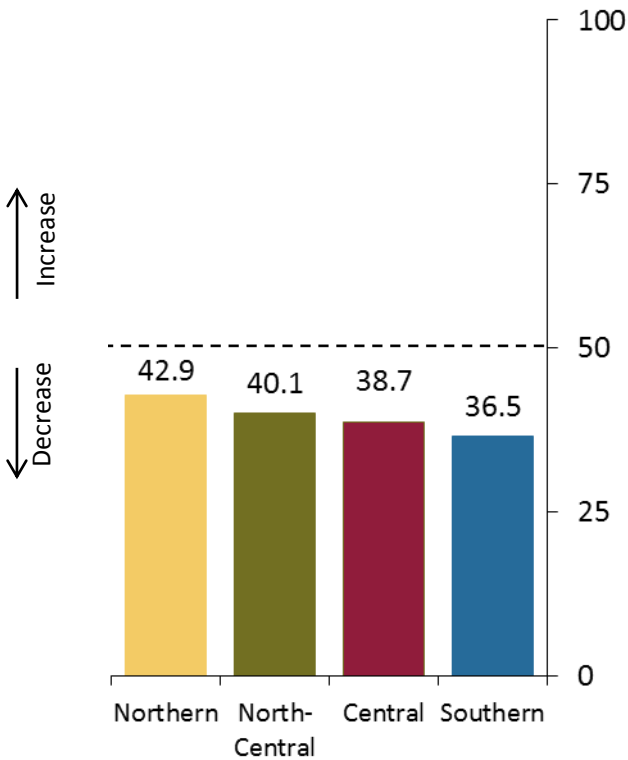
Economic Outlook

- As regards inflation expectations, interviewed business agents stated that they do not anticipate inflationary pressures on salary costs over the next 6 and 12 months, given the slack in regional labor markets.
- With respect to input prices, lower annual growth rates are expected, even though business agents interviewed in the Northern and Southern regions anticipate a moderate increment in these rates, as a result of the VAT equalization in the border region to the rate prevailing in the rest of the country.
- Business agents generally anticipate a low pass-through onto their sales prices, reason for which they expect their annual growth rate to be lower than that of their inputs over the referred period.

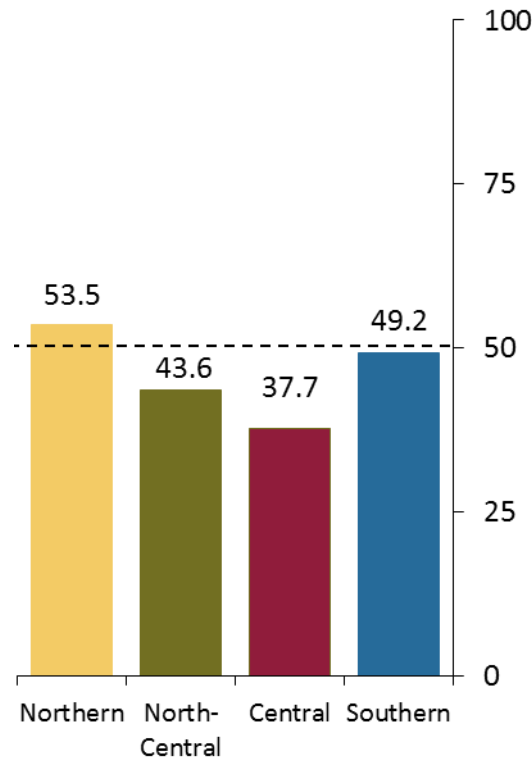
Economic Outlook

Business Agents' Inflation Expectations, Next 6 Months ^{1/} Diffusion index

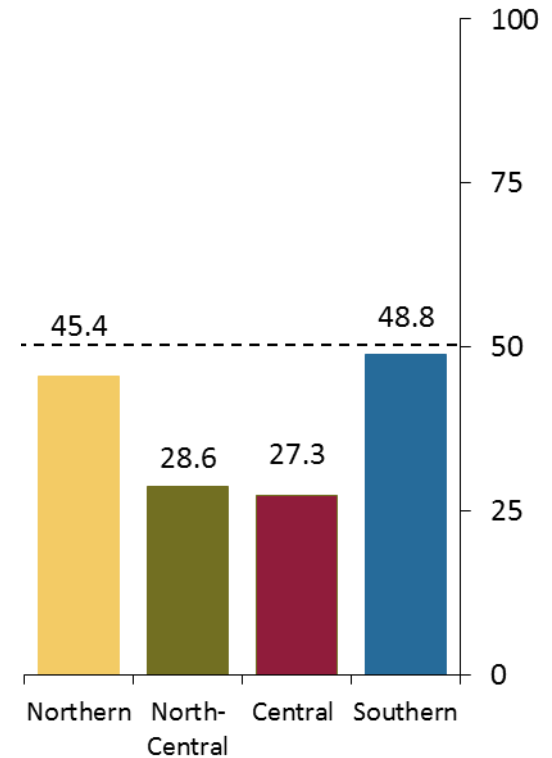
Labor Cost Inflation



Commodity Price Inflation



Own Products' Price Inflation



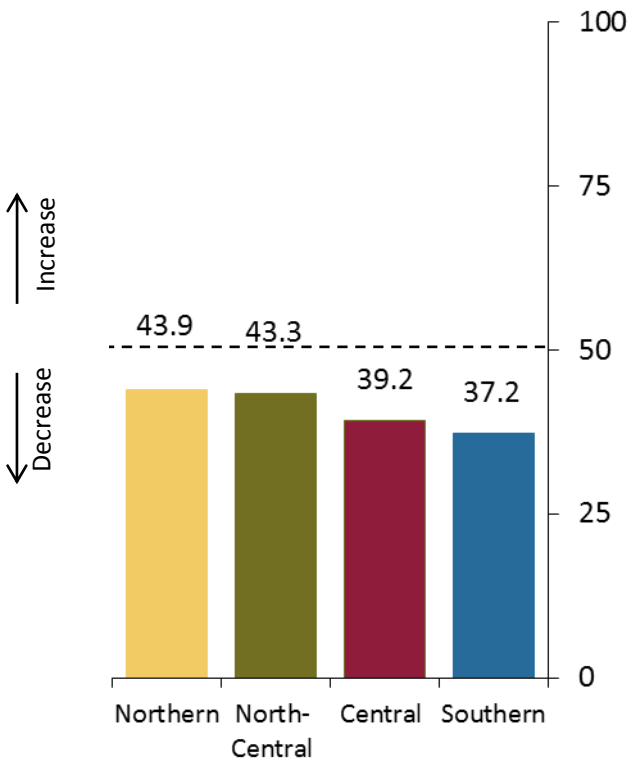
1/ Results obtained from the questions: "With respect to the situation in 4Q 2013, do you expect any adjustment in labor costs, commodity prices and own products and services' prices over the next 6 months?" and "In comparison with the same period of last year, what magnitude of adjustment do you expect: Greater, same or lower?", from the interviews conducted by Banco de México in the period of January 6-31, 2014.

Source: Banco de México.

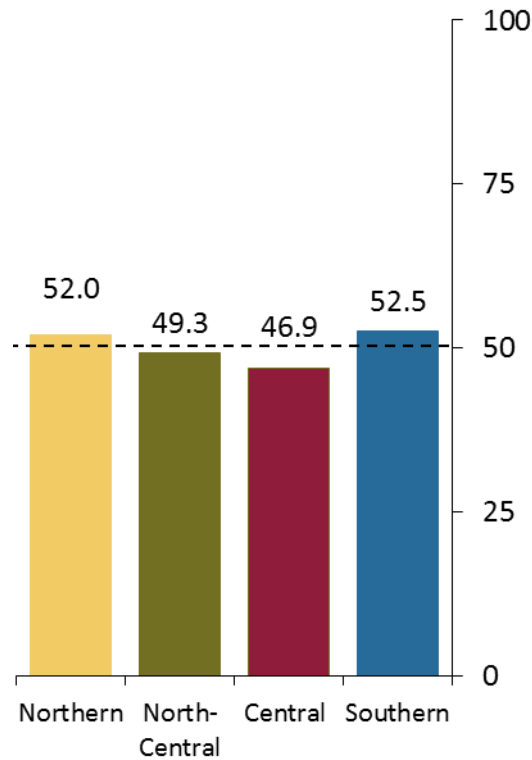
Economic Outlook

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

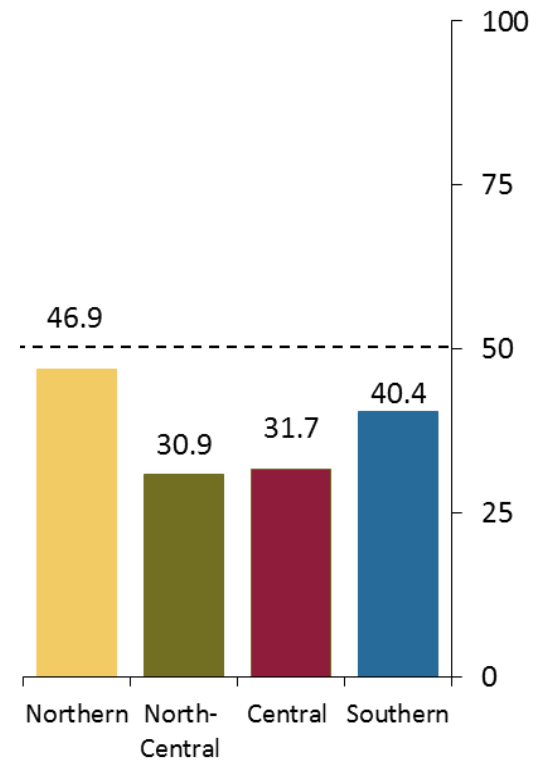
Labor Cost Inflation



Commodity Price Inflation



Own Products' Price Inflation



1/ Results obtained from the questions: "With respect to the situation in 4Q 2013, do you expect any adjustment in labor costs, commodity prices and own products and services' prices over the next 12 months?" and "In comparison with 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 in the period of January 6-31, 2014.

Source: Banco de México.

Box 1: Opinion of Business Agents regarding Structural Reforms Approved in 2013

- In recent years Banco de México has emphasized the importance of pushing forward and implementing structural reforms, that would allow boosting productivity and the economic growth of the country.
- Therefore, on various occasions it has consulted business agents from its network of regional contacts regarding the referred reforms.
- This Report presents the opinion of these contacts, interviewed at the beginning of 2014 about the reforms approved in 2013.
 - ✓ Opinion on the degree of progress that is generally considered to have been made by means of approving these reforms.
 - ✓ Opinion of the reforms that, as estimated, will have the greatest impact on the economic activity of their state in the medium term.

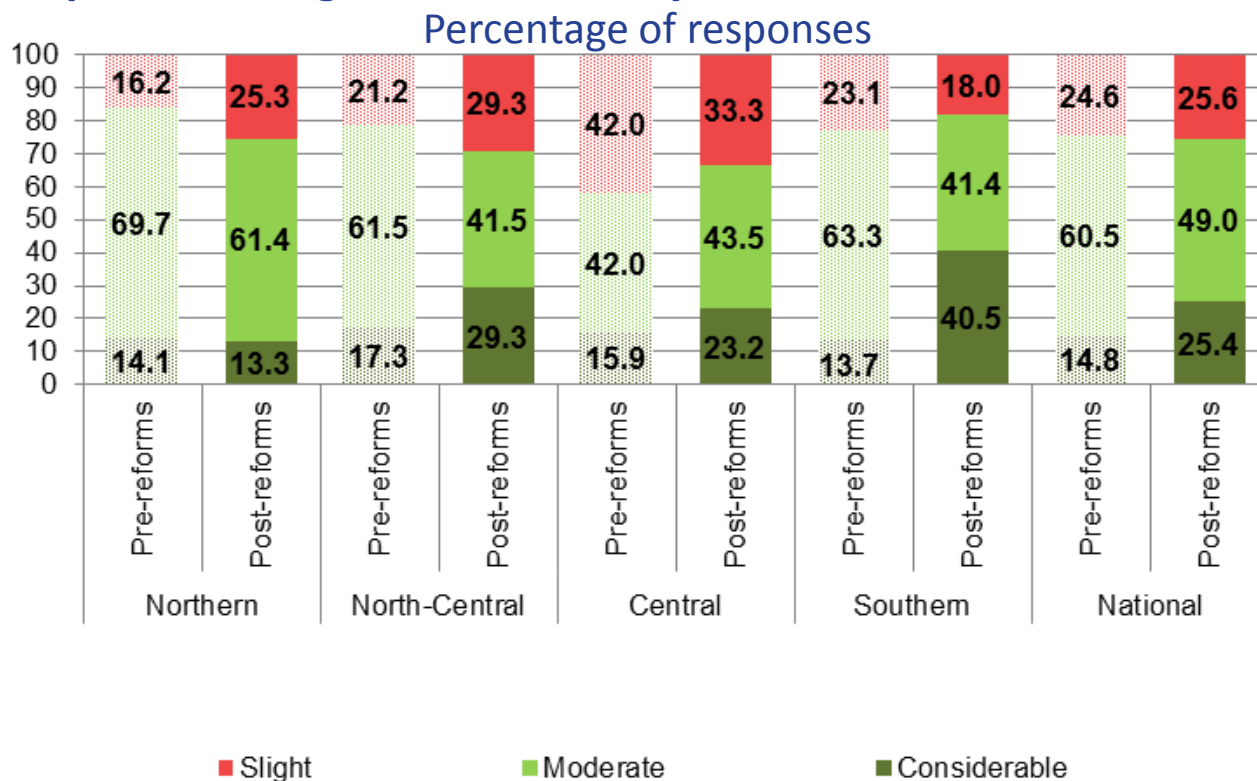
Box 1: Opinion of Business Agents regarding Structural Reforms Approved in 2013

Results

- ① As compared to the expectations prior to the reforms' approval, generally the interviewed business agents presented an improved perception of the achieved progress.

Box 1: Opinion of Business Agents regarding Structural Reforms Approved in 2013

Perception of Progress Achieved by means of Structural Reforms ^{1/}



^{1/} The data prior to reforms were obtained from the interviews conducted by Banco de México between December 17, 2012 and January 31, 2013. The data after the reforms correspond to the results obtained from responses to interviews conducted in the period of January 6-31, 2014.

Source: Banco de México.

Box 1: Opinion of Business Agents regarding Structural Reforms Approved in 2013

Results

- ② In all regional economies, business agents considered that reforms with the greatest impact on the economic activity in their respective states in the medium term are the following:
- ✓ Energy reform
 - ✓ Telecommunications and economic competition reform
 - ✓ Financial reform

Box 2: Local Regulation and Business Set-up Costs in Mexico

- Recently approved structural reforms (with the appropriate secondary legislation backing them and the adequate implementation) will be even more effective insofar as they occur in an environment facilitating new business start-ups.
 - ✓ The previous Report presented data indicating that business start-up costs varied significantly across the regions.^{1/}
- This Report presents the analysis of some determinants of the regional differences in business start-up costs.
 - ✓ More precisely, the relation between the start-up costs and the deregulation of business start-up procedures is studied by federal entity.

^{1/} See the Box “Regional and Municipal Indicators of Ease of Starting up New Businesses in Mexico” in the Regional Economic Report April-June 2012.

Box 2: Local Regulation and Business Set-up Costs in Mexico

- The main result of the analysis lies in the fact that the adoption of measures to ease firms' regulatory compliance is associated with a considerable reduction of business set-up costs in Mexico.
- This result is relevant in the current context of the Mexican economy, in which the importance of implementing measures and strategies at the microeconomic level, which could enhance the impact of structural reforms approved in 2013 on productivity and the economic growth rate of Mexico, stands out.

$$Cost_{it} = \gamma DER_{it} + \beta X_{it} + \mu_i + v_{it}$$

	Variable	Coefficient
	DER	-12.66**
X	Per capita GDP	0.05*
	Per capita public revenue	-1.93**
	Insecurity level	0.08*

Note: * and ** denote significance at 10 and 5 percent, respectively.

Source: Estimated by Banco de México with data from the World Bank, COFEMER, CONAPO, INEGI and SESNSP.

Outline

- I. Introduction
- II. Results July – September 2013
 - A. Economic Activity
 - B. Inflation
 - C. Economic Outlook
- III. Final Remarks**

Final Considerations

Based on the analysis of regional economic data and opinions of interviewed contacts, the following stands out:

- 1 Economic activity in all regional economies observed an expansion in 4Q 2013, although at a lower growth rate than in 3Q 2013. Still, dynamisms varied across regions, being slightly greater in the Northern region, and weaker in the other ones.
- 2 Annual headline inflation increased in late 2013 and in early 2014. However, as expected, inflation has started to decrease. Thus, evidence suggests that the impact of the recent changes in relative prices on inflation will be temporary, and that, so far, the price formation process has not been contaminated.

Final Considerations

- ③ Business contacts interviewed by Banco de México for this Report anticipate regional economies to continue expanding over the next 6 and 12 months.
- ④ As regards the inflation outlook, the referred agents generally stated that they do not anticipate considerable inflationary pressures over the next 6 and 12 months.



BANCO DE MÉXICO

March 2014

www.banxico.org.mx