



Regional Economic Report
April – June 2015



BANCO DE MÉXICO

September 10, 2015

Outline

I. Regional Economic Report

II. Results April – June 2015

A. Economic Activity

B. Inflation

C. Economic Outlook

III. Final Remarks

Regional Economic Report

- The Regional Economic Report is a quarterly publication on recent trends in economic activity, inflation and business agents' expectations in the Mexican regions.¹
- The 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 2Q 2015 and the prospects for regional economic activity and inflation over the following 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. Regional Economic Report

II. Results April – June 2015

A. Economic Activity

B. Inflation

C. Economic Outlook

III. Final Remarks

Economic Activity

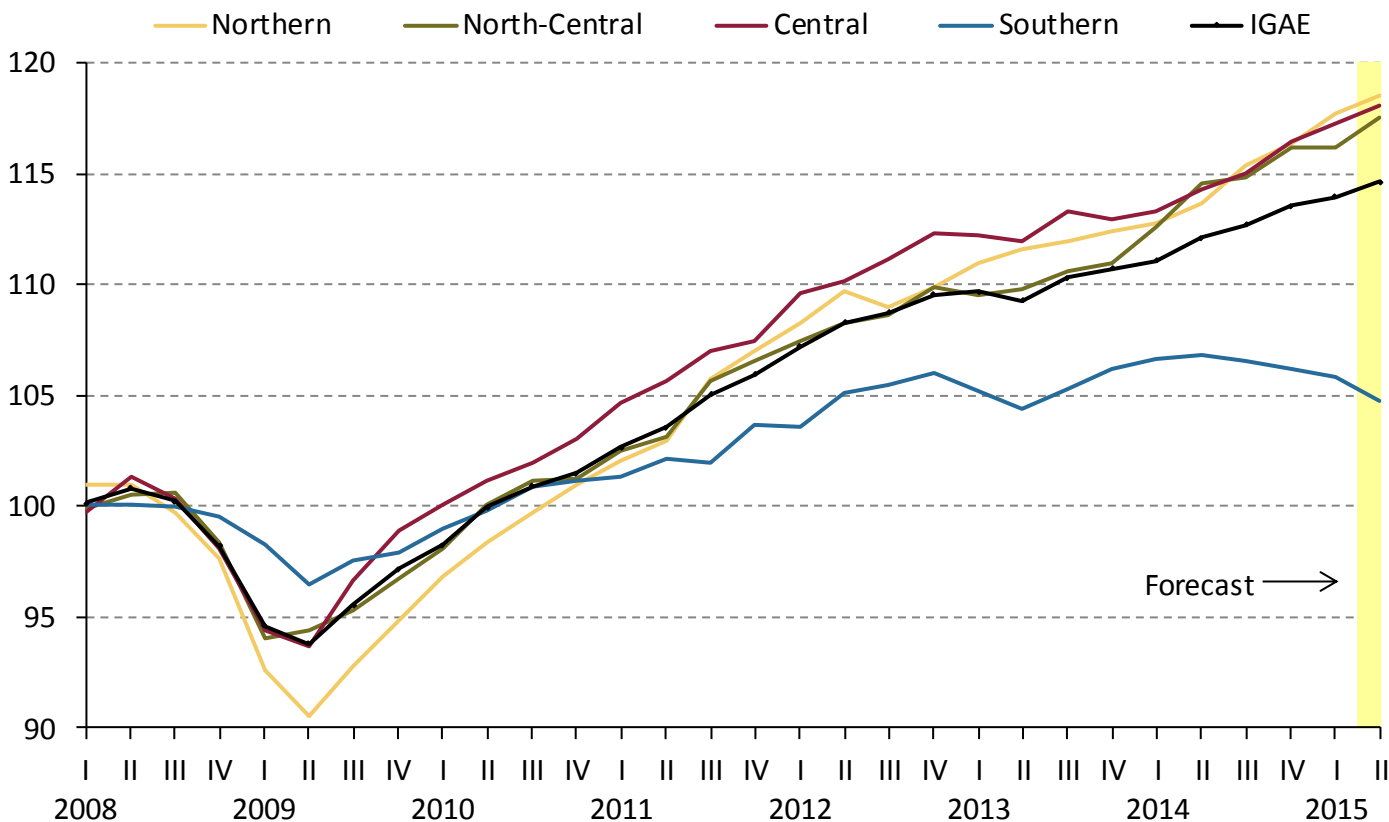
- Economic activity continued to grow at a low pace in all regional economies during 2Q 2015.
 - ✓ This was mainly attributed to the weakness of industrial activity.
 - ✓ Nonetheless, the indicators of the trade and services' sectors expanded during the reference quarter.
- Agricultural production in all regions expanded relative to the levels registered during the same period of last year, particularly in the Northern-Central region.
- In the analyzed quarter, the number of IMSS-affiliated job positions kept growing, although at a lower rate in all regional economies.

Economic Activity

- In the Northern, North-Central and Central regions economic activity kept growing, although at a lower rate than in the previous quarter.
 - ✓ This deceleration is attributed to the evolution of manufacturing, and to the weak performance in construction, particularly in the Northern and Central region.
 - ✓ However, the good performance of transport equipment production continued, mainly in the automobile and aerospace sectors.
- The contraction in the Southern region production was associated, in turn, to the evolution of oil mining.

In 2Q 2015, economic activity maintained an upward trend in the North, North Central and Central regions. In the South, however, economic activity retained its decreasing path.

Quarterly Indicator of Regional Economic Activity ^{1/} Index 2008=100

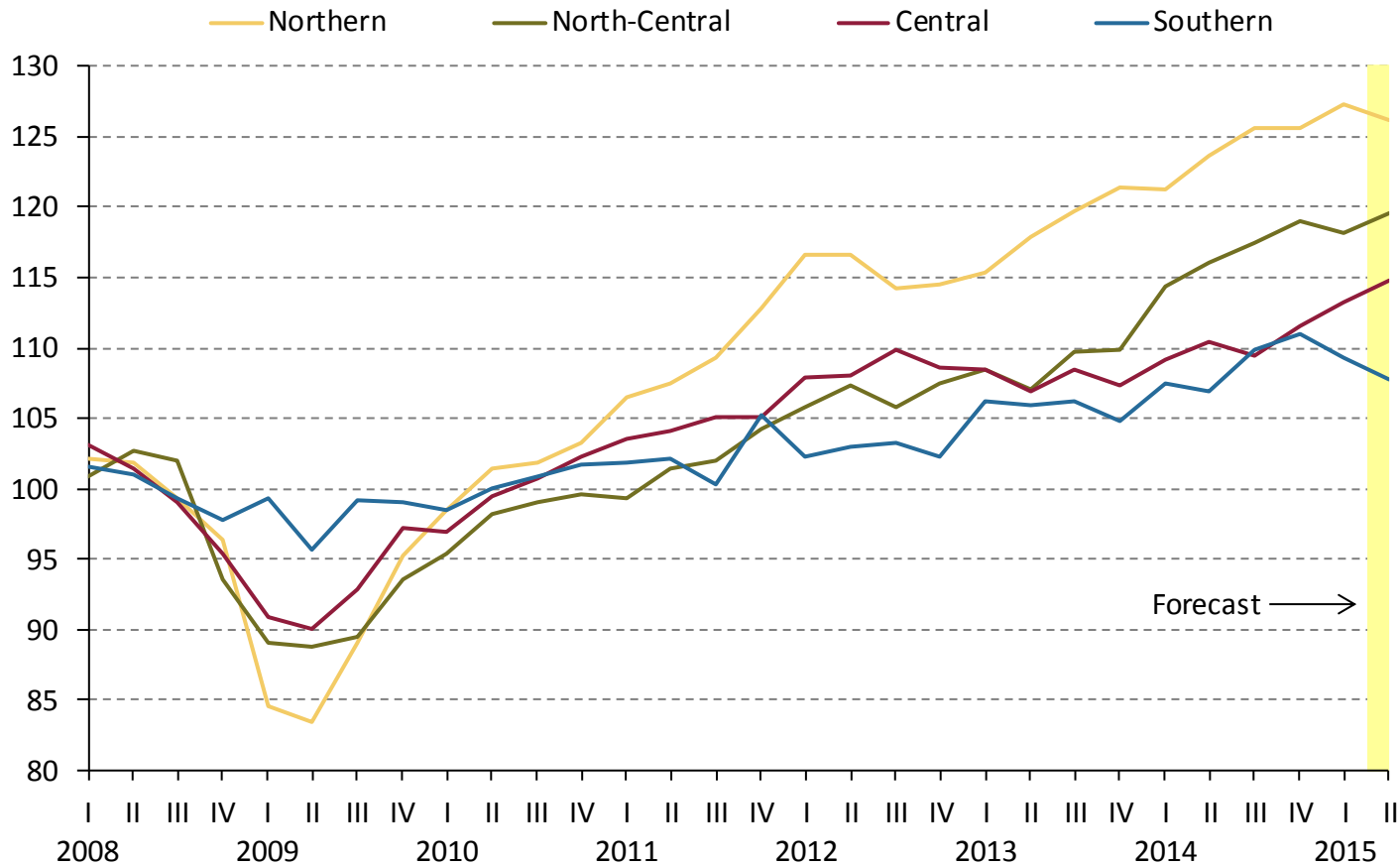


^{1/} This indicator's values in 2Q 2015 are preliminary.

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

It is estimated that during 2Q 2015 manufacturing production kept observing positive growth rates in the North-Central and Central regions, while in the Northern and Southern regions the regional manufacturing indicator signaled a contraction.

Regional Manufacturing Indicator ^{1/} Index 2008=100, quarterly average



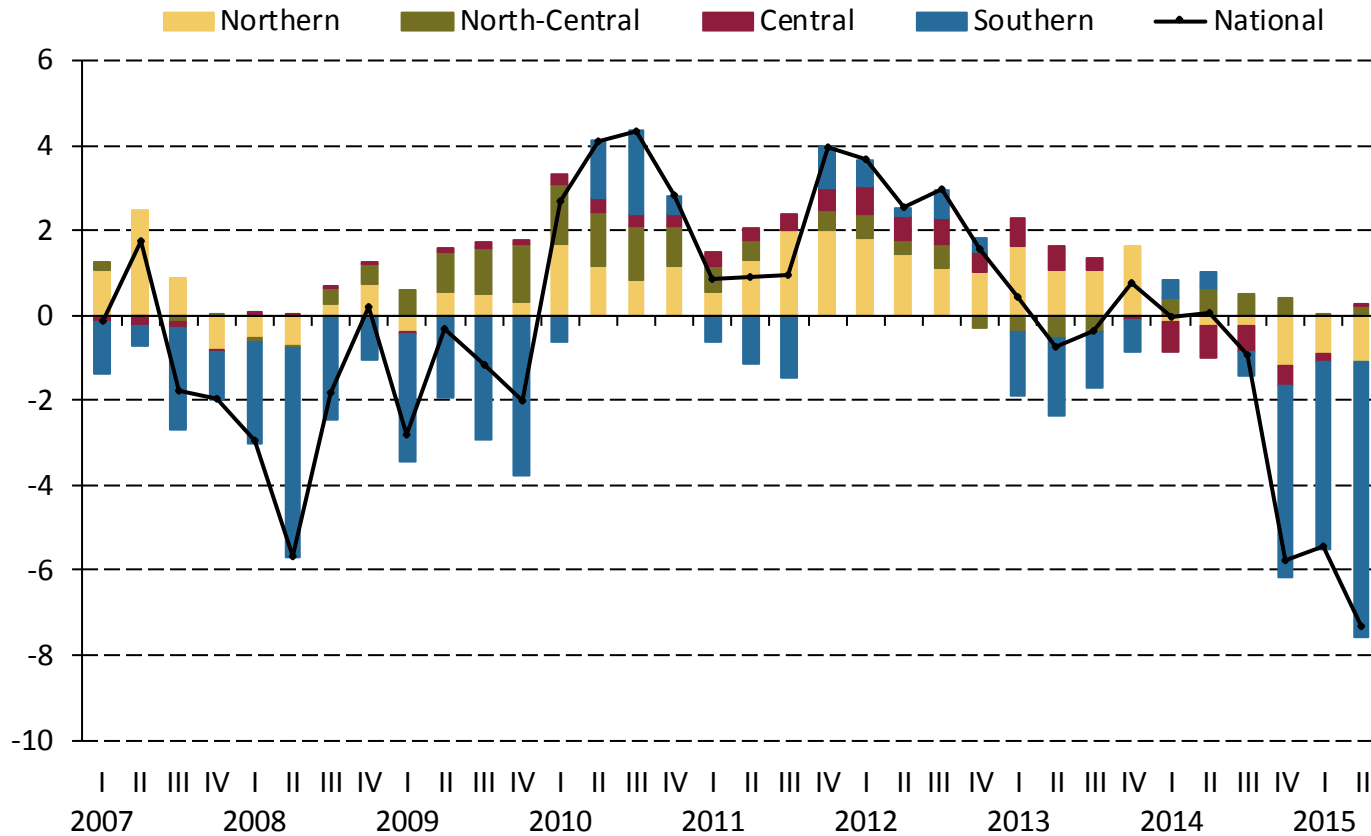
1/ This indicator's values in 2Q 2015 are preliminary.

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

In 2Q 2015, mining activity kept observing unfavorable performance, mainly related to the evolution of oil mining in the Southern region.

Regional Contribution to Mining Activity Expansion ^{1/}

Annual change in percent



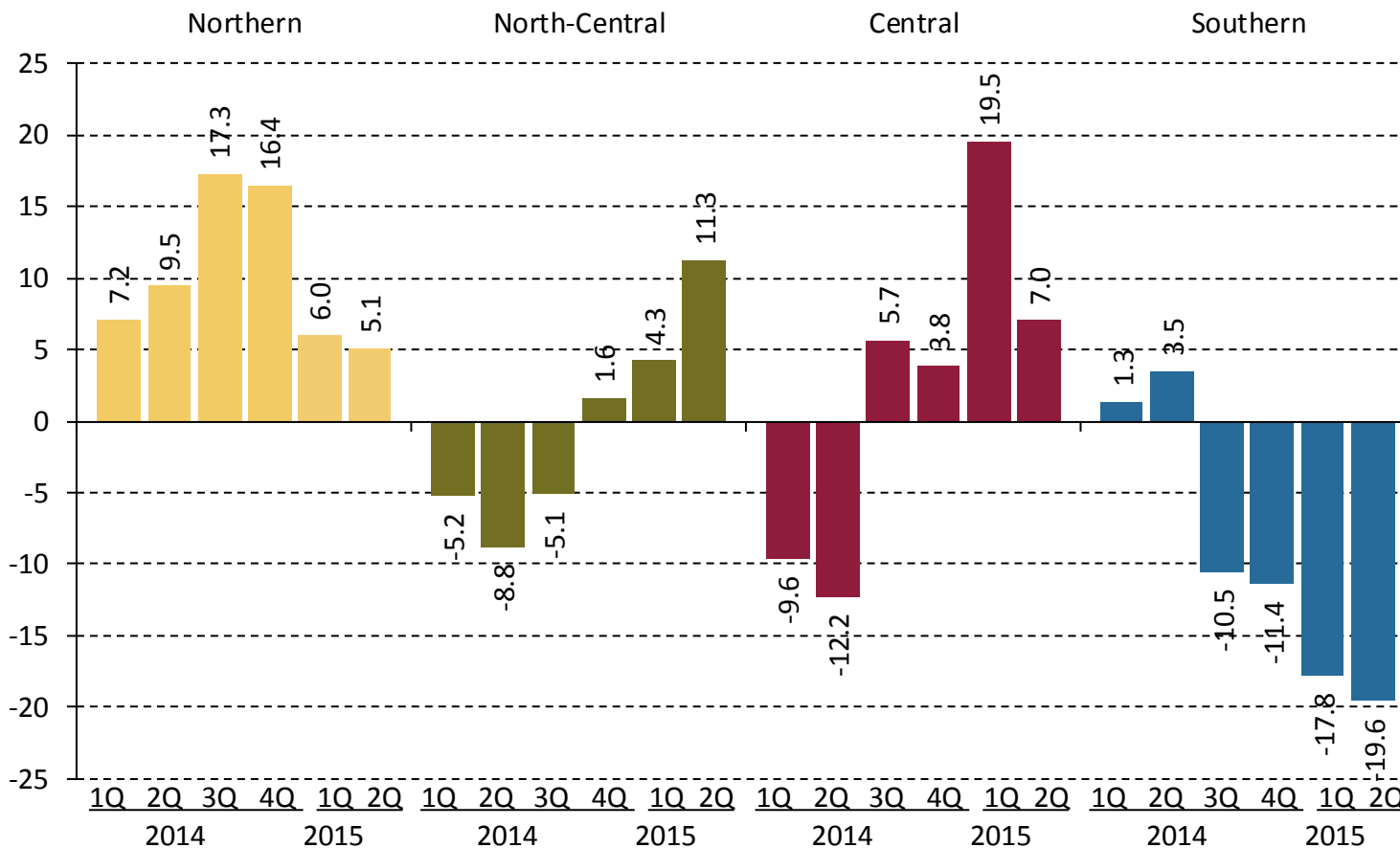
1/ This indicator's values in 2Q 2015 are preliminary.

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

In 2Q 2015, the growth rate of construction at the regional level showed mixed signals. In the North-Central region the growth rate was higher compared to 1Q 2015, in the Northern and Central regions a slowdown was observed, while the Southern region presented a contraction.

Real Value of Production in the Construction Industry by Region

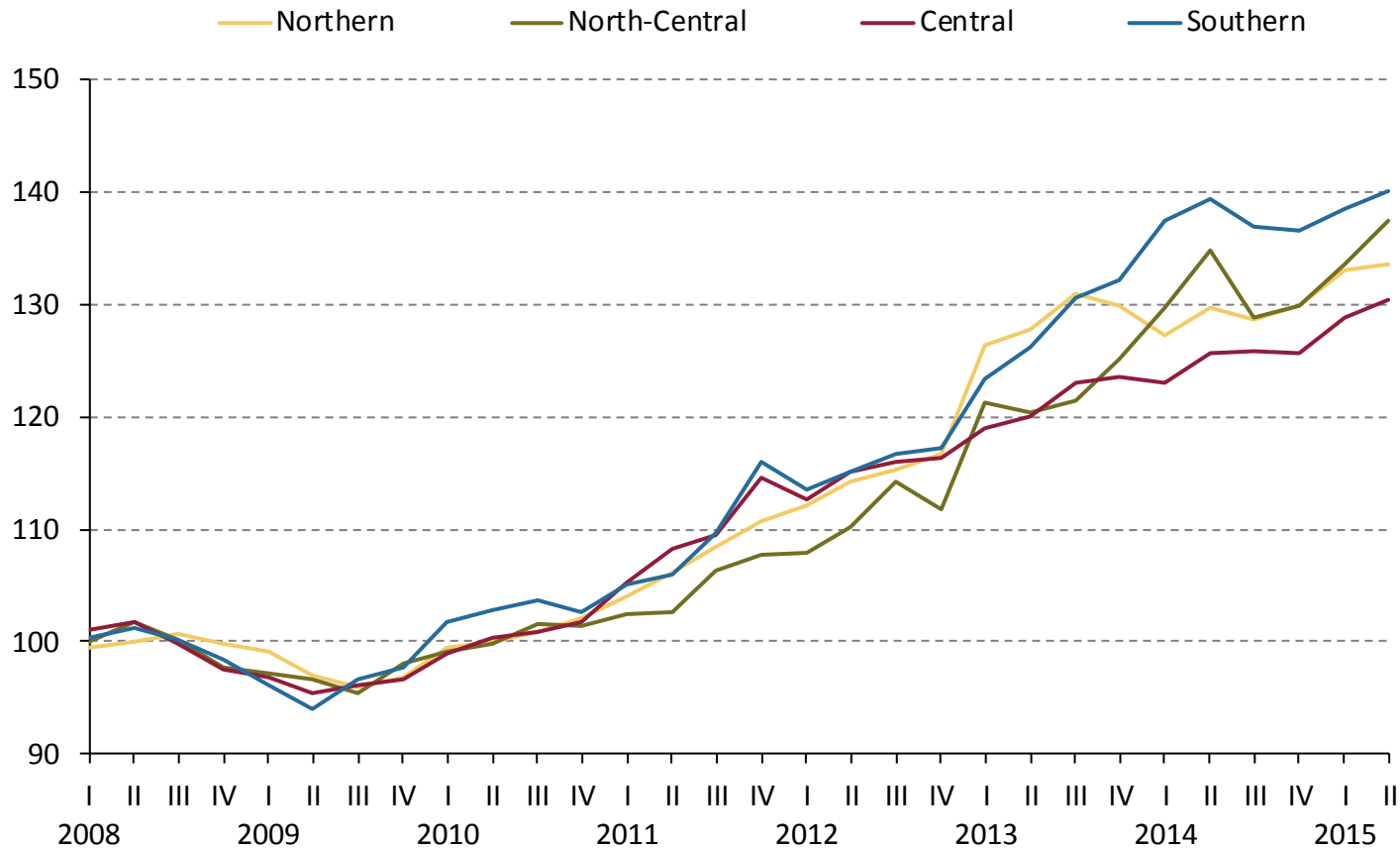
Annual change in percent



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

In 2Q 2015, retail trade maintained an upward trend in all regional economies.

Regional Indicator of Retail Trade Index 2008=100, quarterly average



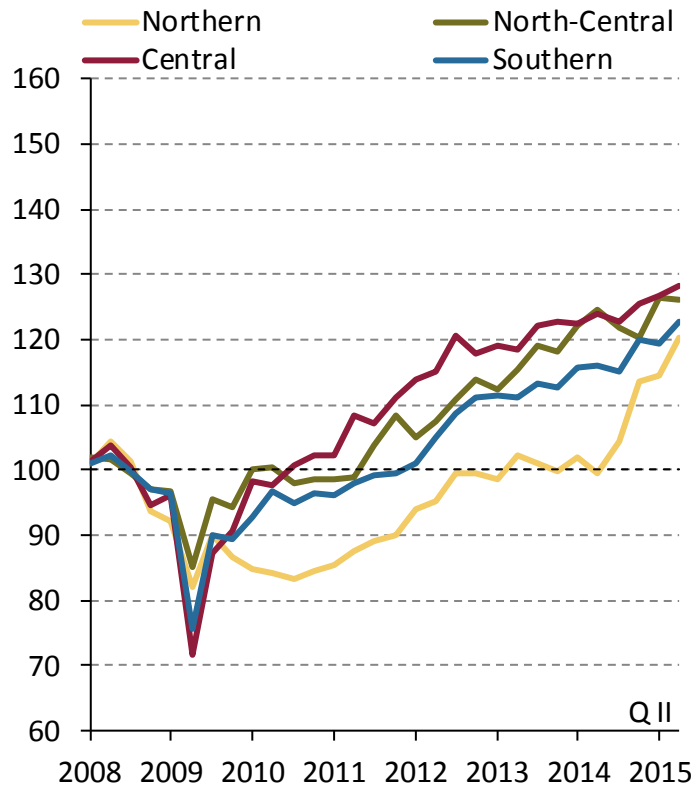
Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Tourism expansion continued in 2Q 2015 in all regions. In the Northern region, the remarkable dynamics was mainly attributed to the growth of hotel occupancy at cities like Monterrey and Ciudad Juarez.

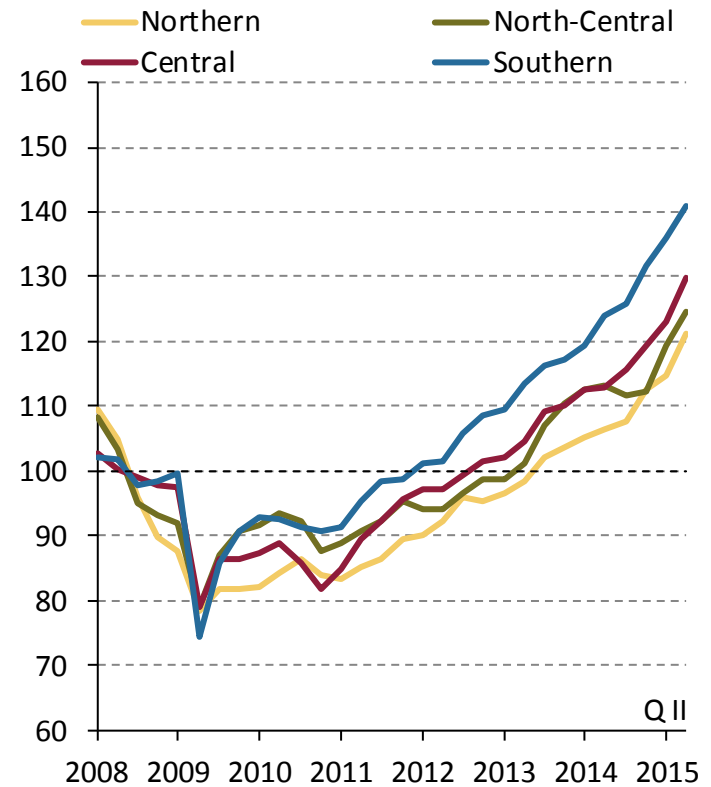
Regional Indicators of Activity in Tourism

Index 2008=100, quarterly average

Hotel Occupancy



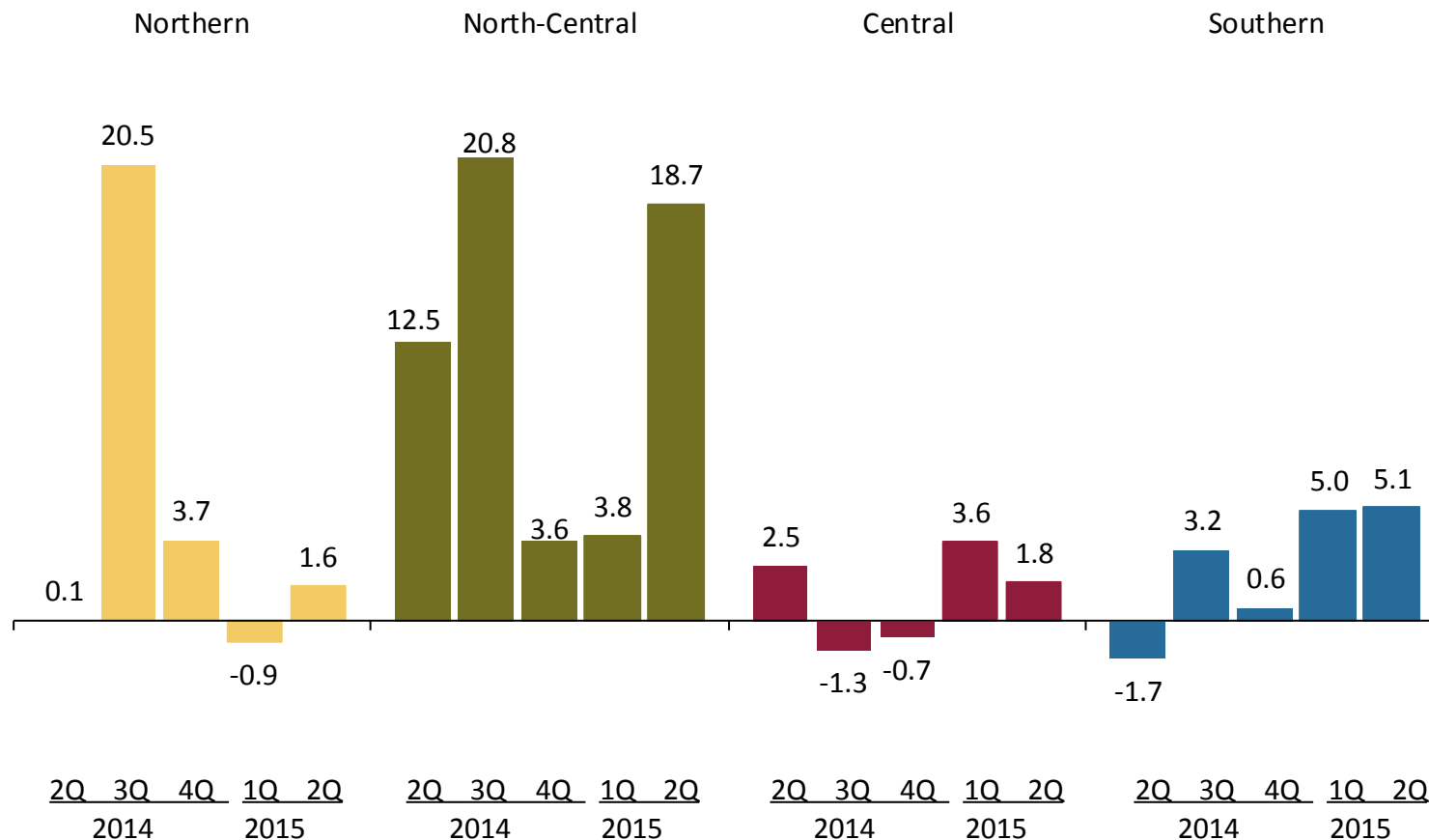
Inflow of Passengers to Airports



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).

Agricultural activity in all regions in 2Q 2015 expanded as compared to the same period of last year, particularly in the North-Central region. This was associated with increased production of corn and wheat.

Index of Regional Agricultural Production Annual change in percent

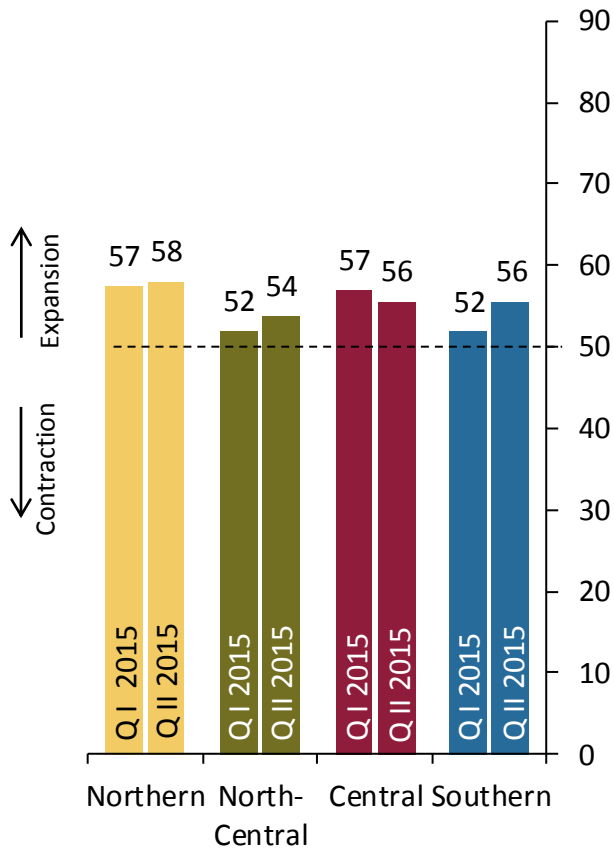


Source: Estimated by Banco de México with data from SAGARPA.

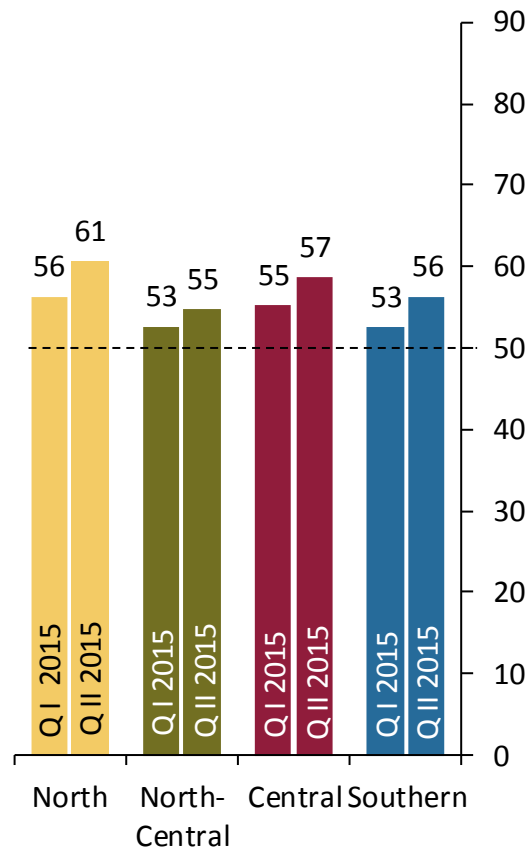
In the four regions, businesses reported an increase in the use of financing.

Main Sources of Financing to Firms Diffusion index

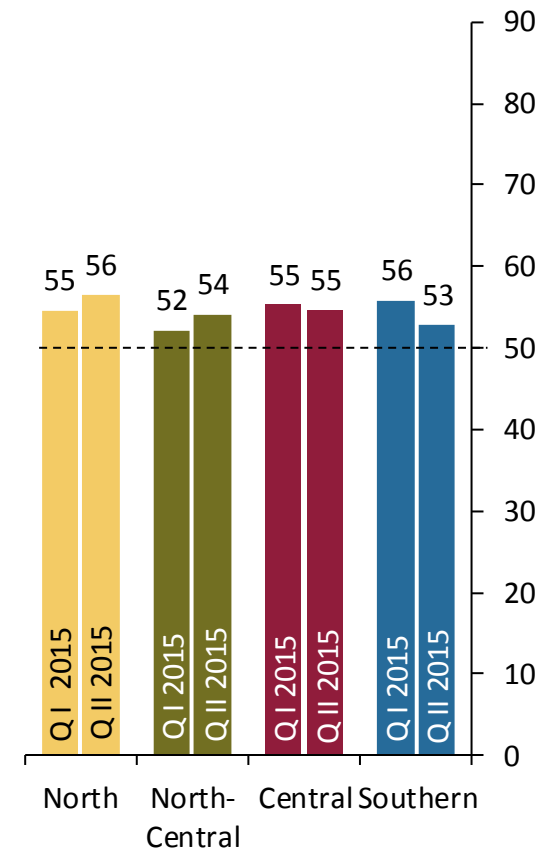
Own Resources



Suppliers



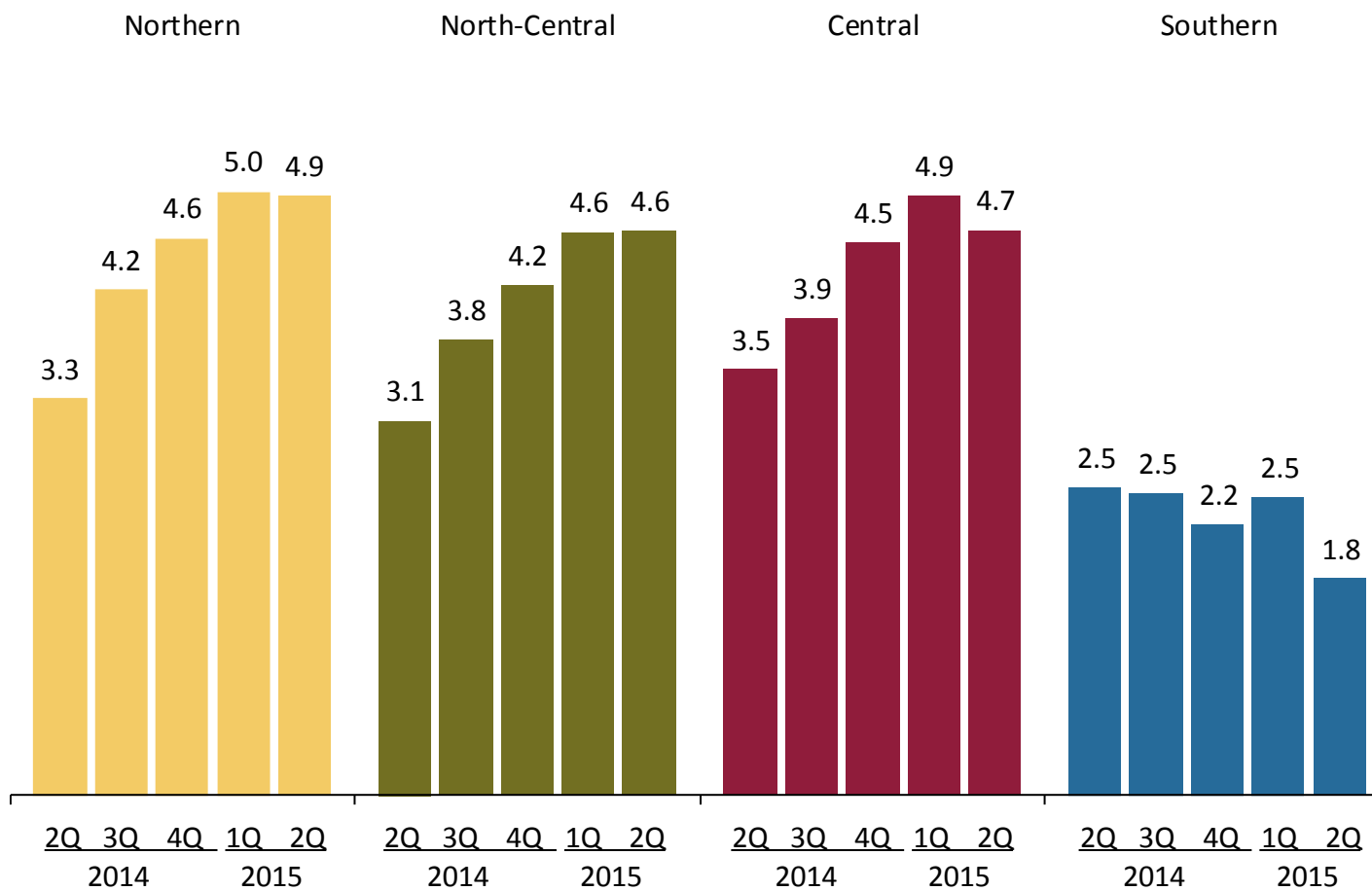
Commercial Banks



Source: Banco de México.

In all regions, the number of IMSS-affiliated job positions during 2Q 2015 kept growing, although at a lower growth rate than in the previous quarter.

Number of IMSS-affiliated employments Annual change in percent



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

Outline

I. Regional Economic Report

II. Results April – June 2015

A. Economic Activity

B. Inflation

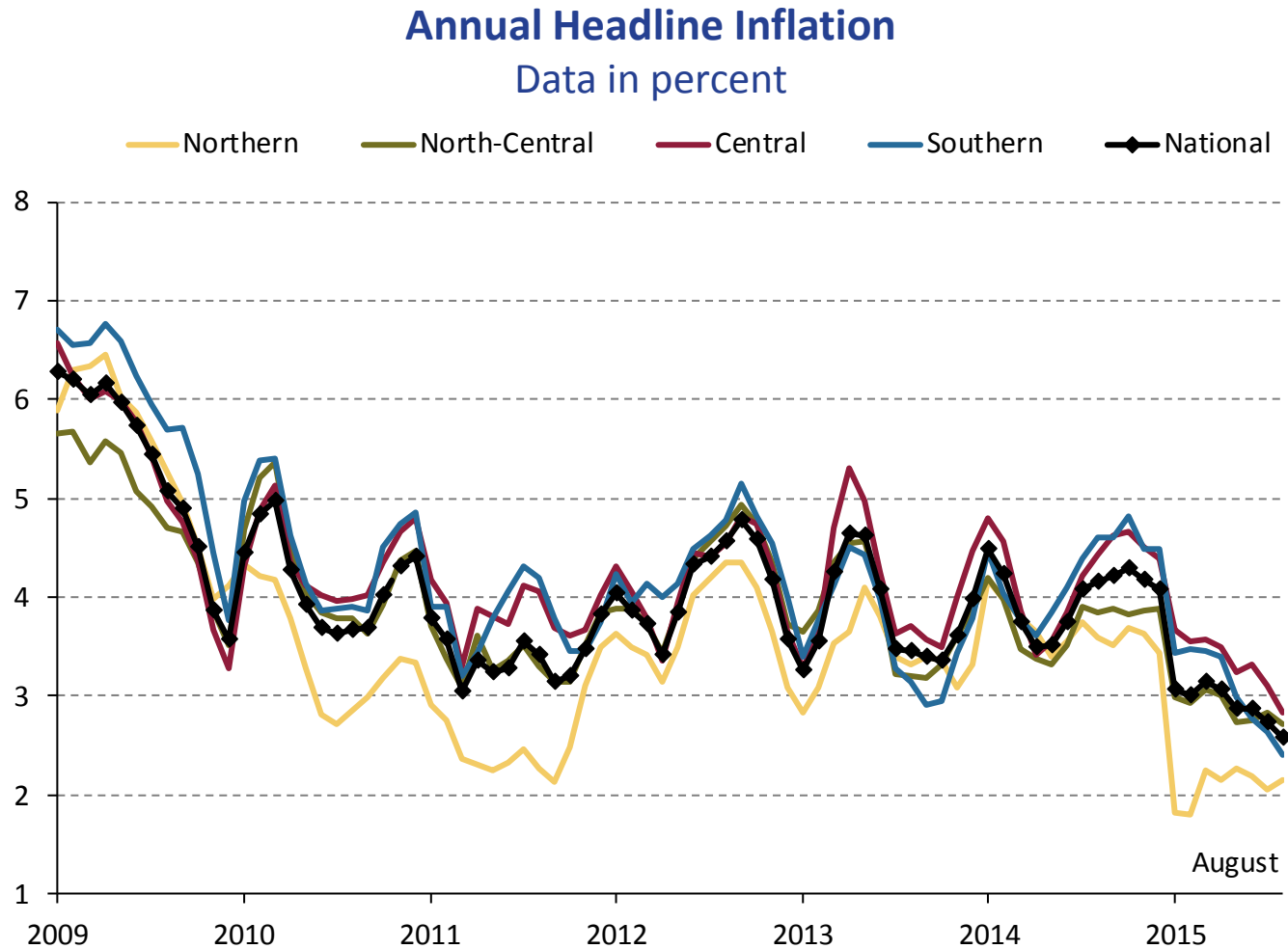
C. Economic Outlook

III. Final Remarks

Inflation

- The long sustained efforts of Bank of Mexico to abate inflation have allowed the convergence of the annual headline inflation rate to its 3 percent permanent target this year, as well as to the attainment of historical minimum levels in that indicator during the 2Q 2015.
 - ✓ This performance has been influenced by several positive shocks, both direct and indirect, stemming from lower prices of general usage inputs such as commodities, telecommunications services and energy prices.
 - ✓ Hence, despite the considerable exchange rate depreciation of the national currency against the US dollar, the pass-through onto prices has been limited.
- Furthermore, the low headline inflation rate has been reflected in annual headline inflation rates below 3 percent across all regions of the country.

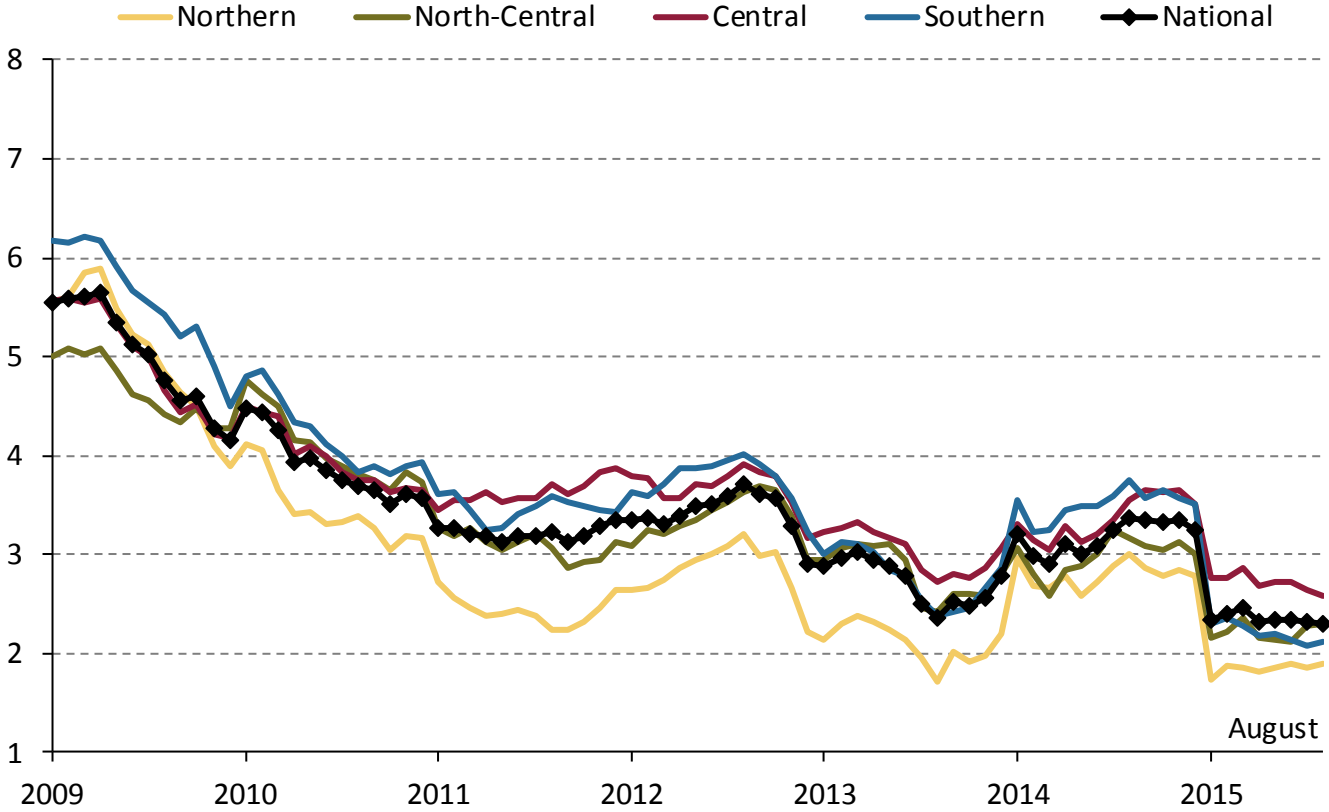
Annual headline inflation lied below 3 percent in all regions.



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

Annual core inflation has had a favorable behavior, lying below 3 percent in all regions since the beginning of the year.

Annual Core Inflation Data in percent



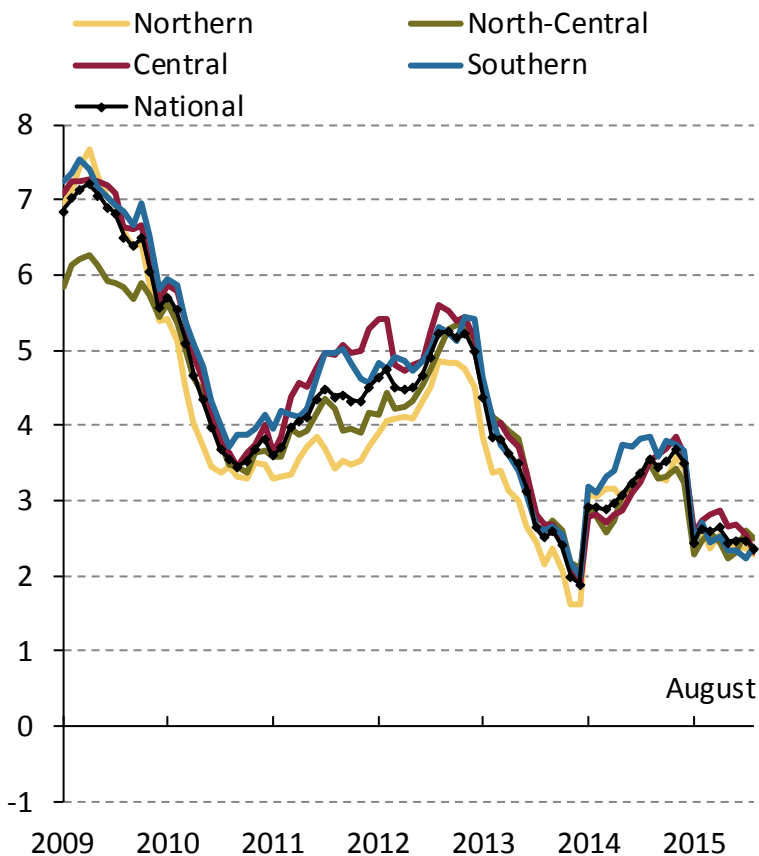
Source: Estimated by Banco de México with data from INEGI and Banco de México.

Merchandise prices behavior suggests that the exchange rate pass-through onto prices has been limited for all regions during 2Q 2015. On the other hand, the services price index annual growth rate has remained low and stable.

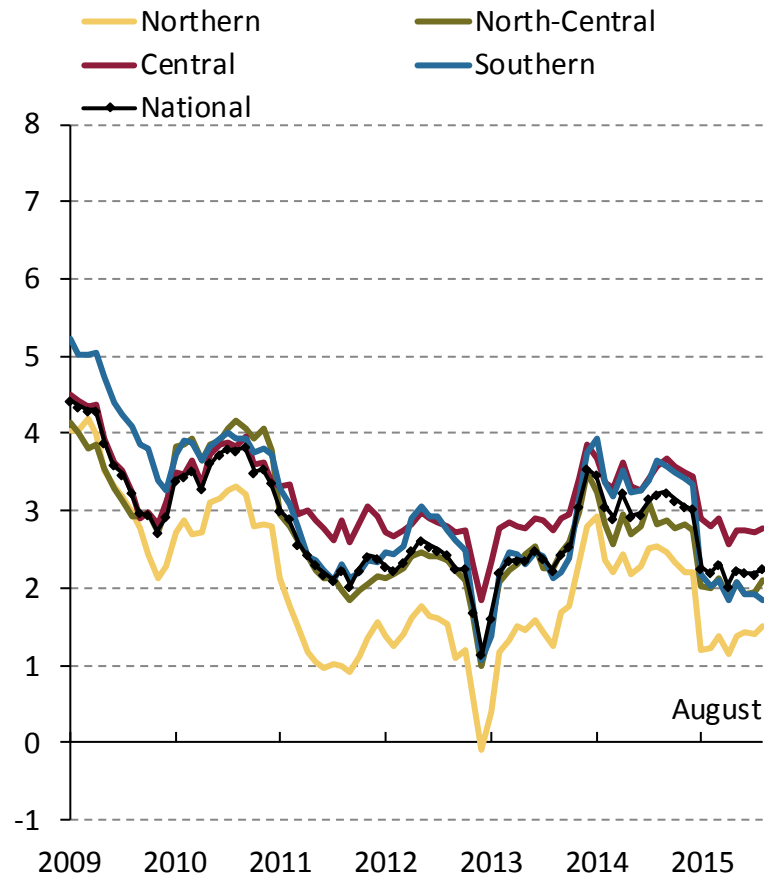
Components of Annual Core Inflation

Data in percent

Merchandise

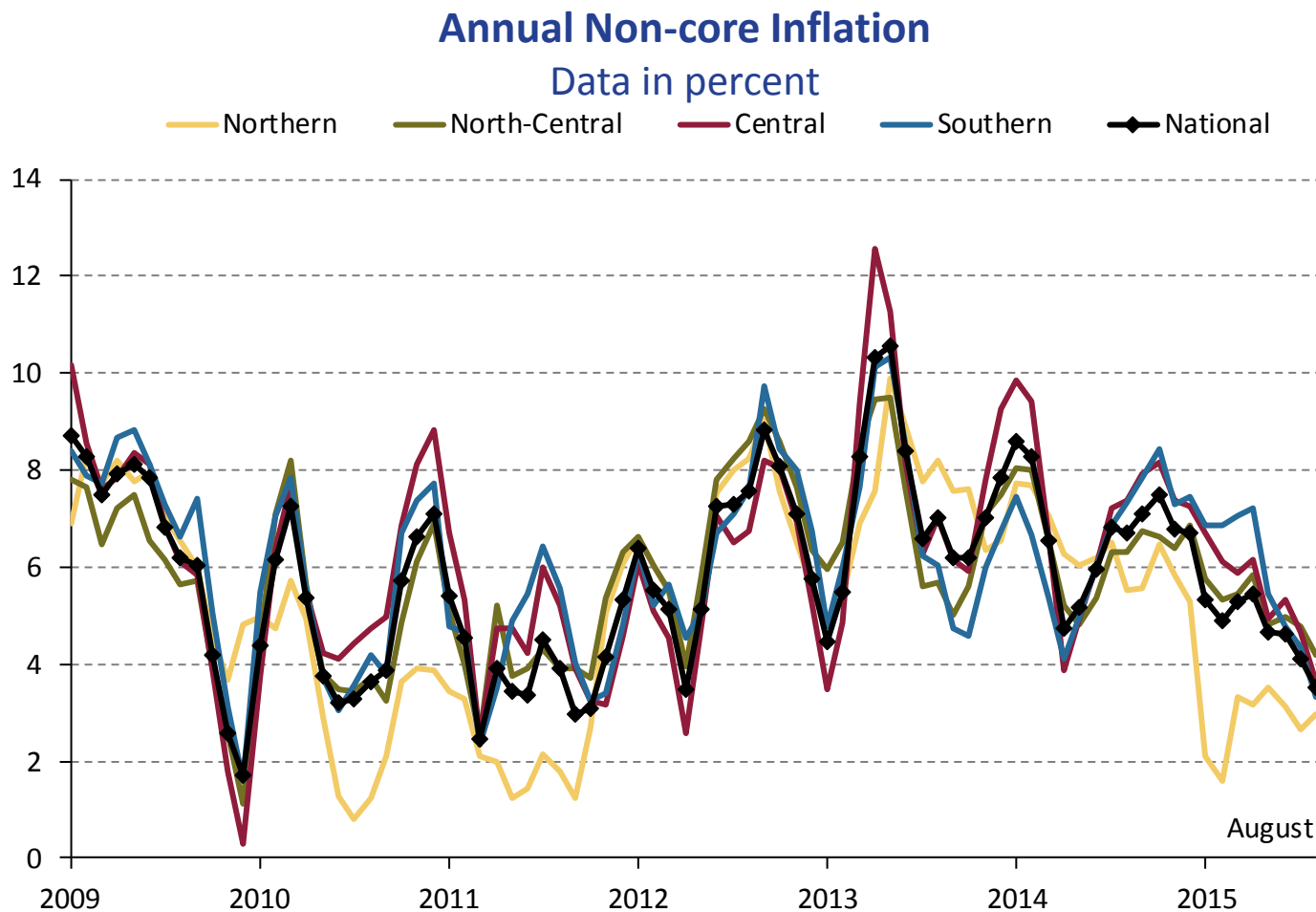


Services



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

During 2Q 2015, non-core inflation was lower than the previous quarter in most regions. This reduction fundamentally came from lower growth rates of energy and government approved fares prices.



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

Outline

I. Regional Economic Report

II. Results April – June 2015

A. Economic Activity

B. Inflation

C. Economic Outlook

III. Final Remarks

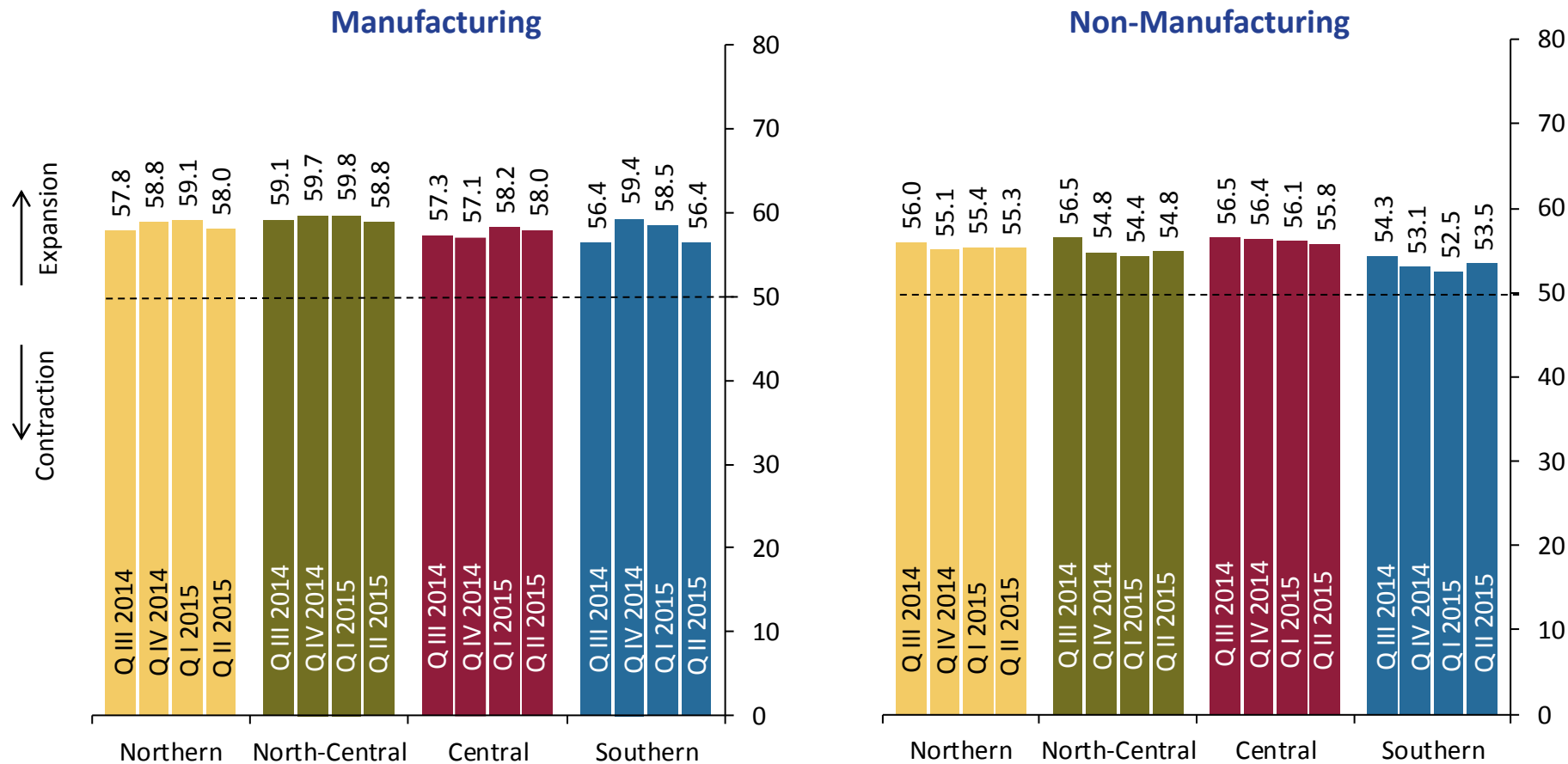
Economic Outlook

- Most business agents expect demand for their goods and services to grow in all regions of Mexico, although in some regions the sign of expansion weakened with respect to the previous quarter.
- The interviewed business contacts indicated that their expectations are based on:
 - ✓ External factors: the prospect of greater dynamism of the U.S. economy and its effect on exporting sectors.
 - ✓ Domestic factors: i) the expectations of a recovery in private consumption; ii) the persistency of low inflation; iii) higher growth of some services; and iv) favorable conditions for firms' financing.

The indicators of orders for the manufacturing and non-manufacturing sectors point to higher levels of economic activity in all regional economies over the next months.

Regional Index of Manufacturing and Non-Manufacturing Orders: Outlook of Economic Activity, Next 3 Months ^{1/}

Diffusion indices



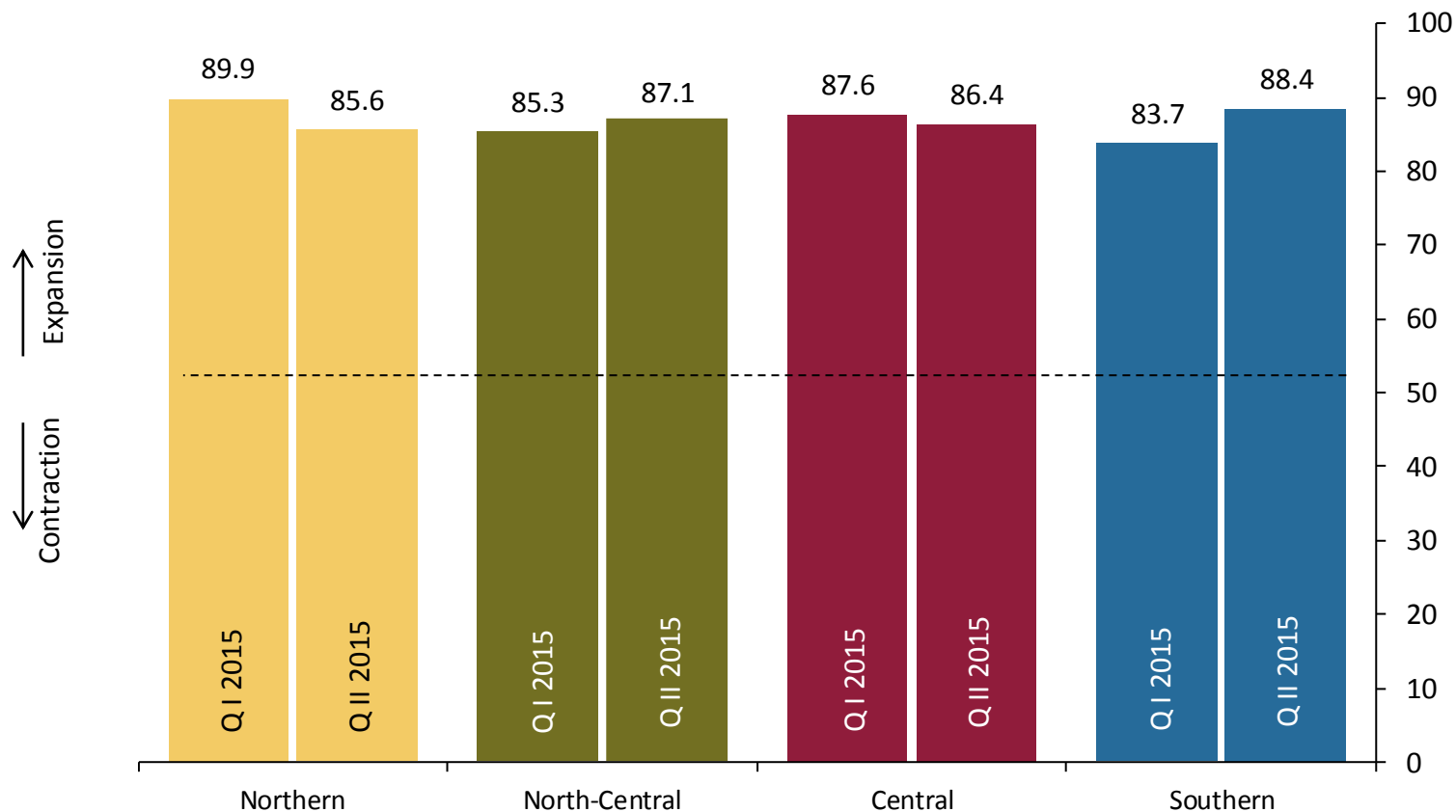
^{1/} Seasonally adjusted data.

Source: Banco de México.

Interviewed business contacts anticipate an expansion of demand for own goods and services over the next 12 months. However, in the Northern and Central regions the sign of expansion weakened with respect to 1Q 2015.

Business Agents' Expectations: Estimated Demand, Next 12 Months ^{1/}

Diffusion index



1/ Results obtained from responses to the question: "With respect to the situation in the current quarter, how do you expect demand for own goods and services to change over the next 12 months?", from the interviews conducted by Banco de México.

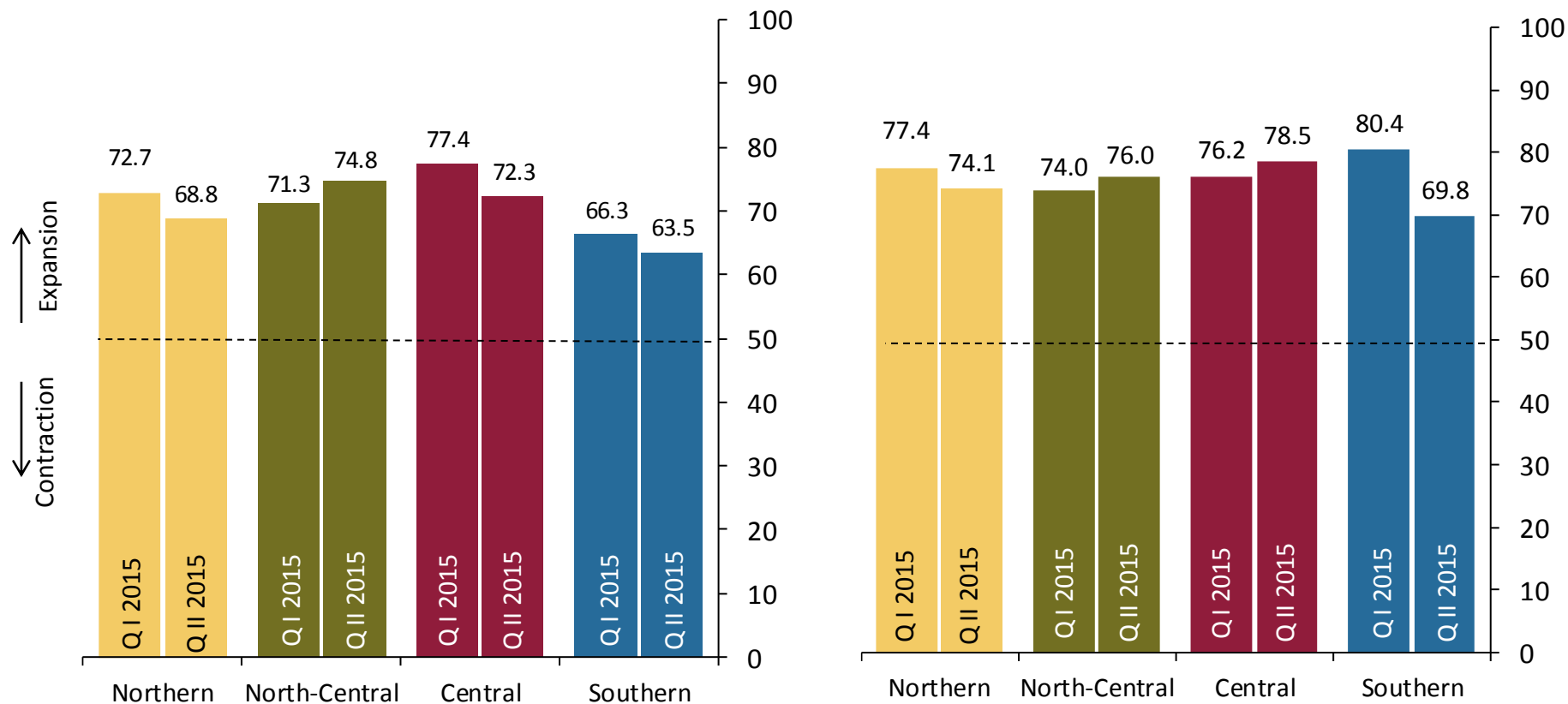
In line with the estimated increase in demand for own goods and services, business contacts expect an expansion in hired personnel and physical capital stock in their firms, although in some regions the sign of expansion weakened, specially in the Southern region.

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

Diffusion indices

Hired Personnel

Physical Capital Stock



1/ Results obtained from responses to the questions: "With respect to the situation in the current quarter, 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.

Box:

Features and Implication of the Skills and Knowledge Gap in Mexico

- Previous Reports presented the analysis of several factors that contribute to productivity growth of businesses in all regions.
- Over these factors, infrastructure, local regulation, economic competition and the efficiency of the justice system stand out. Another element that could boost productivity is the *strengthening of the skills and knowledge of the labor force*.
- This Box deepens over the features and implications of the difference between the skills and knowledge of the labor supply, and the skills and knowledge that firms demand.

Box:

Features and Implications of the Skills and Knowledge Gap in Mexico

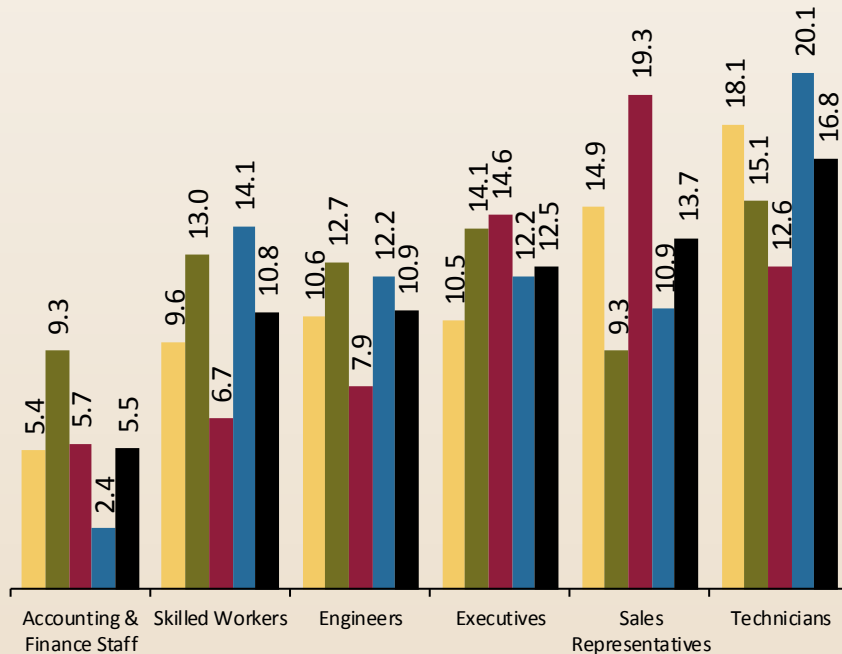
- In particular, it presents the opinions of business agents interviewed by Banco de México for this report in the four regions of the country regarding:
 - ✓ Difficulties faced by firms at the time of hiring people with the required skills and abilities.
 - ✓ The lack of abilities of the hired personnel.
 - ✓ Main implications of the existence of a gap between the supply and demand of skills and knowledge.
 - ✓ Measures adopted by firms in order to counteract such implications.

Box:

Features and Implications of the Skills and Knowledge Gap in Mexico

Jobs Employers are Having Difficulty Filling Percent

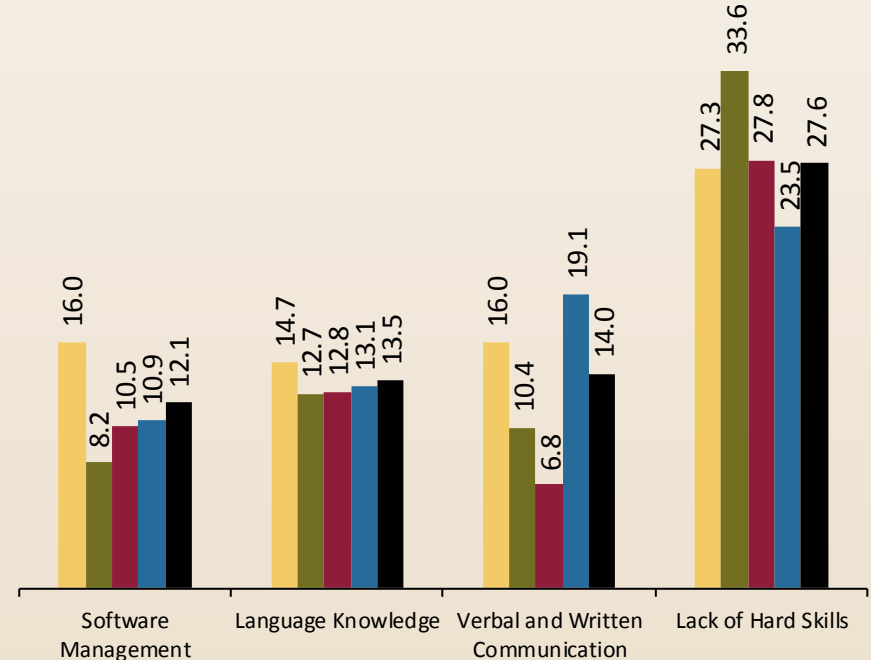
■ Northern ■ North-Central ■ Central ■ Southern ■ National



Source: Banco de México's estimates based on data from a survey of 500 managers from the four regions of the country performed between June 15 and July 16 of 2015. Question asked: "In which jobs are you finding the greatest difficulties to hire workers due to the lack of talent?"

Reasons for Difficulty Filling Jobs Percent

■ Northern ■ North-Central ■ Central ■ Southern ■ National



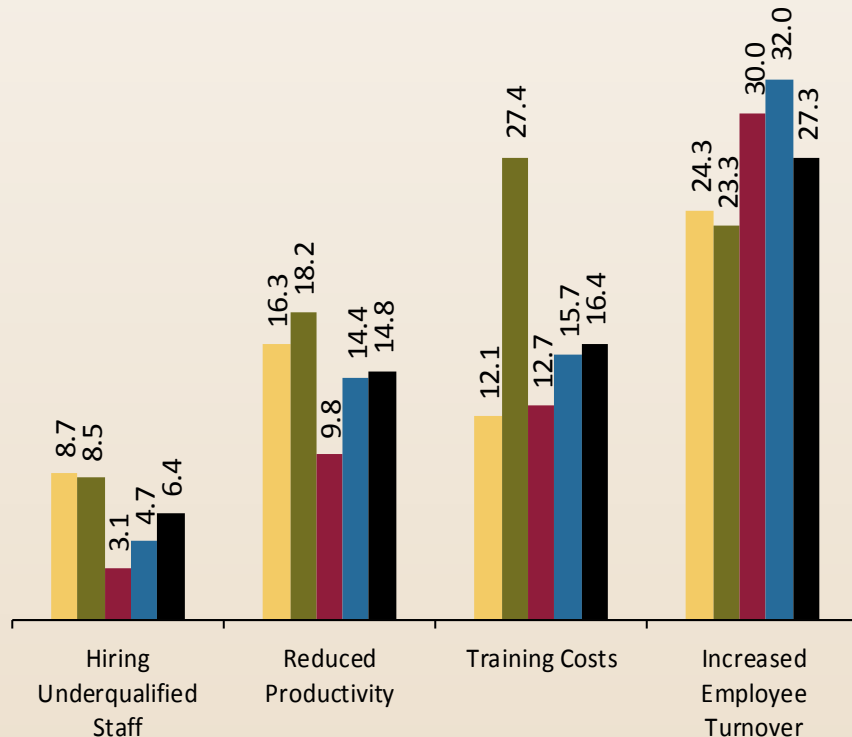
Source: Banco de México's estimates based on data from a survey of 500 managers from the four regions of the country performed between June 15 and July 16 of 2015. Question asked: "Which are the skills and abilities that your workers require the most?"

Box:

Features and Implications of the Skills and Knowledge Gap in Mexico

Effects of Difficulty Filling Jobs Percent

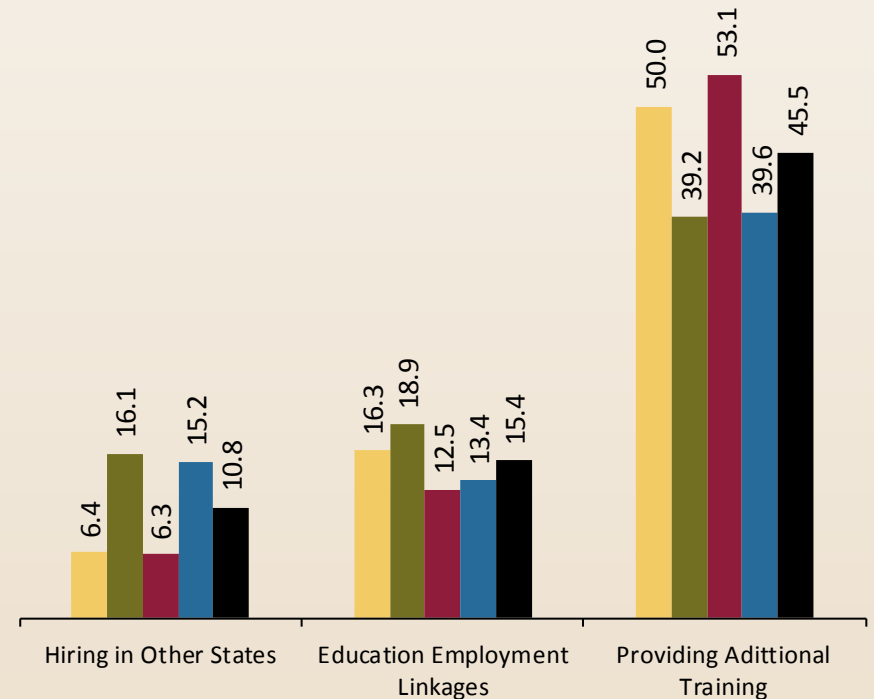
■ Northern ■ North-Central ■ Central ■ Southern ■ National



Source: Banco de México's estimates based on data from a survey of 500 managers from the four regions of the country performed between June 15 and July 16 of 2015. Question asked: "Which are the effects faced by your firm as a result of this difficulty to fill the available job positions?"

Strategies Employers Use to Overcome Talent Shortages Percent

■ Northern ■ North-Central ■ Central ■ Southern ■ National



Source: Banco de México's estimates based on data from a survey of 500 managers from the four regions of the country performed between June 15 and July 16 of 2015. Question asked: "Which measures has your firm implemented in order to overcome your talent shortages?"

Box:

Features and Implications of the Skills and Knowledge Gap in Mexico

- The results of the survey suggest the existence of a gap between the skills and knowledge that people acquire during their educational formation process, and those required by firms.
 - ✓ On this point, it would be recommendable to improve the coordination between firms and educational institutions in order for the latter to strengthen their programs on the skills and knowledge required by firms.
- This requires, among other things, creating incentive compatible schemes for the educational system to develop human resources with the quality and pertinence that a competitive economic environment demands.
 - ✓ Along these lines, it should be expected that the correct implementation of the Education Reform helps to close the skills and knowledge gap in the future.

Economic Outlook

- Among upward risks to regional economic activity, in all regions business agents indicated the following:
 - ✓ A greater dynamism of the U.S. economy.
 - ✓ The possibility that private investment in automobile and energy sectors maintain a favorable evolution.
 - ✓ Increased investment flows associated to the Energy Reform and to infrastructure projects.
- Moreover, across regions, business contacts mentioned the following among upward risks:
 - ✓ In the Northern and Southern regions, the possibility of enlarging the port infrastructure as an additional impulse to regional economic activity.
 - ✓ In the Northern, North-Central and Central regions, the positive impact of cost reductions arising from the completion of various gas pipelines that are currently under construction.

Economic Outlook

- Among downward risks to regional economic activity, interviewed contacts in the four regions indicated the next:
 - ✓ New episodes of exchange rate volatility.
 - ✓ A possible slowdown of the U.S. economic activity.
 - ✓ The possibility of a further deterioration in the perception of public safety.
- Additionally, Southern region business contacts mentioned:
 - ✓ The possibility of adverse weather phenomena.
 - ✓ A further fall in international oil prices.
 - ✓ That the oil production platform does not recover.

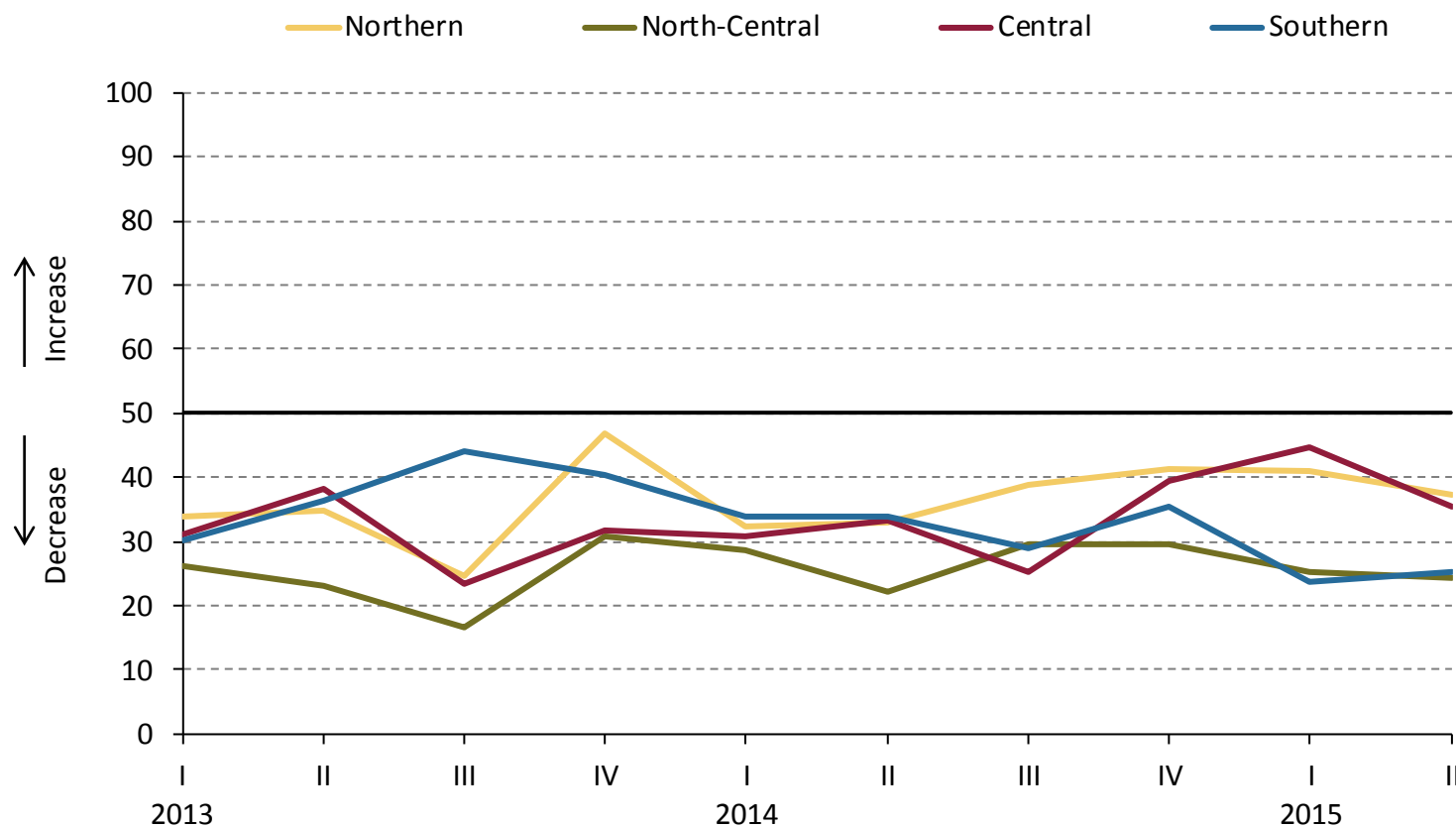
Economic Outlook

- As regards inflation expectations for the next 12 months, most interviewed contacts in the four regions of Mexico anticipate annual changes in sales prices of their goods and services to be lower than in 2014.
- Over the same horizon, interviewed contacts expect annual growth rates in wage costs to be lower than in the previous year.
- As regards input prices inflation expectations, although in general the referred business agents expect them to be lower than in the previous year, this sign weakened. Moreover, in the Northern region business agents anticipate annual changes in input prices to be greater than in 2014.

In all regional economies, interviewed business agents anticipate, in general, annual changes in their sales prices to be smaller than in 2014. In the Northern, North-Central and Southern regions, the sign of lower annual growth rates in their prices even intensified with respect to the previous quarter.

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

Diffusion index

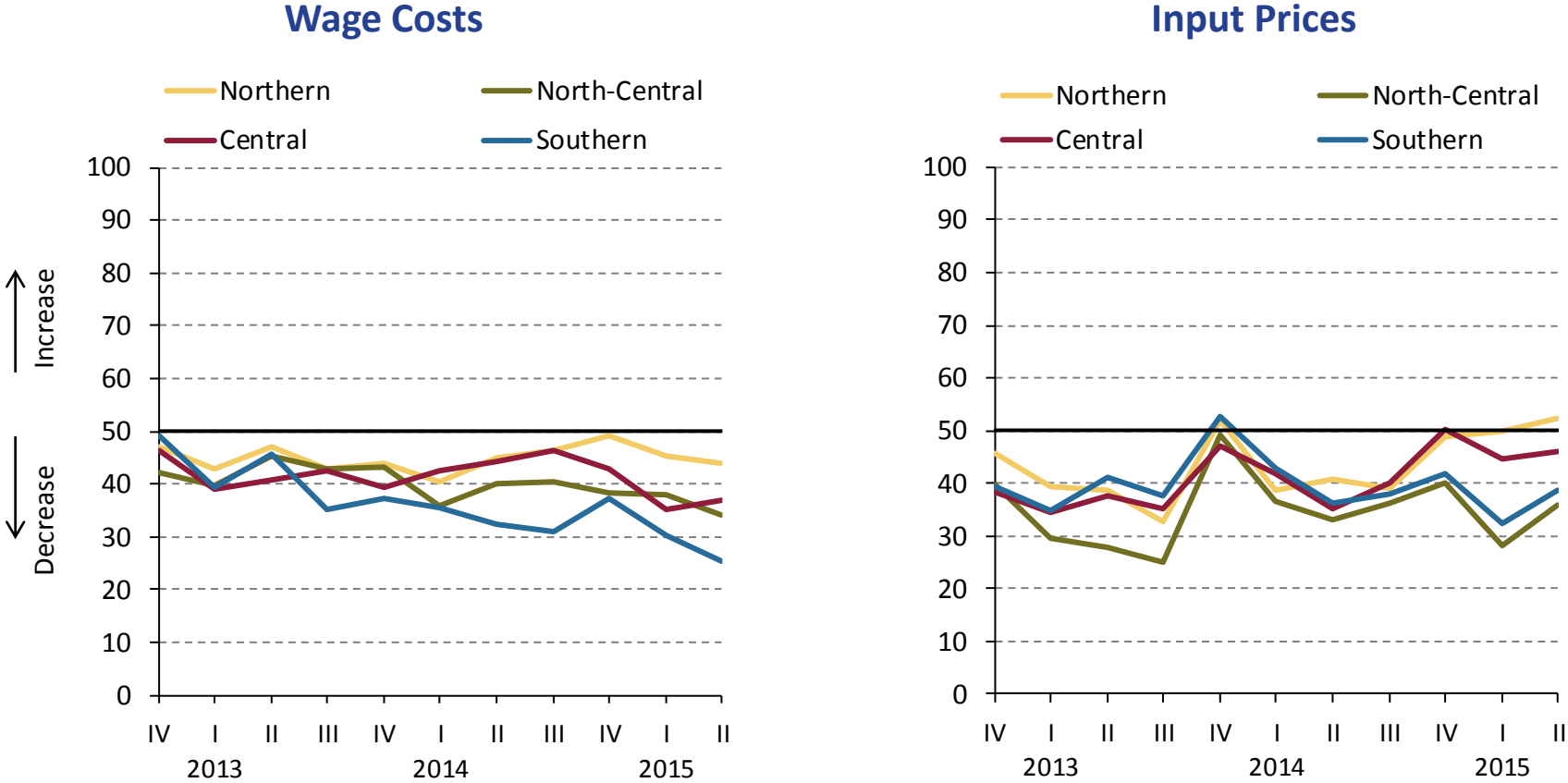


^{1/} Results obtained from responses to the questions: “With respect to the situation in 2Q 2015, do you expect any adjustment in sales prices of own goods and services over the next 12 months?” and “As compared to the same period of last year, what magnitude of adjustment do you expect: greater, same or lower?”, from the interviews conducted by Banco de México.

Interviewed business agents anticipate, in general, annual changes in their wage costs to be smaller than in 2014. In contrast, the expectation of a lower increase in input prices weakened in most regions.

Business Agents' Expectations: Dynamics of Annual Inflation in Salaries and Inputs, Next 12 Months ^{1/}

Diffusion index



1/ Results obtained from responses to the question: "With respect to the situation in 2Q 2015, do you expect any adjustments in wage costs and input prices 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.

Outline

I. Regional Economic Report

II. Results April – June 2015

A. Economic Activity

B. Inflation

C. Economic Outlook

III. Final Remarks

Final Remarks

- ① During 2Q 2015, economic activity kept showing a modest growth in all regions. This was mainly attributed to a weakness of industrial activity, even though trade activity and the services' sector observed a favorable performance.
- ② Annual headline inflation lied below the 3 percent target during 2Q 2015 in all regions of Mexico. Besides the monetary policy stance, lower commodity, telecommunications services, and energy prices also contributed.
- ③ Business agents interviewed by Banco de México expect demand for own goods and services to expand over the next 12 months in all regions, although this sign weakened as compared to last quarter.
- ④ As regards inflation, business contacts anticipate that during the following 12 months annual growth rates of their prices will be lower than observed in the same period of last year.



BANCO DE MÉXICO

September 2015

www.banxico.org.mx