



Regional Economic Report
January – March 2014



BANCO DE MÉXICO

June 12, 2014

Outline

- I. Introduction**
- II. Results January - March 2014**
 - 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 1Q 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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A. Economic Activity

B. Inflation

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III. Final Remarks

Economic Activity

- The slowdown of economic activity observed in most regional economies in late 2013 persisted at the beginning of 2014. As a consequence, regional economies expanded at a low growth rate in 1Q 2014.
- Business contacts interviewed by Banco de México attributed this performance to transitory factors that affected domestic demand, and to a lesser extent, external demand.
- Despite this, it should be pointed out that by the end of 1Q 2014 some indicators of regional economic activity improved slightly.

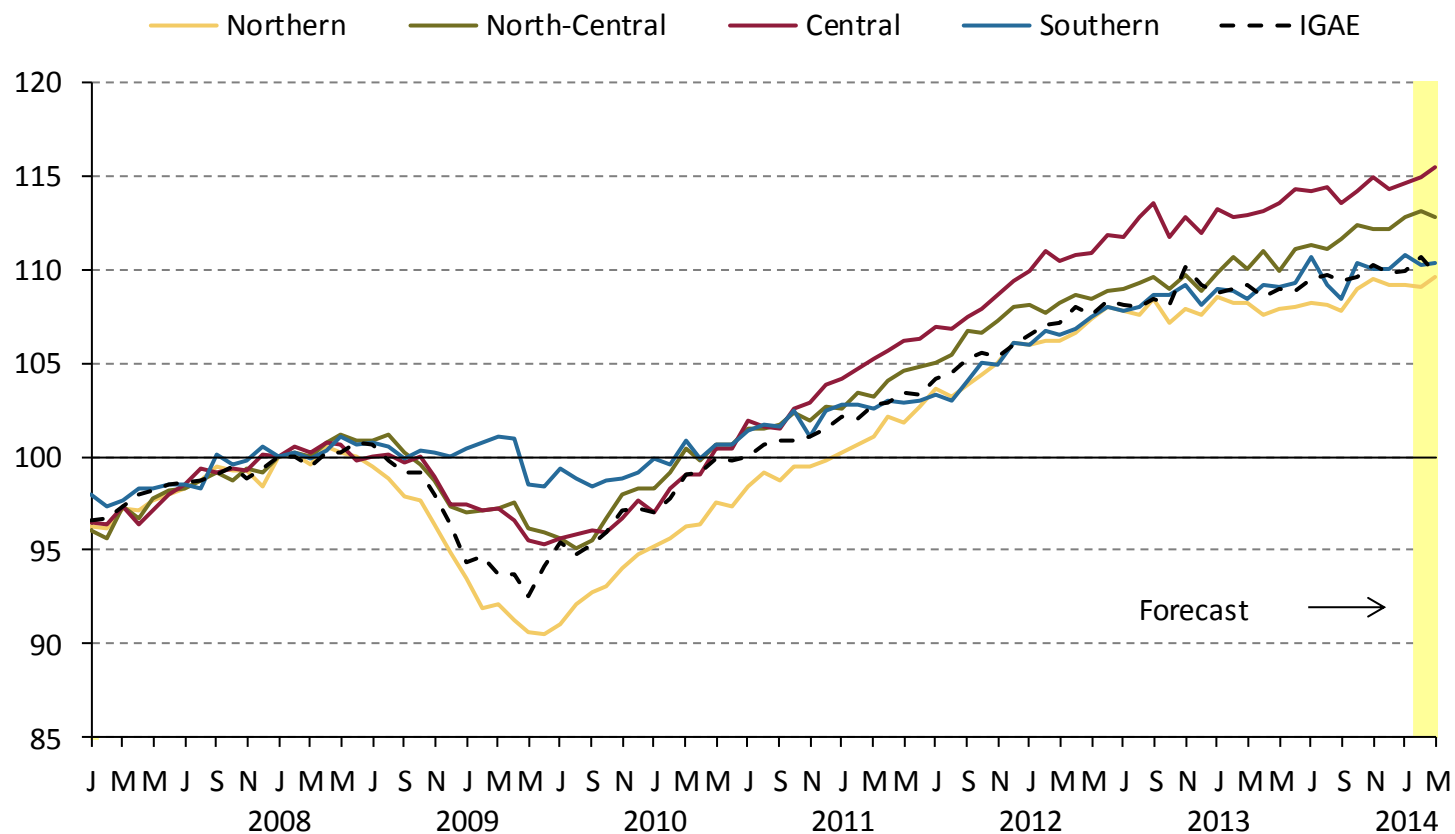
Economic Activity

- The abovesaid was reflected in the indicators of economic activity by sector.
 - ✓ Manufacturing activity expanded, although in the north the pace of growth decelerated and in the center it remained weak.
 - ✓ Retail sales recorded an annual growth rate lower than in 4Q 2013.
 - ✓ Agricultural and construction sectors presented mixed signals among regions, while the tourism sector generally strengthened.
 - ✓ The number of IMSS-insured workers expanded at a moderate rate.

Economic Activity

Regional Coincident Index ^{1/}

Base January 2008 = 100

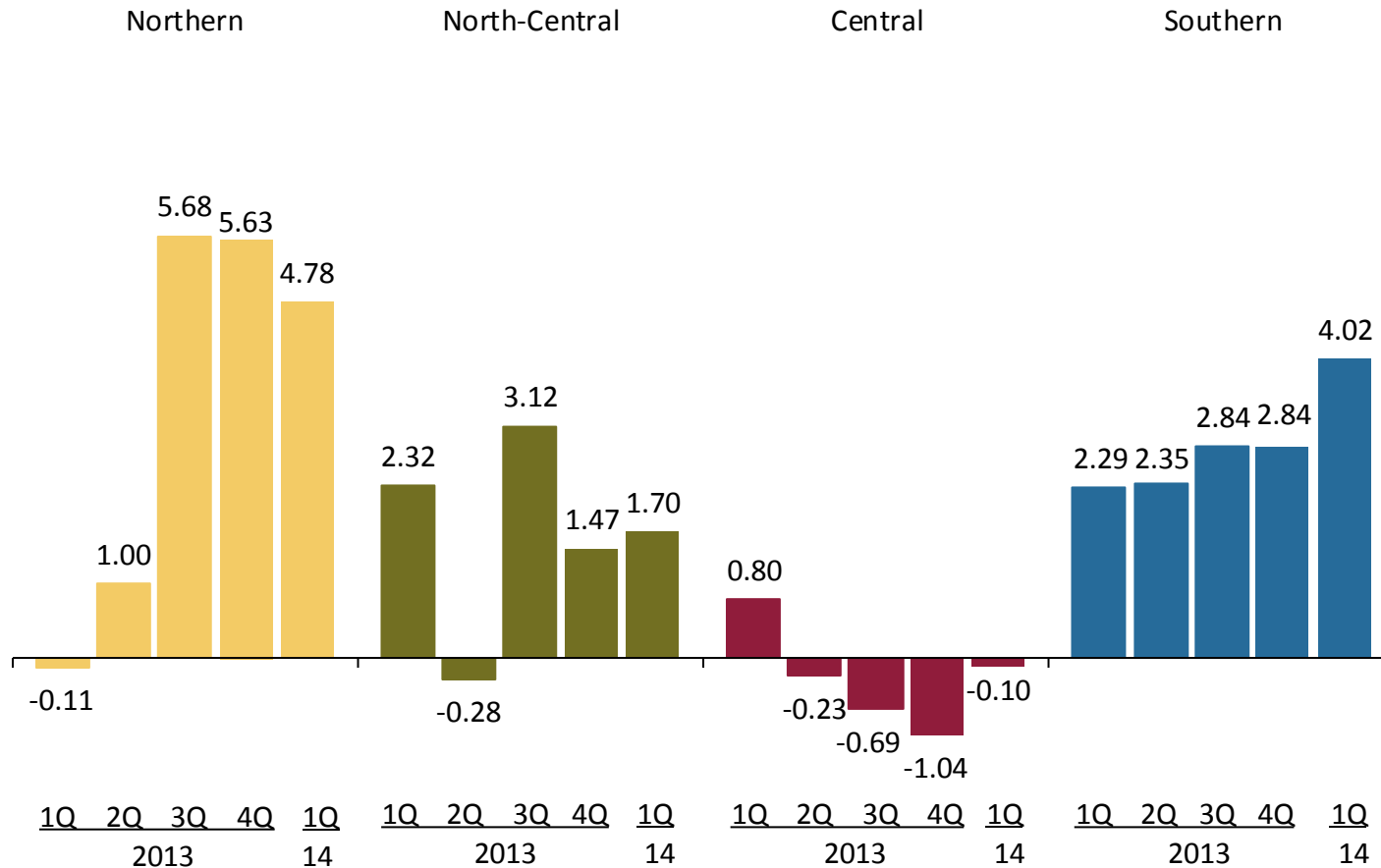


1/ This indicator's values in February and March 2014 are a forecast.

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

Economic Activity

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



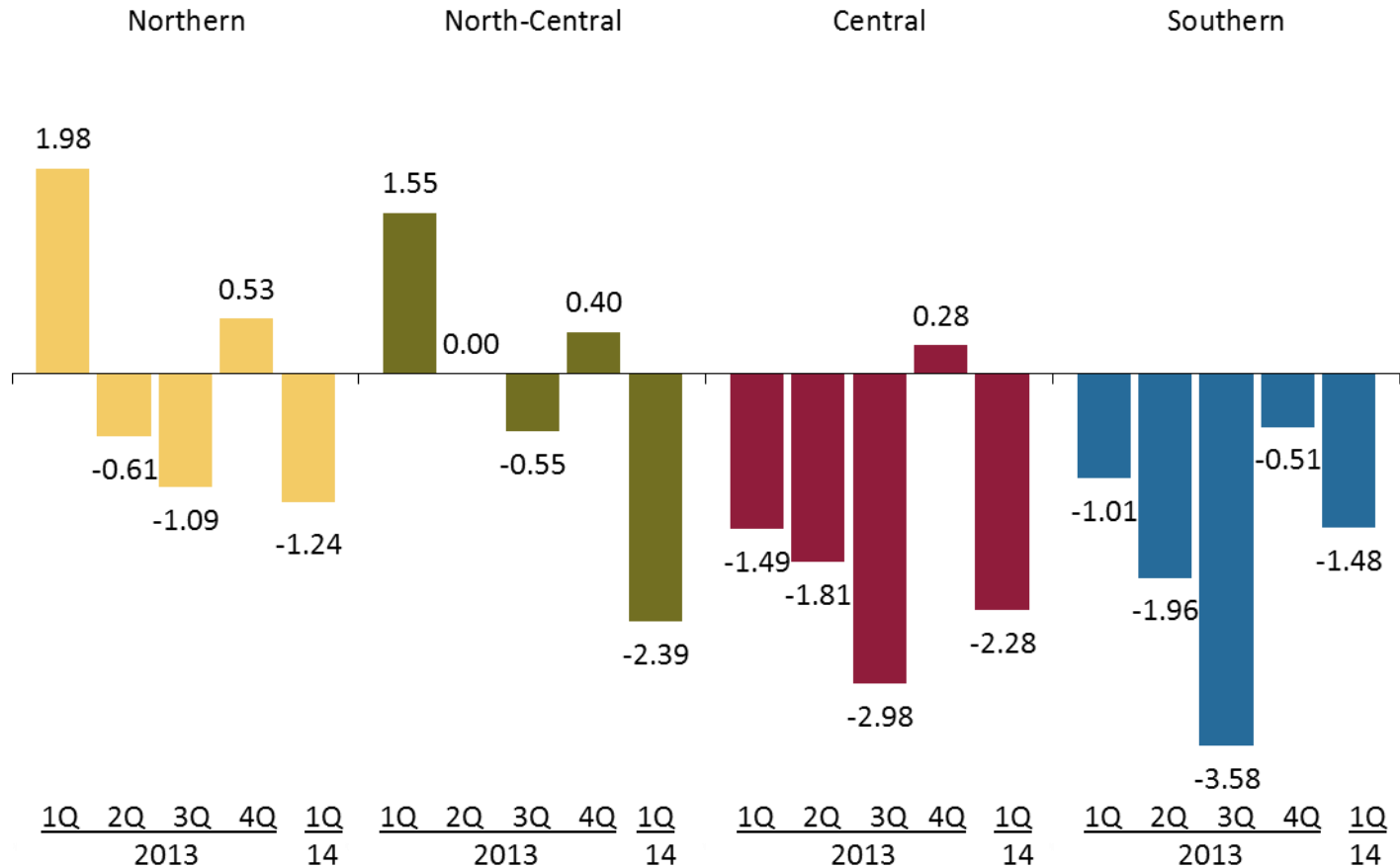
1/ This indicator's values in 1Q 2014 are a forecast.

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

Economic Activity

Regional Retail Sales Indicator

Annual change in percent

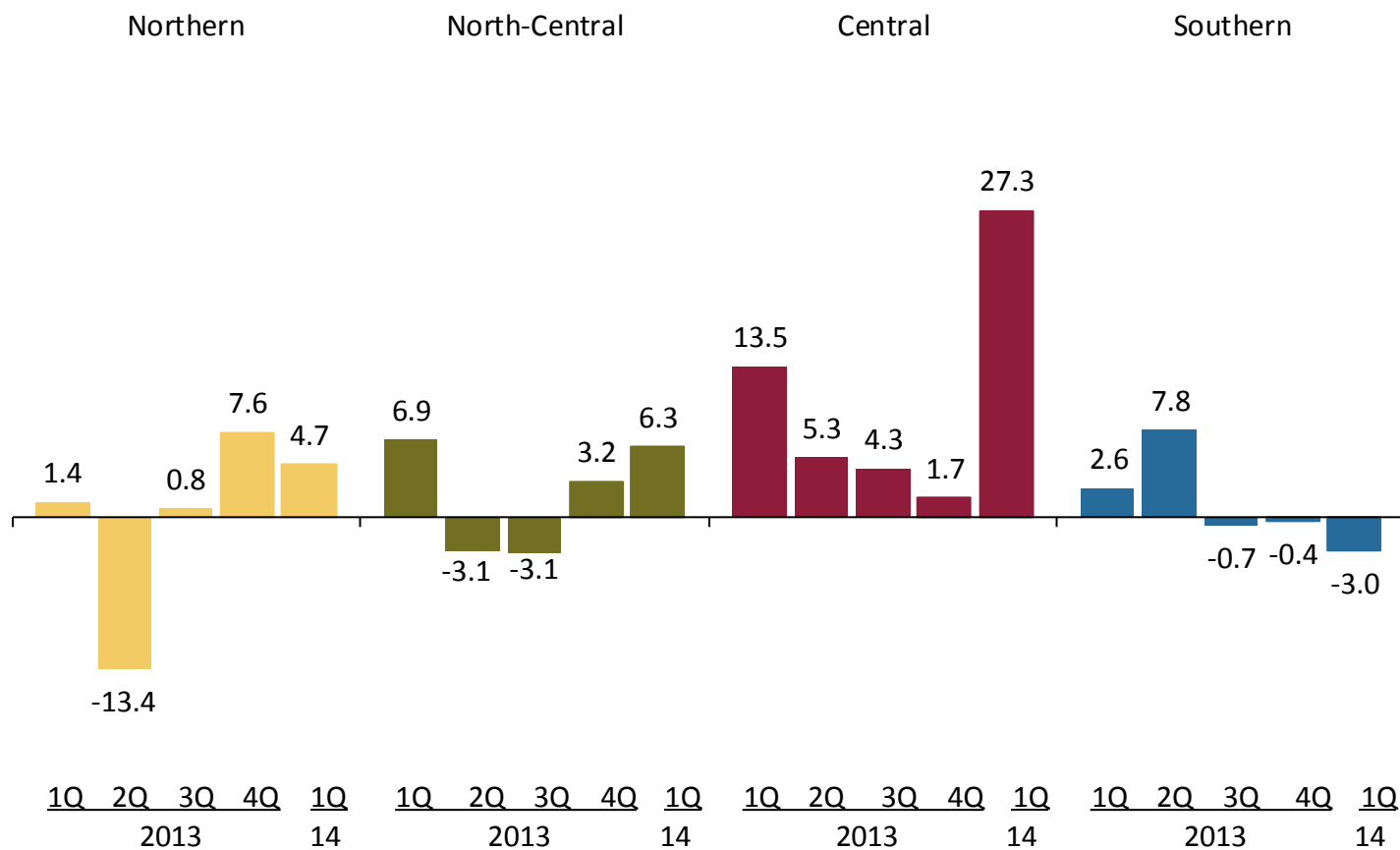


Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Economic Activity

Regional Agricultural Production Index

Annual change in percent

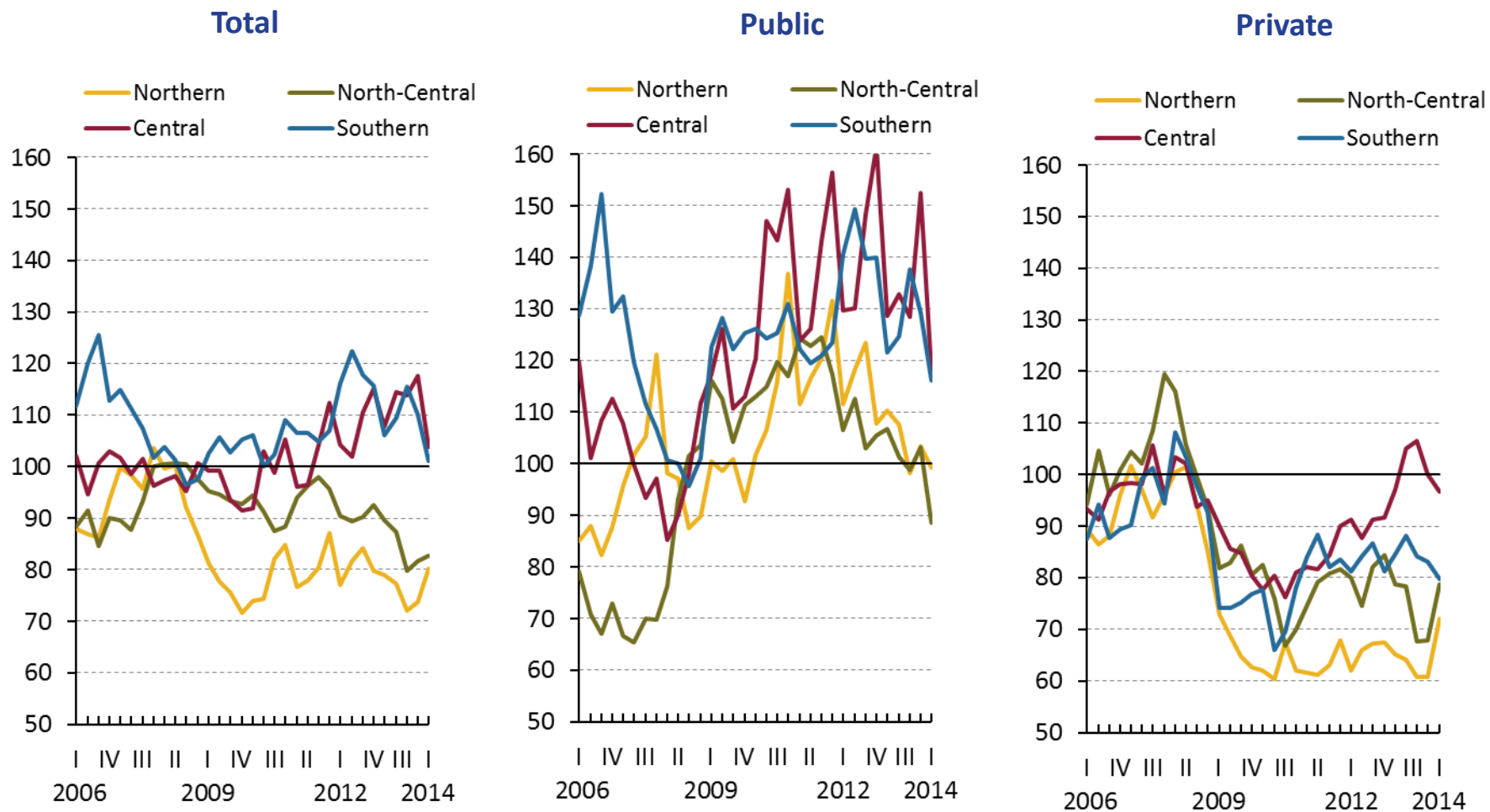


Source: Estimated by Banco de México with data from SAGARPA.

Economic Activity

Real Value of Production in the Construction Industry by Region

Index, base 2Q 2008 = 100, quarterly average



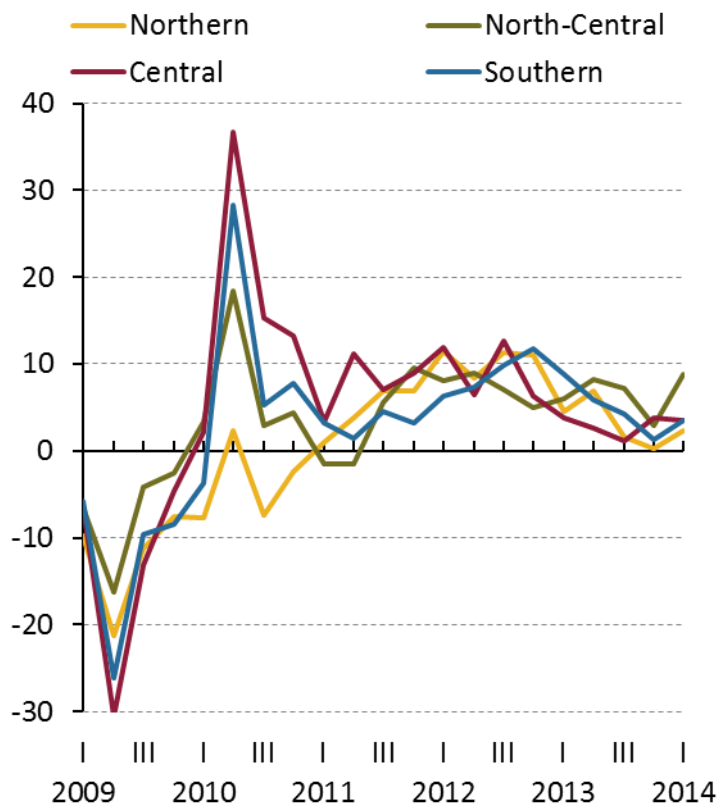
Source: Estimated by Banco de México with seasonally adjusted data from INEGI.

Economic Activity

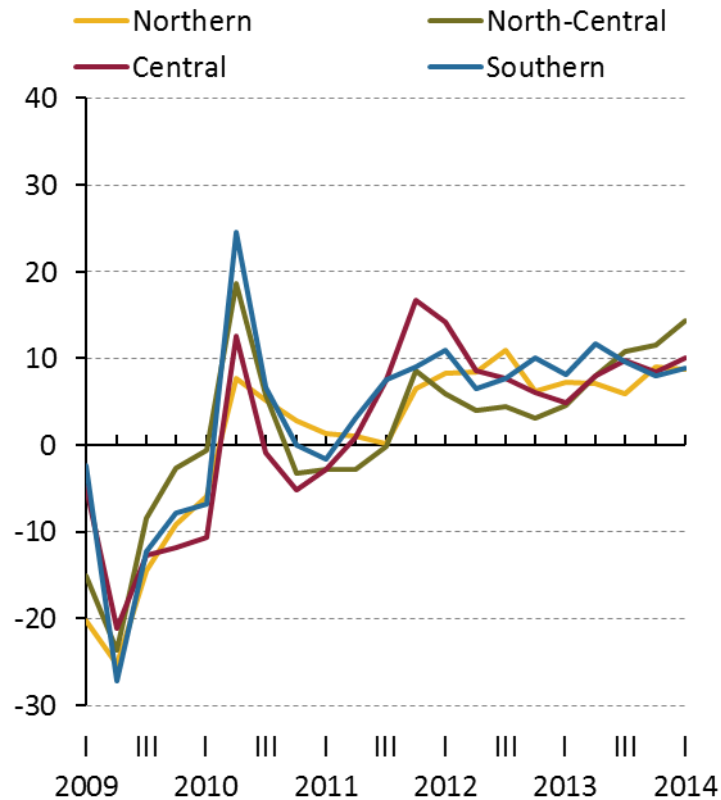
Regional Indicators of Activity in Tourism

Annual change in percent

Hotel Occupancy



Inflow of Passengers to Airports



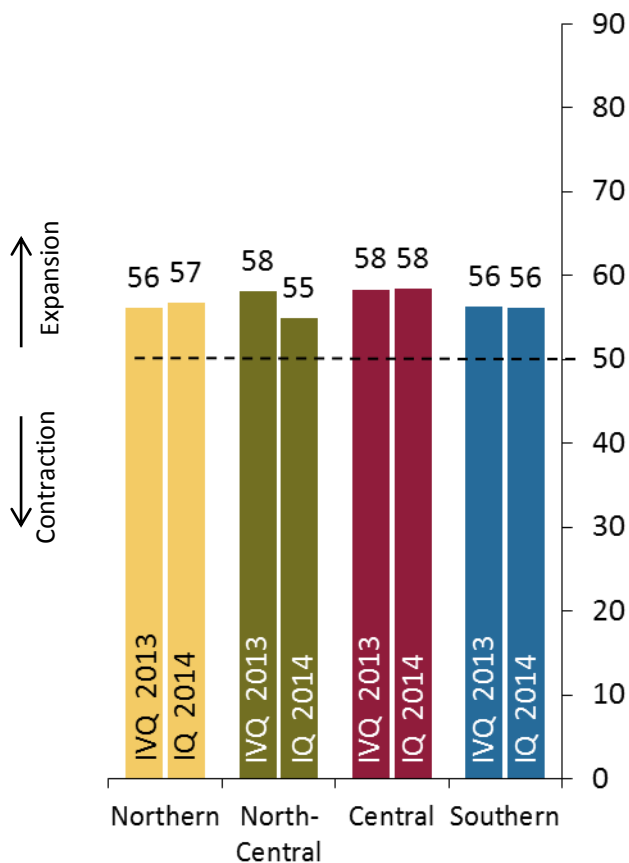
Source: Estimated by Banco de México with seasonally adjusted data from the Mexican Secretariat of Tourism and from Airports and Auxiliary Services (ASA, for its acronym in Spanish).

Economic Activity

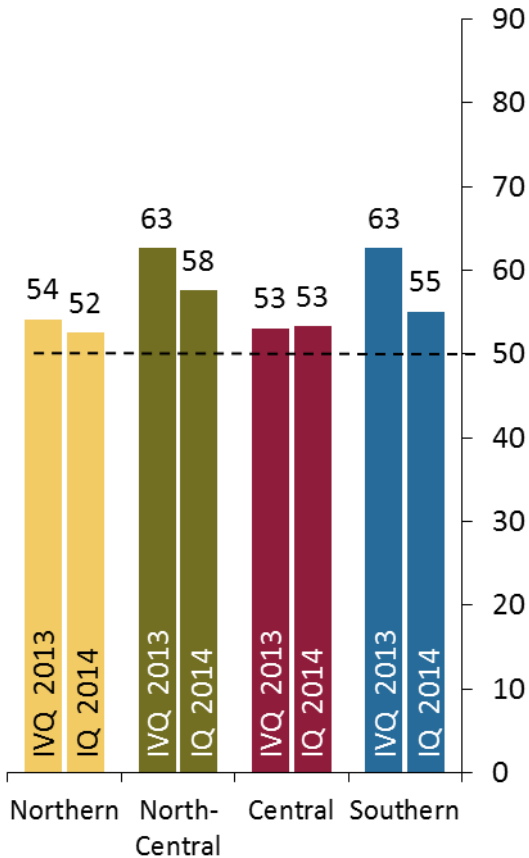
Main Sources of Financing to Firms

Diffusion index

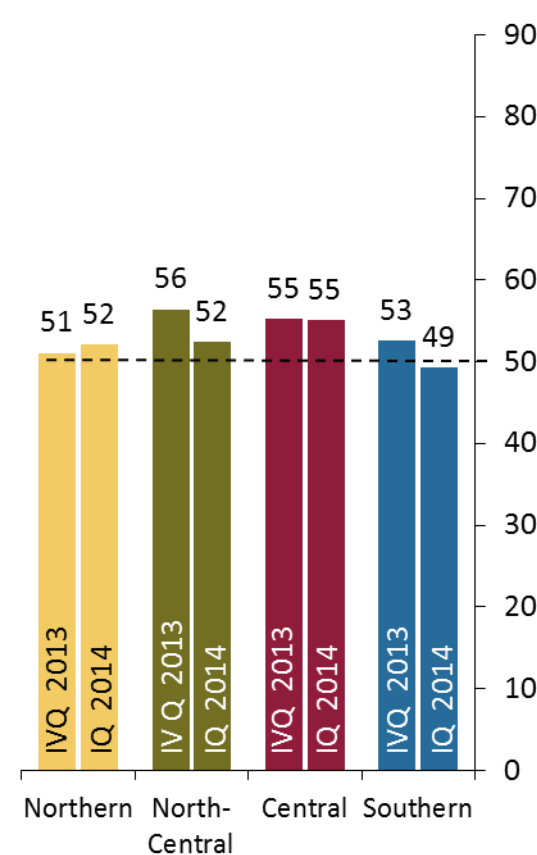
Own Resources



Suppliers



Commercial Banks

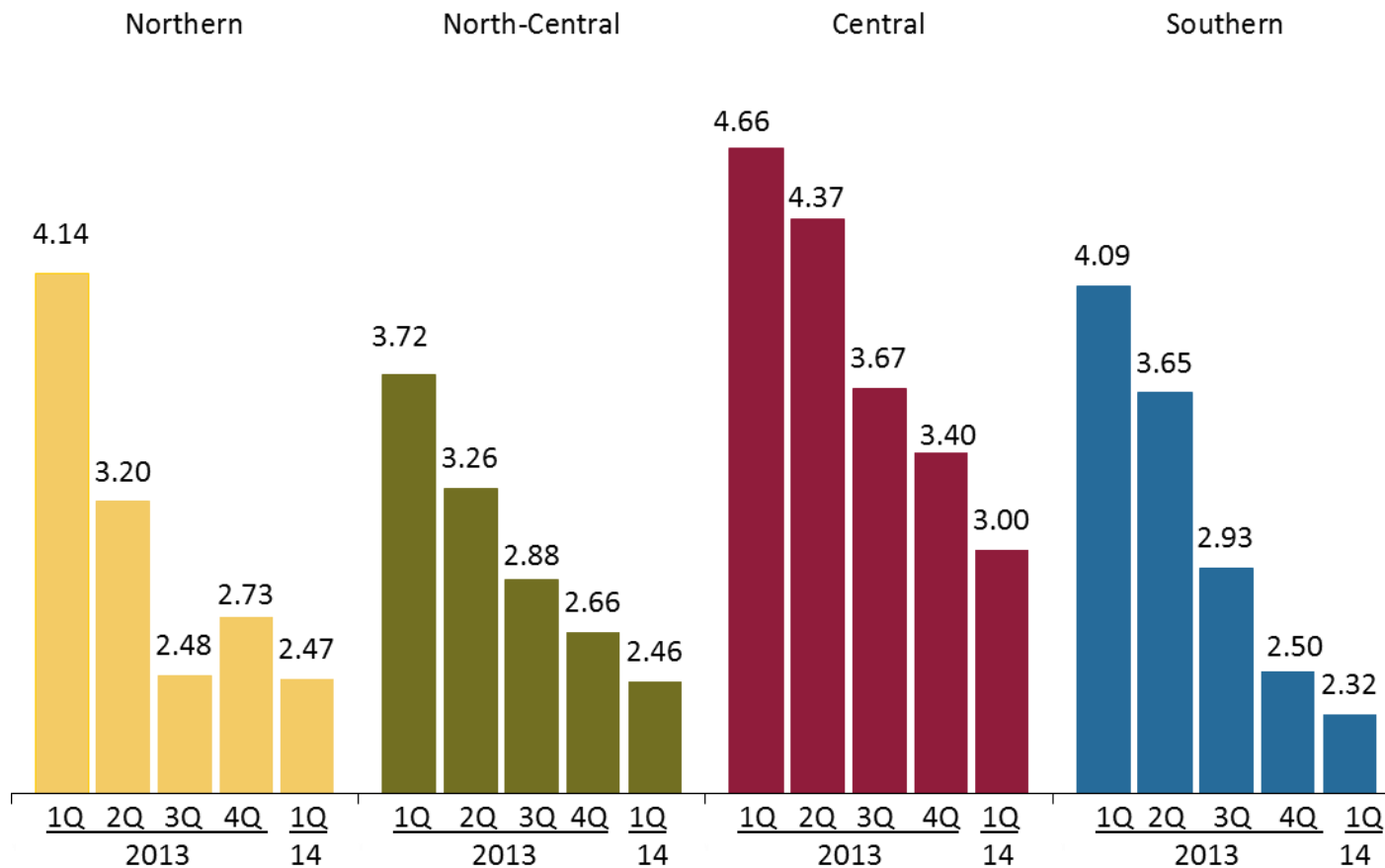


Source: Banco de México.

Economic Activity

Number of IMSS-insured Workers

Annual change in percent



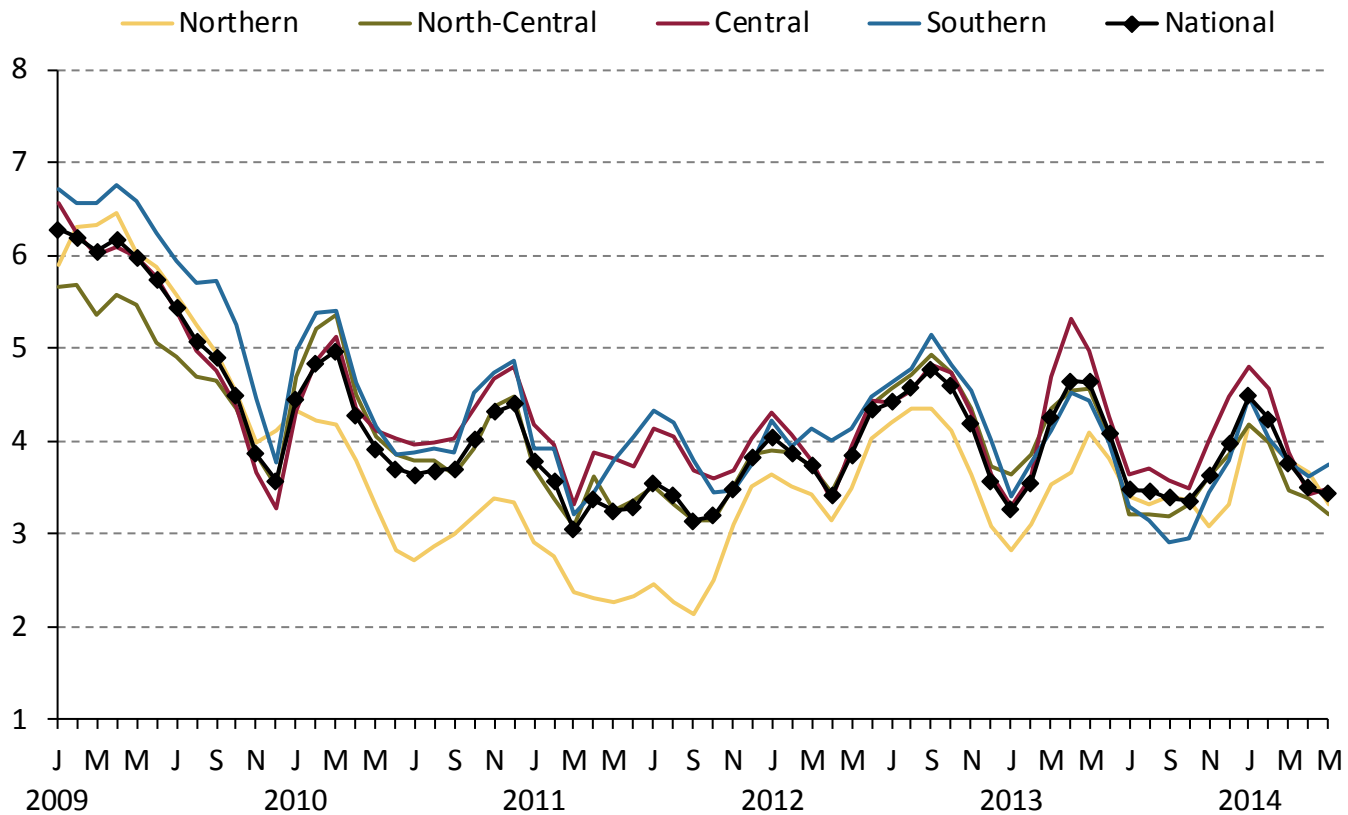
Source: Estimated by Banco de México with seasonally adjusted data from IMSS.

Inflation

- During 1Q 2014 annual headline inflation decreased in all regions to levels well below 4 percent, after reaching a high level in the first fortnight of January.
 - ✓ In this regard, it should be pointed out that the impact of fiscal measures on prices at the beginning of the year was concentrated in the group of goods directly affected by these adjustments and that no second round effects were generated on the price formation process of the economy.
- Annual core inflation recorded around 3 percent in the four regions during the period covered by this Report, despite the rebound in the first fortnight of January.
- The downward trend of annual headline inflation was significantly supported by the favorable trajectory of its non-core component; particularly by the decreasing annual change of the agricultural price subindex in all regions.

Inflation

Annual Headline Inflation Percent



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

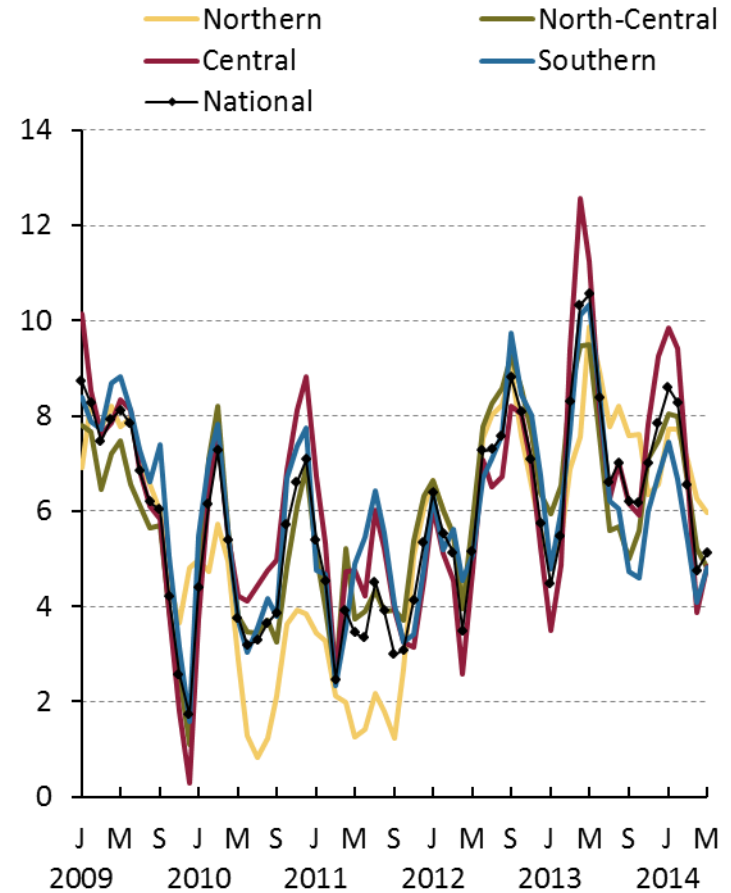
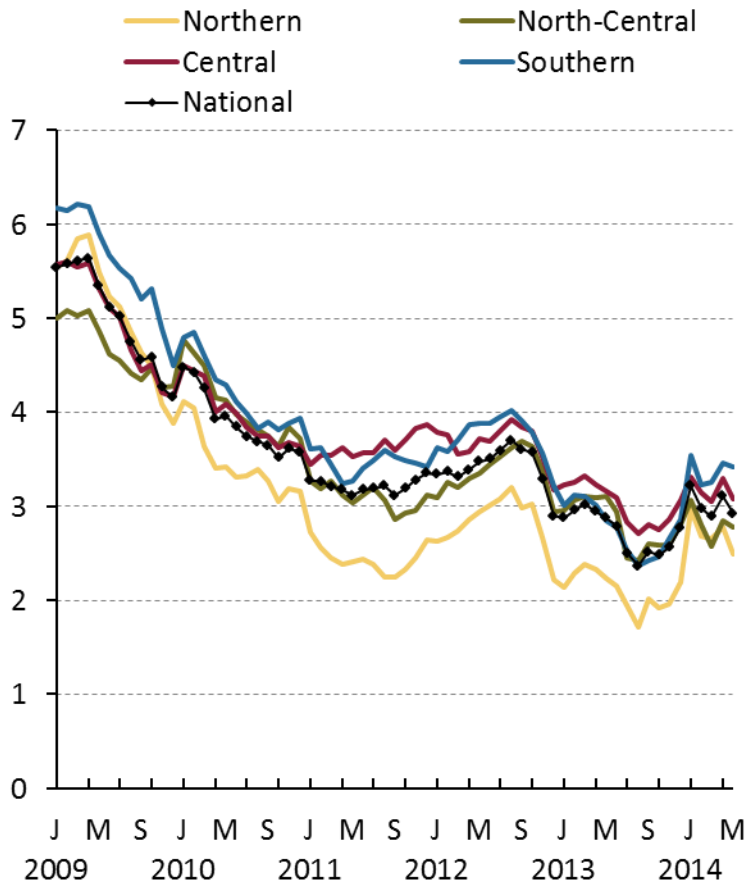
Inflation

Components of Annual Headline Inflation

Percent

Core

Non-core



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

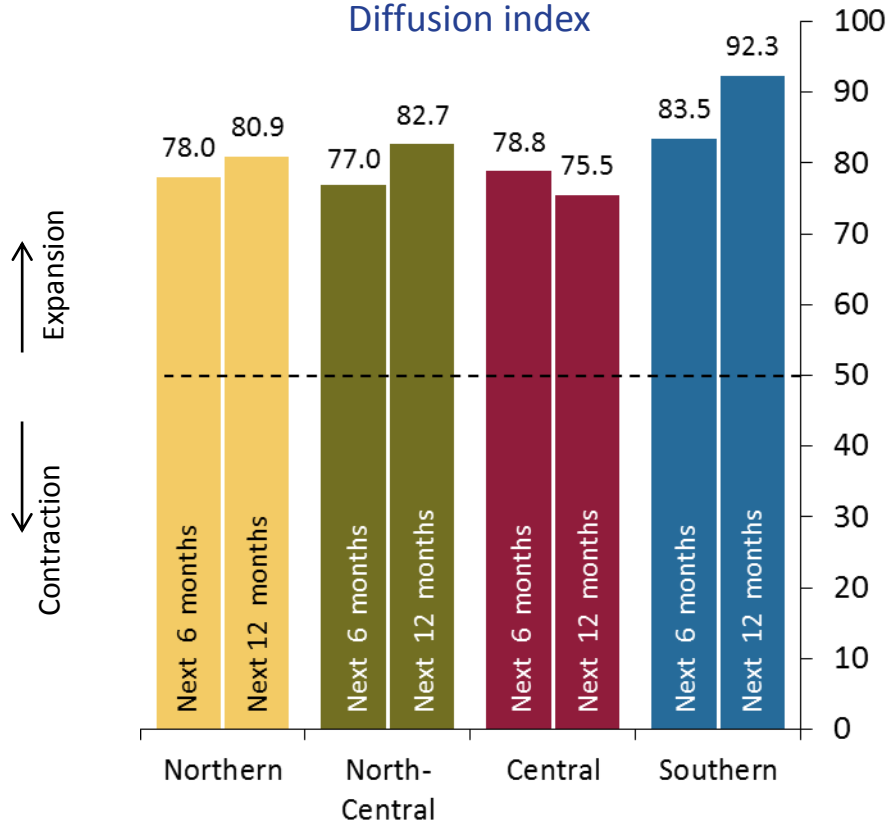
Economic Outlook

- Business agents interviewed by Banco de México anticipate demand for their goods and services in the four regions to continue expanding over the following 6 and 12 months. This expectation is mainly associated to:
 1. The impulse expected from the exports derived from the U.S. economic recovery.
 2. An anticipated positive impact of public expenditure on infrastructure.
- The interviewed business contacts generally stated that they would increase the number of hired personnel, as well as the physical capital stock in their firms over the next 6 and 12 months.

Economic Outlook

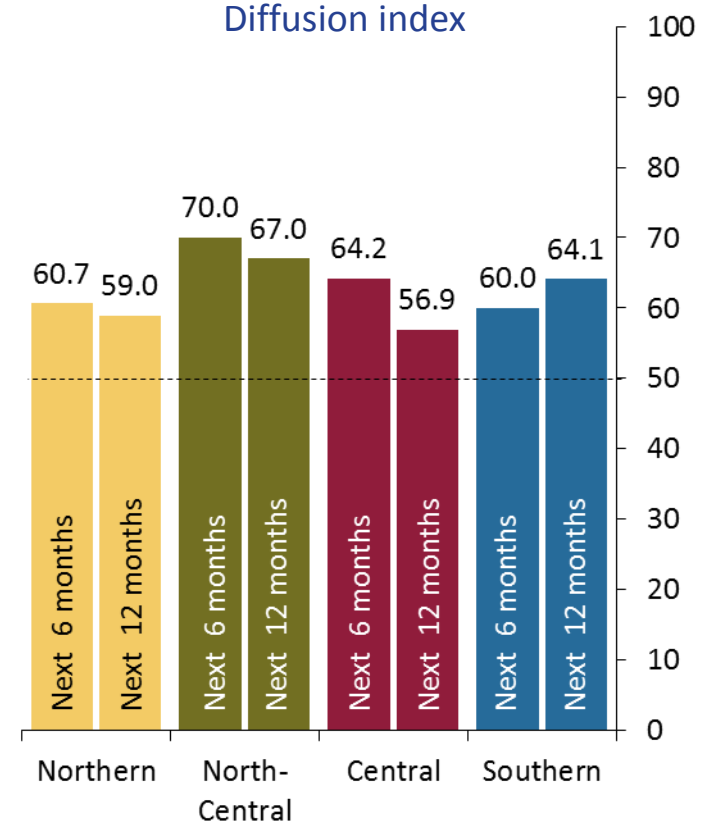
Demand as Expected by Business Agents ^{1/}

Diffusion index



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

Diffusion index



1/ Results obtained from responses to the question: “With respect to the situation in 1Q 2014, 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 March 18-April 16, 2014.

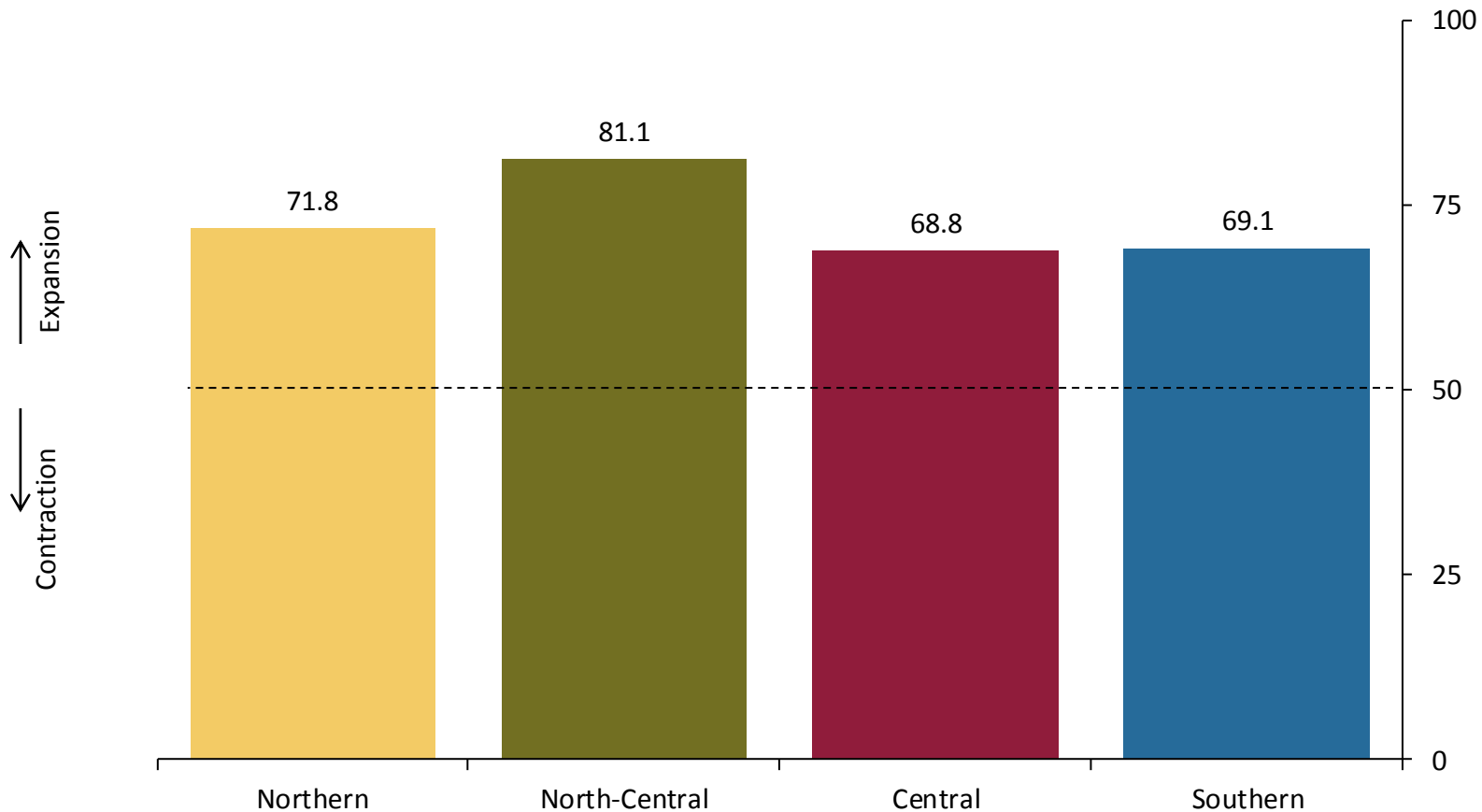
Source: Banco de México.

2/ Results obtained from responses to the question: “With respect to the situation in 1Q 2014, 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 March 18-April 16, 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 1Q 2014, 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 March 18-April 16, 2014.
Source: Banco de México.

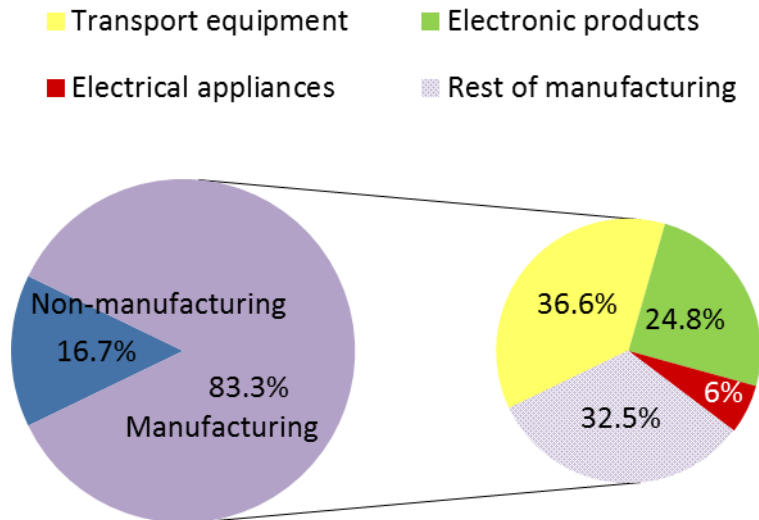
Box: Exports and Regional Clusters

- The interviewed business contacts expect the recovery of economic activity in the short and medium terms to be partly related to the strengthening of exports in the manufacturing sector.
- This Box analyzes the potential some regions of the country have to exploit this environment. To that end:
 1. Sectors with a greater weight in the manufacturing exports are identified.
 2. The share of regions in the referred sectors' exports is determined.
 3. The clusters' location in the analyzed industries is identified.
 - ✓ In particular, the analysis presented before in the Box “Formation of Regional Clusters in the Mexican Automobile Sector” in the Regional Economic Report July-September 2013 is extended to more sectors.

Box: Exports and Regional Clusters

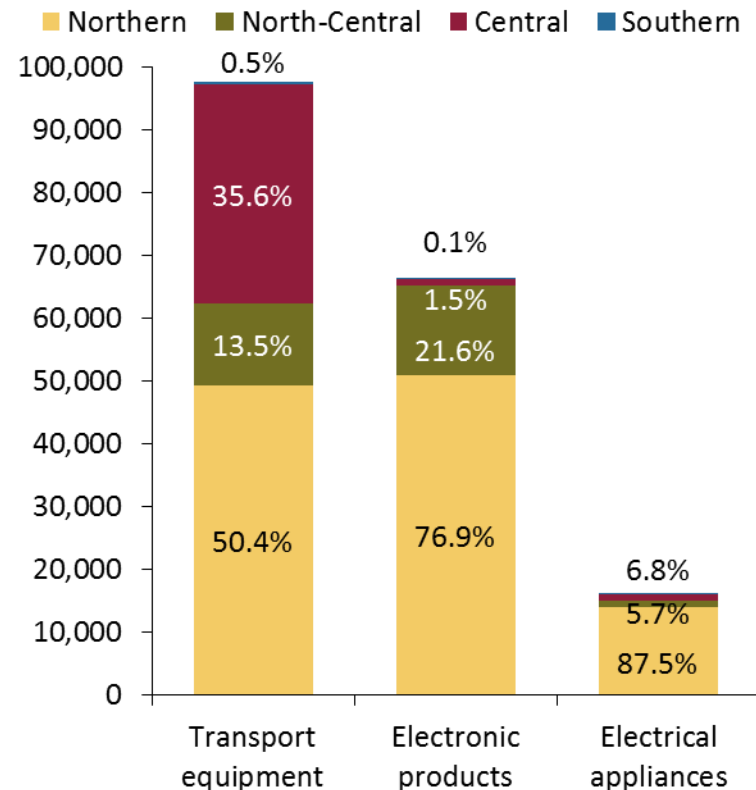
Total Exports and Manufacturing Exports by Sector (2012)

Percent



Regional Share of Exports by Sector (2012)

USD million and regional distribution of the sector

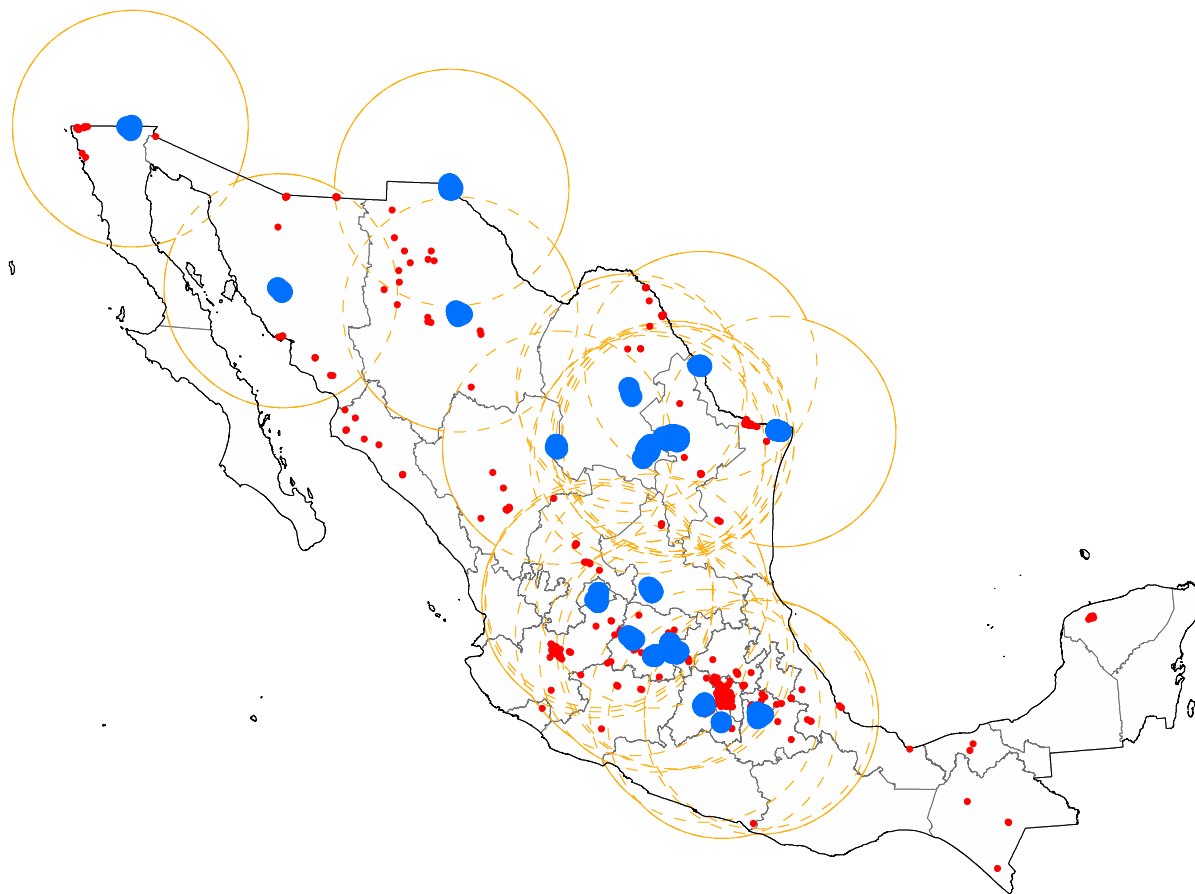


Source: Estimated by Banco de México with data from INEGI.

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Box: Exports and Regional Clusters

Regional Clusters in the Automobile Sector ^{1/}



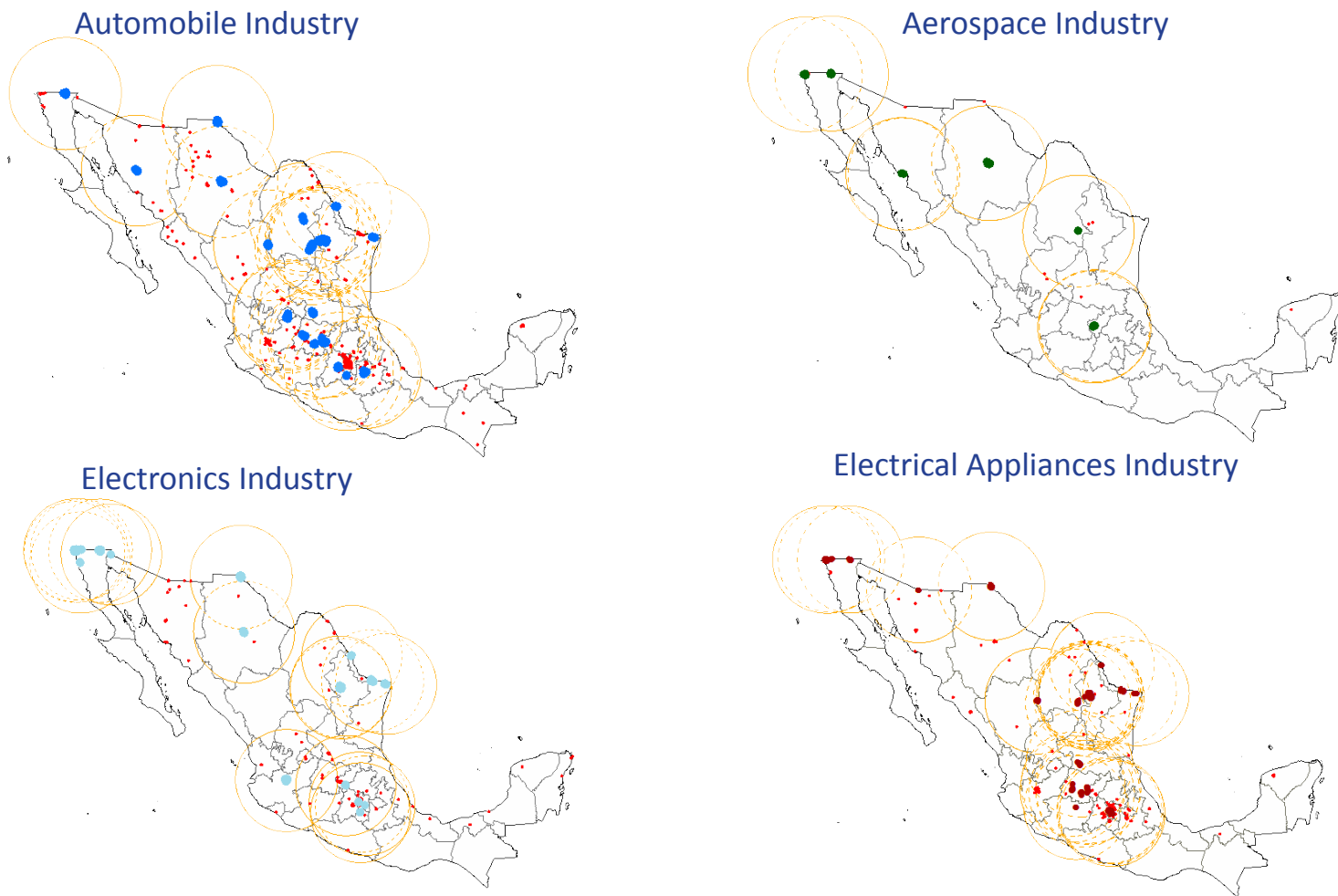
- Economic units
- Clusters
- Radius of influence

1/ The red dots indicate the location of the automobile sector's economic units, while blue dots point to the location of the sector's clusters. The circles indicate the radius of influence of the referred clusters.

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

Box: Exports and Regional Clusters

Regional Clusters in Export Sectors ^{1/}



1/ Large colored dots indicate the location of the sector's cluster, while small red dots indicate the location of the sector's economic units in other municipalities. The circles indicate the clusters' radius of influence in each sector.

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

Box: Exports and Regional Clusters

- The potential to take advantage of the momentum that is expected from external demand is higher in the Northern and Central regions.
- In these regions, industries with a greater weight in exports tend to form clusters.
- Productivity gains derived from agglomeration and scale economies in the clusters contribute to enhancing competitiveness of export sectors.

Geographic Distribution of Clusters ^{1/}



1/ States that have at least one cluster in one of the referred sectors.
Source: Estimated by Banco de México with data from INEGI.

Economic Outlook

- Even though the interviewed business contacts anticipate a recovery of the economic activity in their respective regions, they also commented on the main risks estimated in the following 6 and 12 months.

Upside risks

- ✓ A more vigorous than anticipated recovery of the U.S. economic activity.
- ✓ A greater dynamism of public expenditure on infrastructure and a shift in expectations that would result in a larger impulse to private investment.

Downside risks

- ✓ A recovery in consumption slower than anticipated.
 - ✓ A deterioration of the perception on public safety.
- Business agents stressed the importance of structural reforms being implemented in such a way that would propitiate productivity gains, which would allow enhancing competitiveness of regional economies.

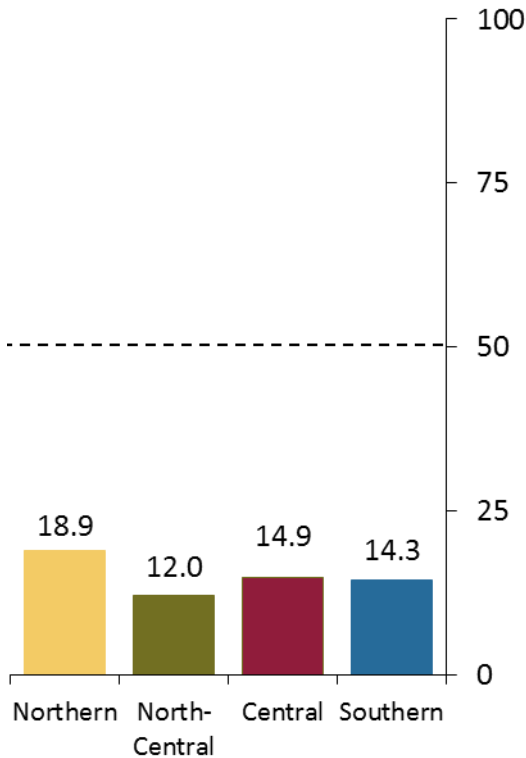
Economic Outlook

- With respect to inflation expectations for the next 6 and 12 months, business contacts pointed out that:
 - ✓ No inflationary pressures on salary costs are anticipated, due to the slack conditions expected to prevail in regional job markets.
 - ✓ As regards input prices, lower annual growth rates are estimated as compared to last year.
 - ✓ Lower annual growth rates of their sales prices are anticipated.

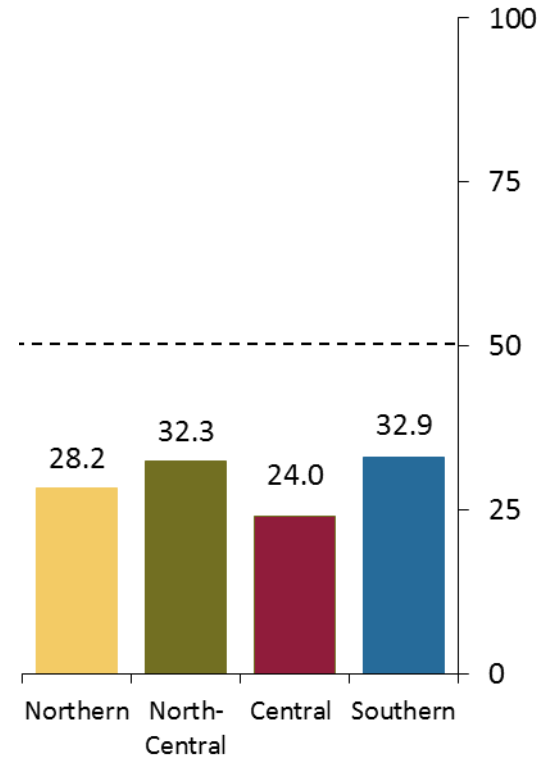
Economic Outlook

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

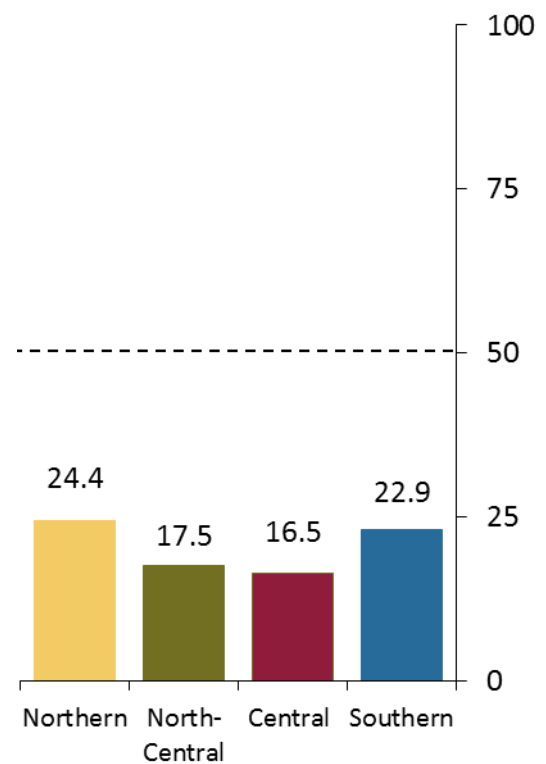
Labor Cost Inflation



Commodity Price Inflation



Own Products' Price Inflation



1/ Results obtained from the questions: "With respect to the situation in 1Q 2014, 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 March 18-April 16, 2014.

Source: Banco de México.

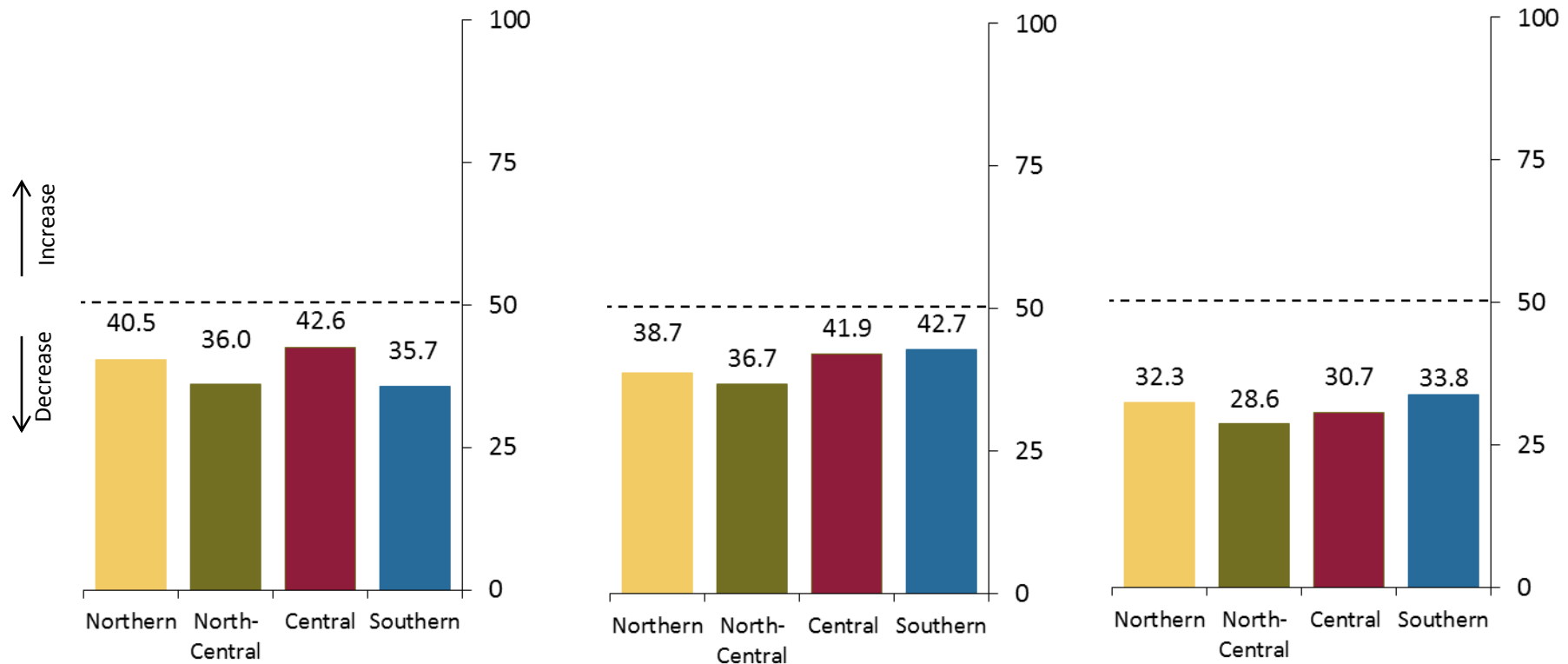
Economic Outlook

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 1Q 2014, 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 March 18-April 16, 2014.

Source: Banco de México.

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Final Remarks

In the analysis of the regional economic data and the opinions of the interviewed business contacts, the following stands out:

- ① The slowdown of economic activity observed in most regional economies in late 2013 persisted at the beginning of 2014. Still, by the end of 1Q 2014 some indicators of regional economic activity started to improve slightly.
- ② In line with the opinions of consulted business contacts, a higher dynamism of the economic activity is expected over the next 6 and 12 months.
 - This expectation is mainly supported by the recovery of the U.S. economy, as well as a higher dynamism of public investment in infrastructure.

Final Remarks

- ③ According to the interviewed business contacts, the inflation outlook over the horizon of 6 and 12 months is optimistic. In particular, lower annual growth rates in labor costs and lower commodity prices as compared to last year are anticipated. In line with this, lower annual growth rates of the goods and services' sales prices with respect to 2014 are also estimated in the referred horizon.



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