

Regional Economic Report

July – September 2013

BANCO DE MÉXICO

December 11, 2013

Outline

I. Introduction

II. Results July – September 2013

   A. Economic Activity

   B. Inflation

   C. Economic Outlook

III. Final Considerations

Outline

I. **Introduction**

II. Results July – September 2013

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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 3Q 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 federal entities 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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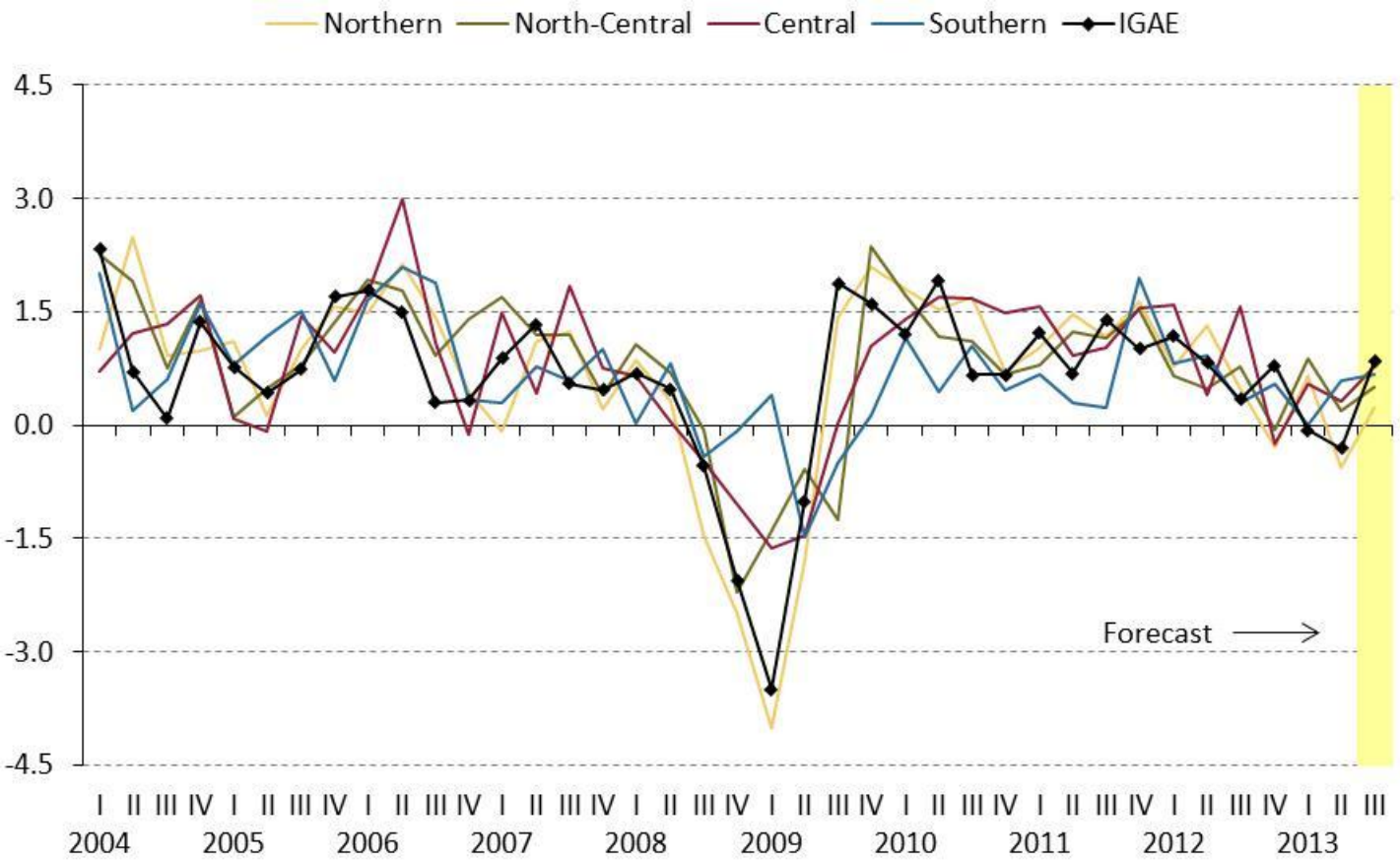
Economic Activity

- Economic activity in all regional economies observed an incipient recovery in 3Q 2013.
  - ✓ This recovery is mainly associated to the dynamism of the manufacturing sector, which responded to a better performance of external demand.
  - ✓ Tourism and funding to firms expanded, while the number of IMSS-insured workers kept growing.
  - ✓ In contrast, sales' and construction indicators in most regional economies still do not present clear signs of recovery.
  - ✓ The hurricanes "Ingrid" and "Manuel" moderately affected the economic activity, primarily in the agricultural sector which presented a differentiated performance by region.

Economic Activity

Regional Coincident Index 1/

Quarterly change in percent, s.a.

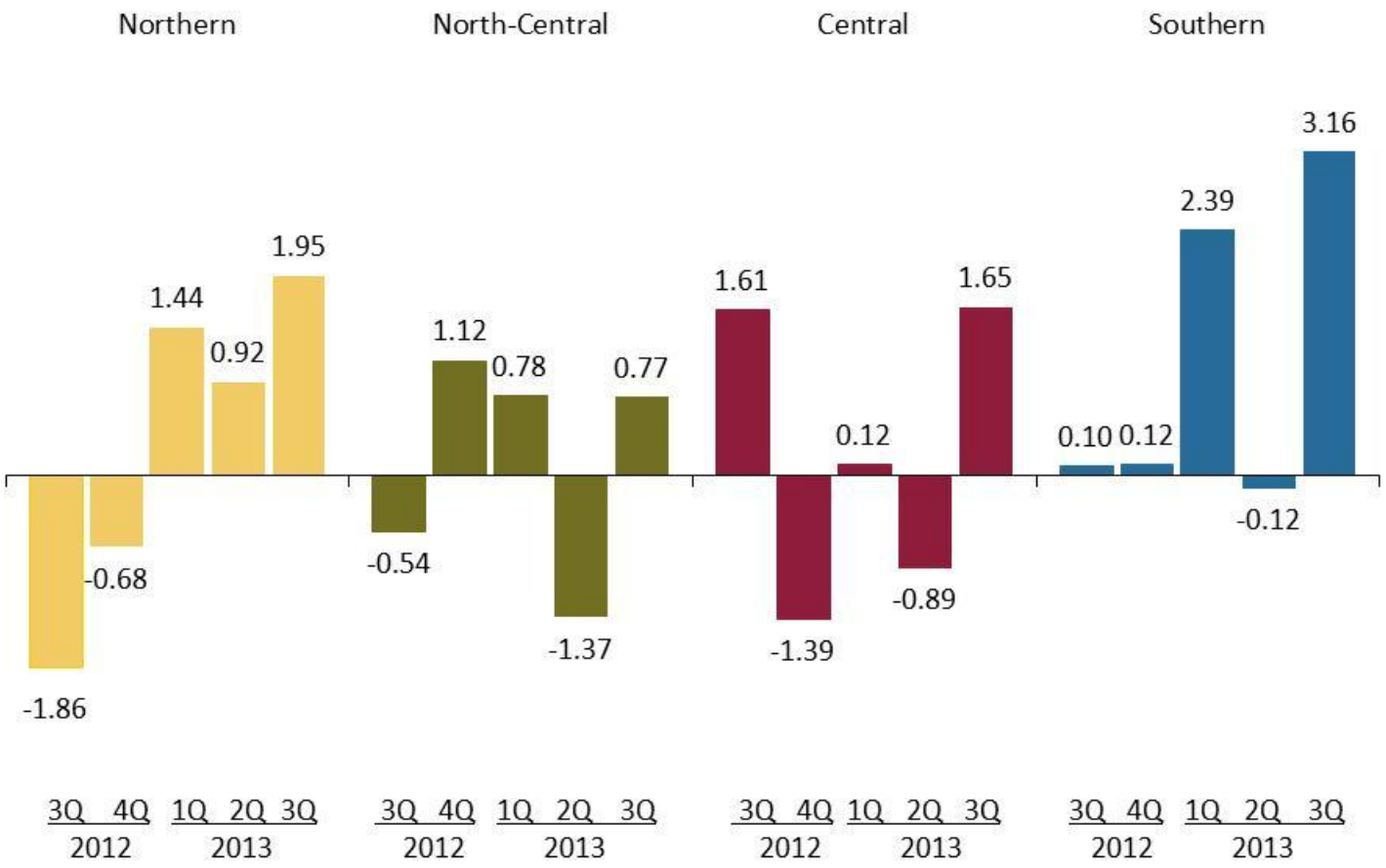


1/ This indicator's values in 3Q 2013 are a forecast.
Source: Estimated by Banco de México with data from IMSS and INEGI.

Economic Activity

Regional Manufacturing Indicator 1/

Quarterly change in percent, s.a.



1/ This indicator's values in 3Q 2013 are a forecast.
Source: Estimated by Banco de México with data from INEGI.

Box: Formation of Regional Clusters in the Mexican Automobile Sector

- Business agents of different economic sectors interviewed by Banco de México for this Report pointed out, especially in the Northern, North-Central and Central regions, the link between the performance of the automobile industry and that of their respective region.

- To deepen the comprehension of this relation, a Box of this Report presents a study of the pattern of this industry's regional development.

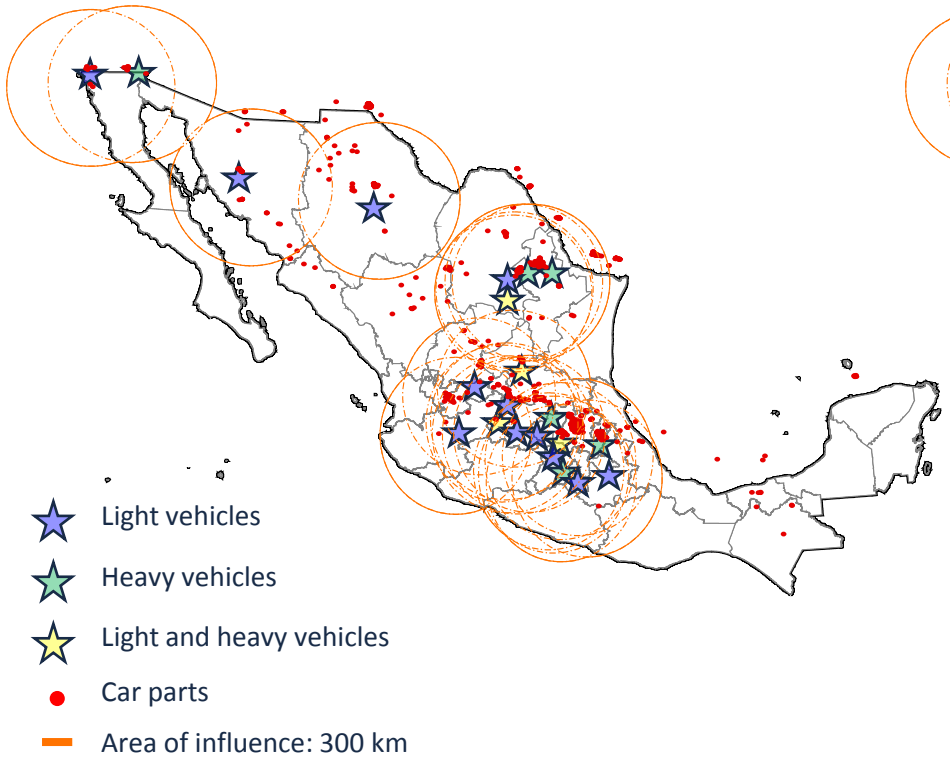
- In particular, it analyzes the hypothesis that this pattern is characterized by the geographic concentration of the economic activity in the automobile sector.

Box: Formation of Regional Clusters in the Mexican Automobile Sector

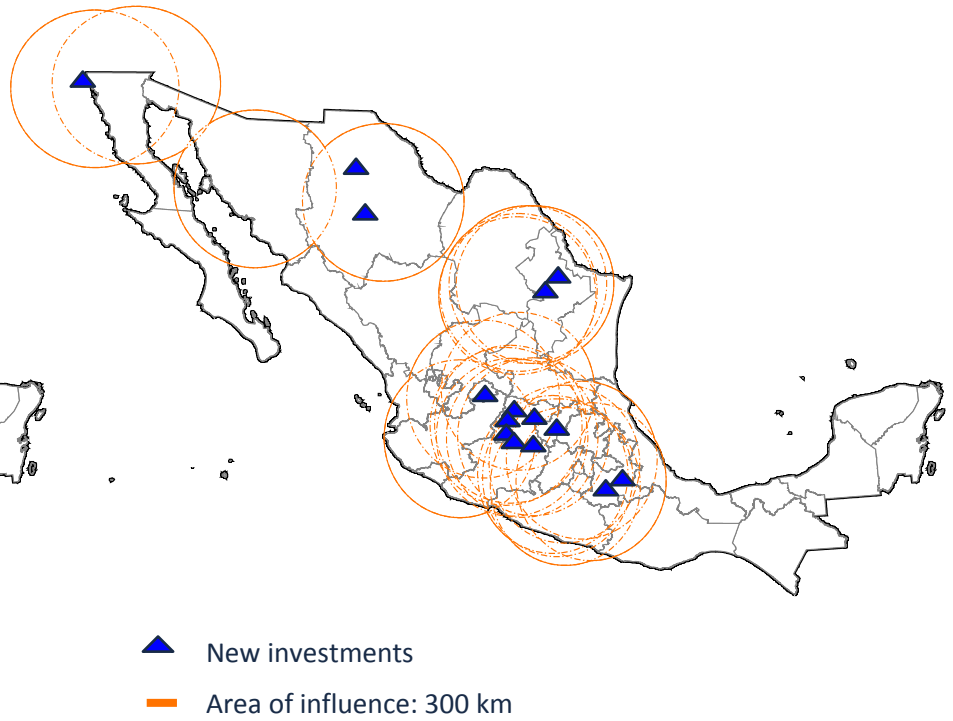
- The analysis shows that the automobile sector is characterized by its geographic concentration and that it has managed to consolidate the formation of clusters.
  - ✓ This allows the sector's firms to take advantage of agglomeration economies and to reduce their production costs.
  - ✓ Thus, the new investment projects, announced in the automobile industry for the next years, are located in the geographical area of influence of some car manufacturing plants of the country.
- The favorable evolution of the automobile sector, despite the slowdown in external demand during the previous quarters, indicates that fostering agglomeration economies and, therefore, increasing productivity contributes to making regional economies more resilient to economy-wide shocks.
- According to the interviewed business agents of the automobile sector, public policies fostering the development of human capital and the provision of infrastructure in their regions are key elements in supporting the formation of clusters.

Box: Formation of Regional Clusters in the Mexican Automobile Sector

Geographic Distribution of Automobile Industry Production Units



Geographic Distribution of Investment Projects in the Automobile Sector Announced in 2013



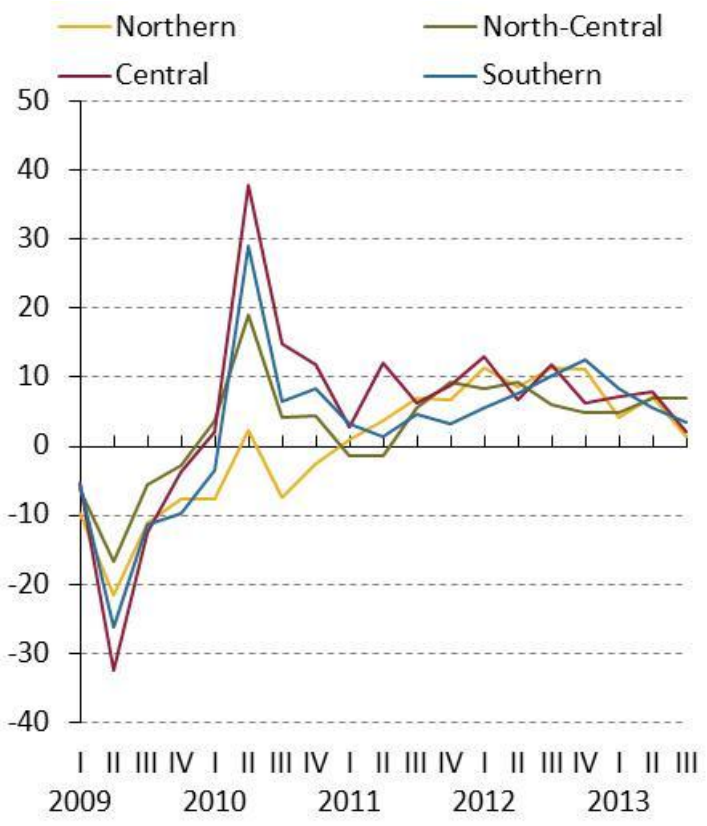
Source: Prepared by Banco de México based on data from INEGI and the Ministry of Economics.

Economic Activity

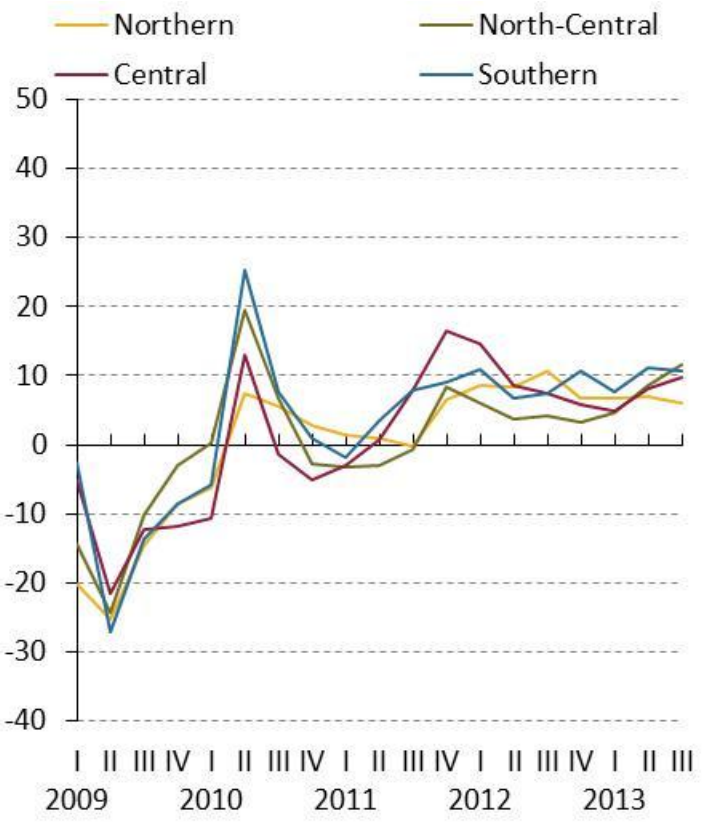
Regional Indicators of Activity in the Tourism Sector

Annual change in percent

Hotel Occupancy



Inflow of Passengers to Airports

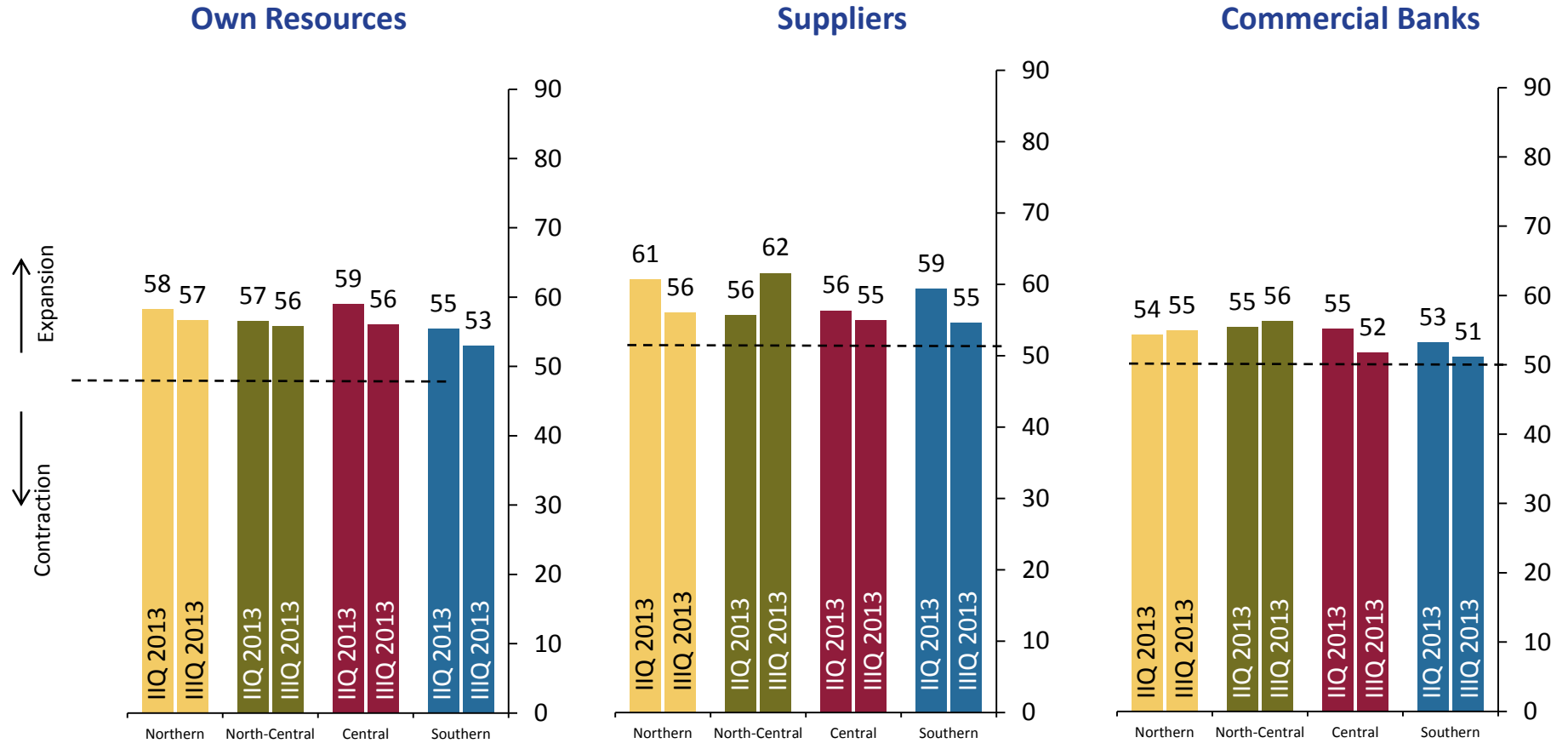


Source: Estimated by Banco de México with data from the Mexican Secretariat of Tourism and from Airports and Auxiliary Services (ASA, for its acronym in Spanish).

Economic Activity

Main Sources of Financing to Firms

Diffusion index

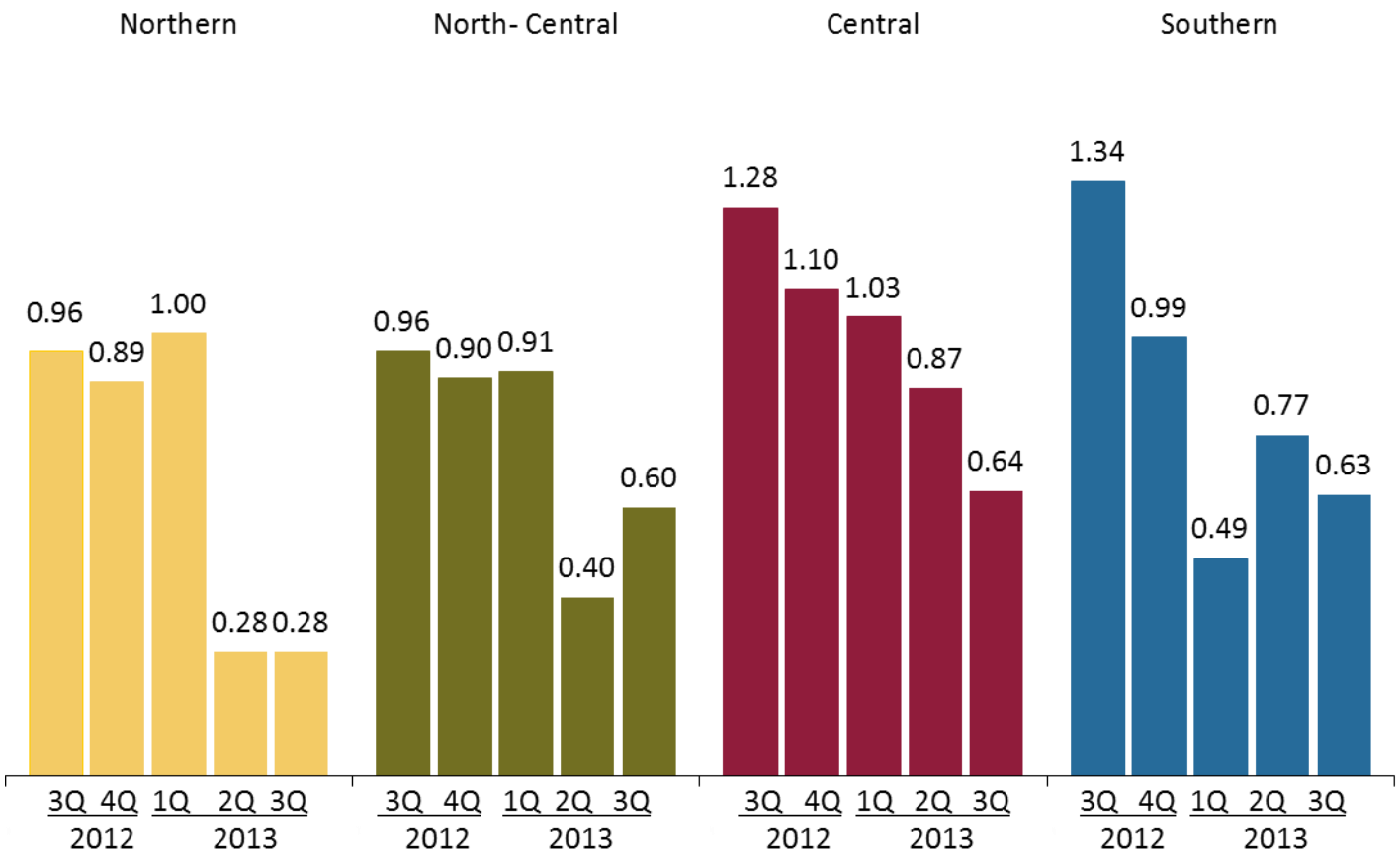


Source: Banco de México.

Economic Activity

Number of IMSS-insured Workers

Quarterly change in percent, s.a.

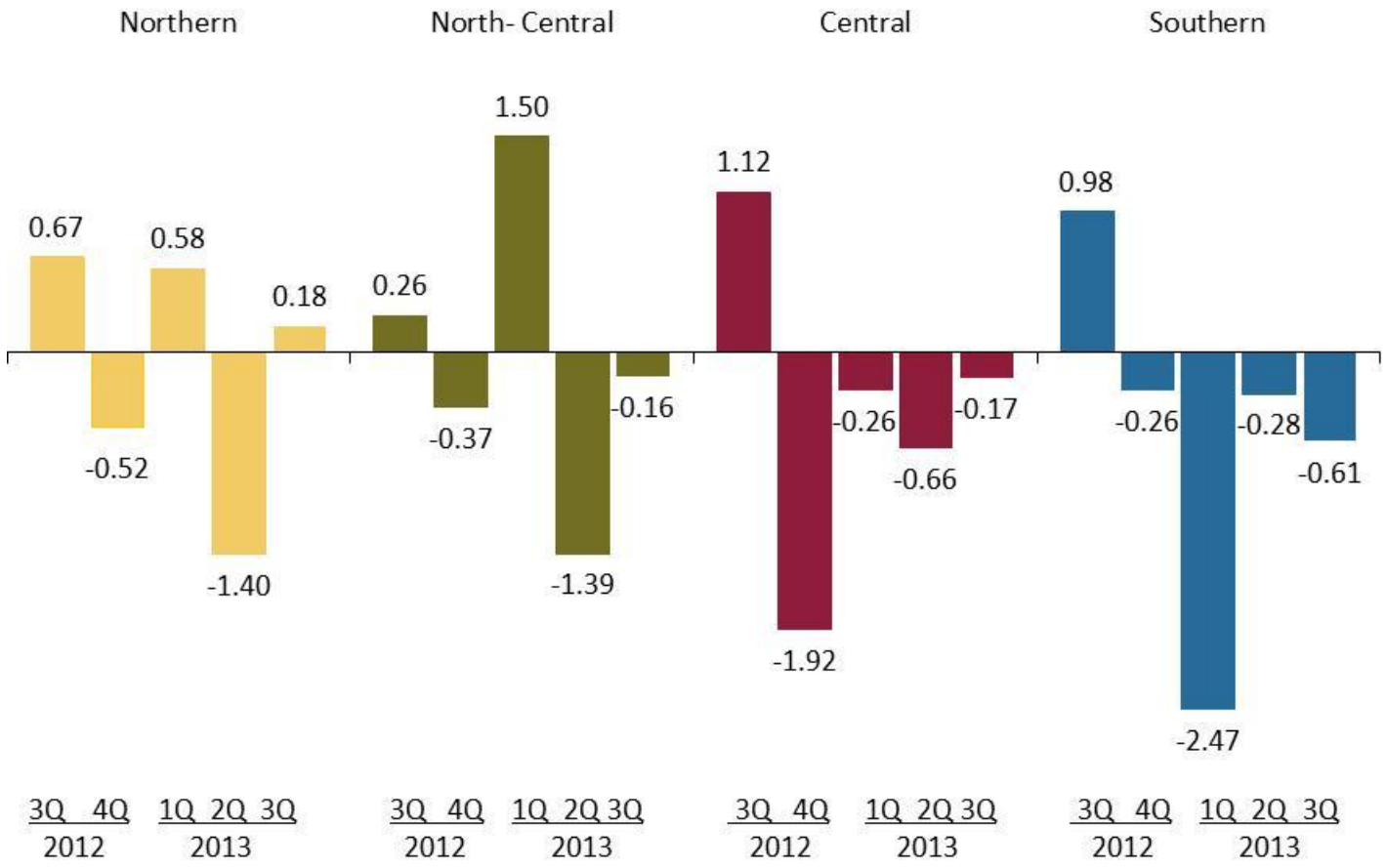


Source: Estimated by Banco de México with data from IMSS.

Economic Activity

Regional Retail Sales Indicator

Quarterly change in percent, s.a.

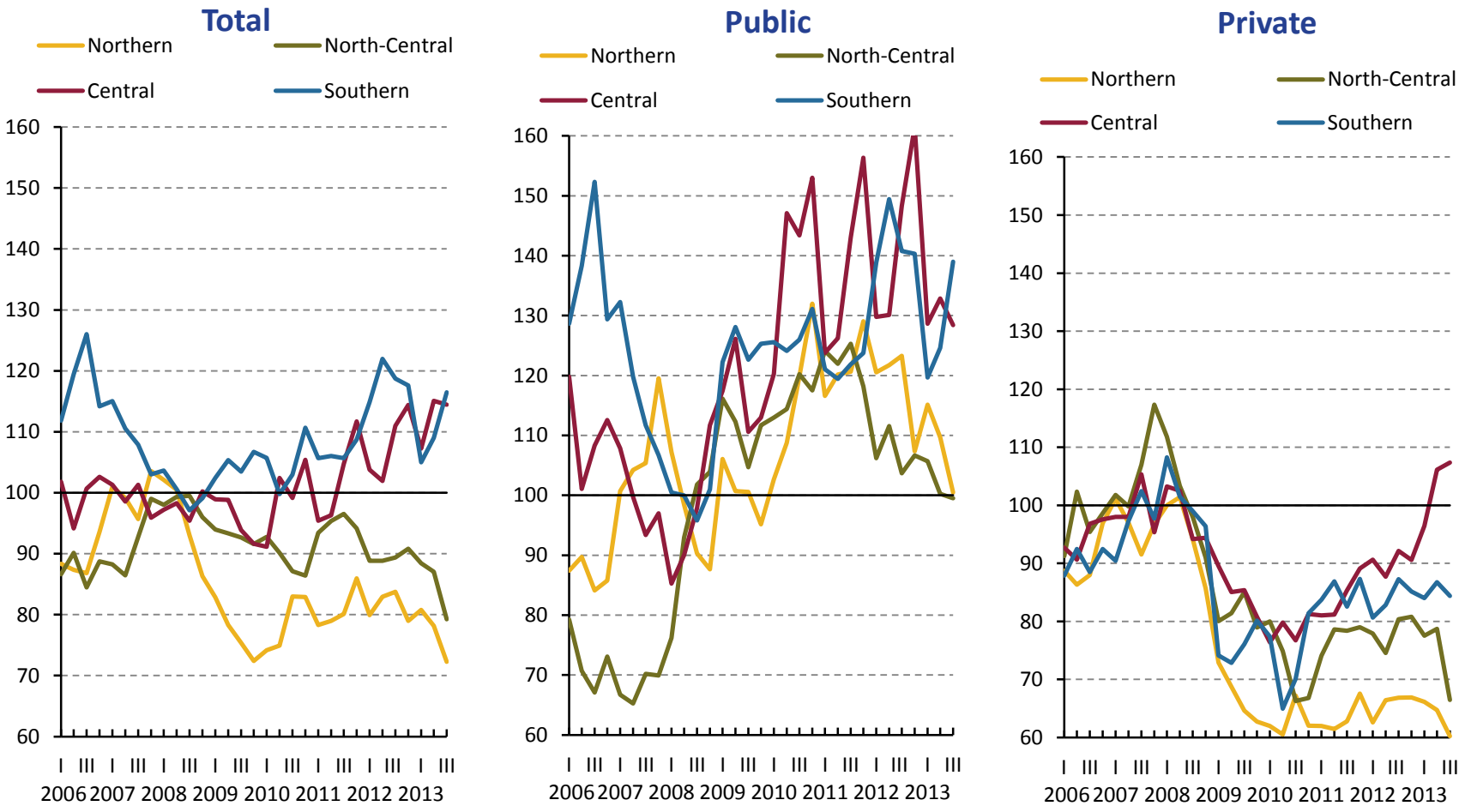


Source: Estimated by Banco de México with data from INEGI.

Economic Activity

Real Value of Production in the Construction Industry by Region

Index, base 2Q 2008 = 100, quarterly average, s.a.

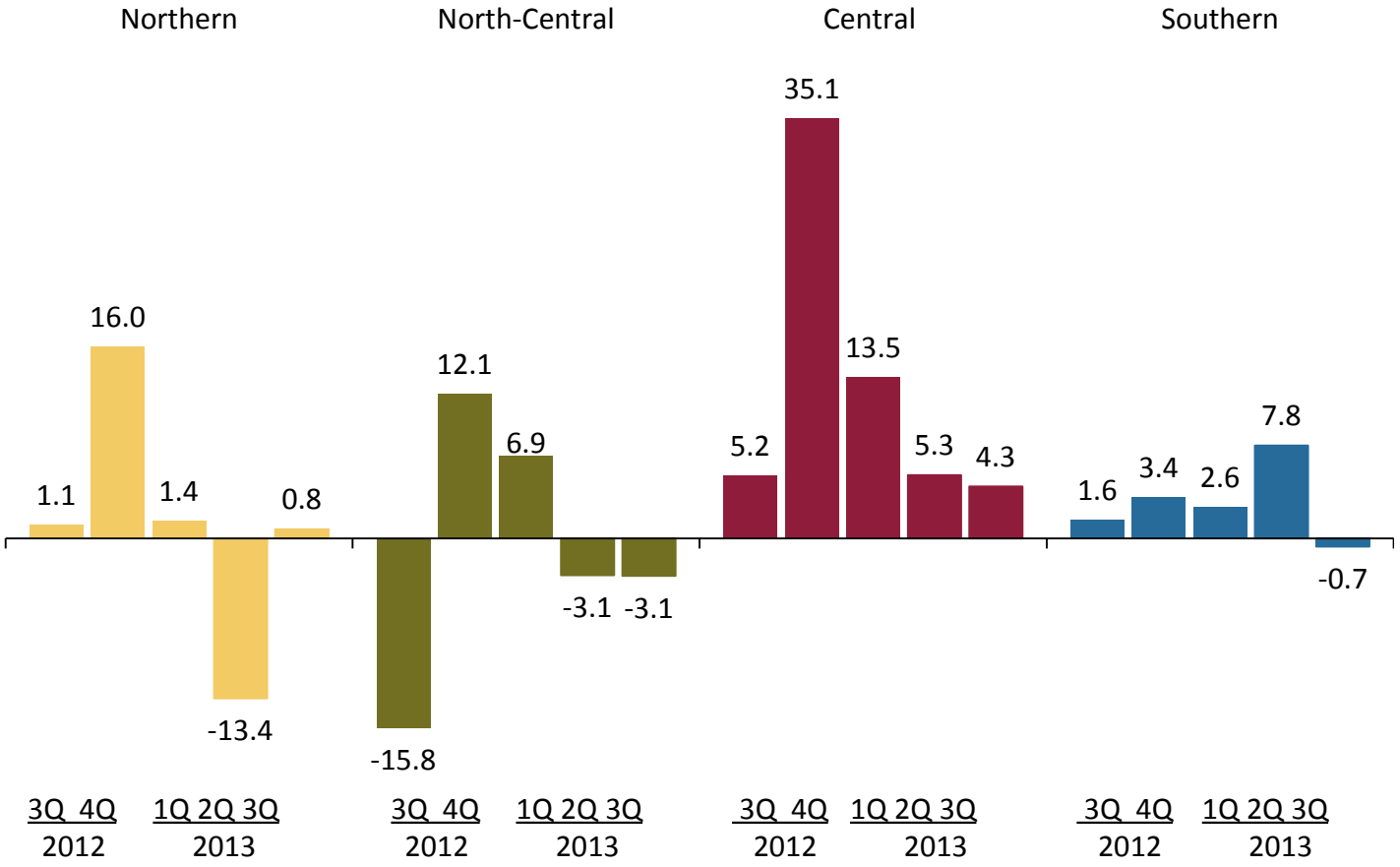


Source: Estimated by Banco de México with data from INEGI.

Economic Activity

Regional Agricultural Production Index

Annual change in percent



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

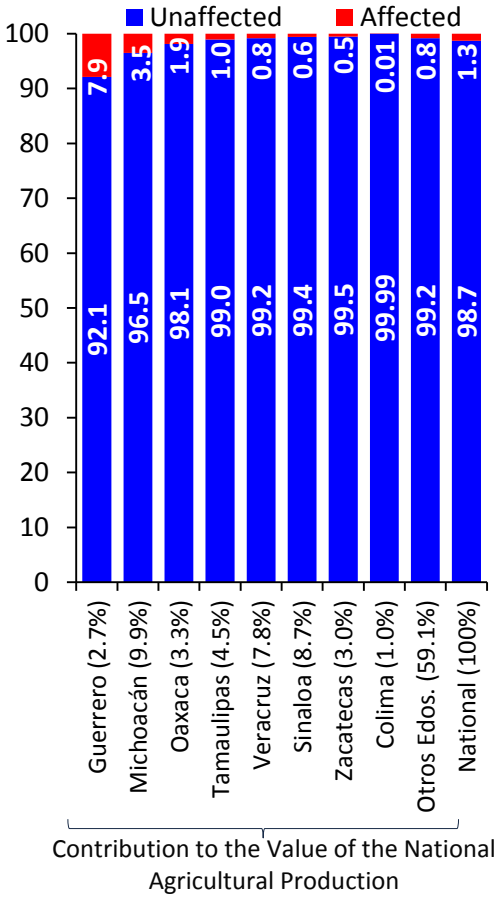
Box: Impact of the Hurricanes "Ingrid" and "Manuel" on Regional Economies

- By the end of the analyzed quarter, the economic activity in Mexico was altered by the simultaneous impact of the hurricanes "Ingrid" and "Manuel".
  - ✓ These caused floods in urban and rural areas and affected the infrastructure of transport and certain services.
  - ✓ Agriculture was the most severely affected, while tourism, transport and commerce also observed a certain impact.
  - ✓ Still, the economic activity was only disrupted locally in some states and municipalities of the Southern, North-Central and Northern regions.
    - With regard to agriculture, the most severe impact was registered in the states with a small share of Mexican agricultural production.
  - ✓ Thus, the impact to the national economy was moderate.

Box: Impact of the Hurricanes "Ingrid" and "Manuel" on Regional Economies

Affected Agricultural Area by Federal Entity

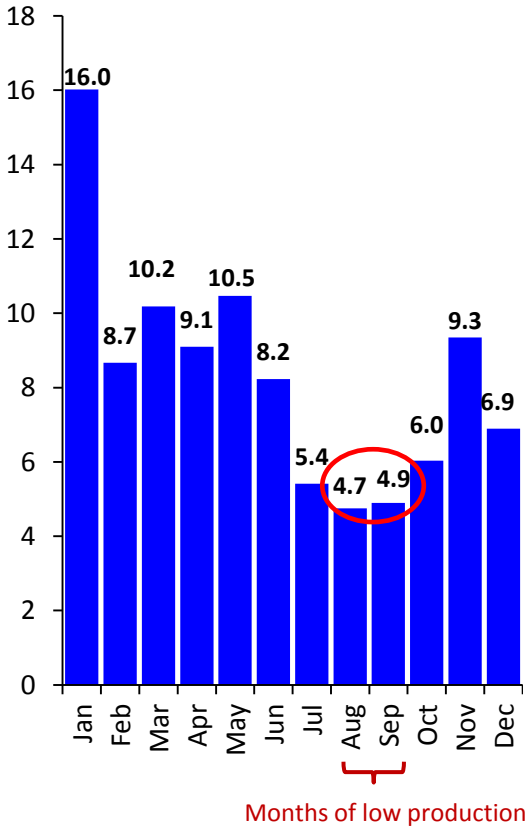
Share of area cultivated in 2012



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

Agricultural Production: Average from 2006 to 2012

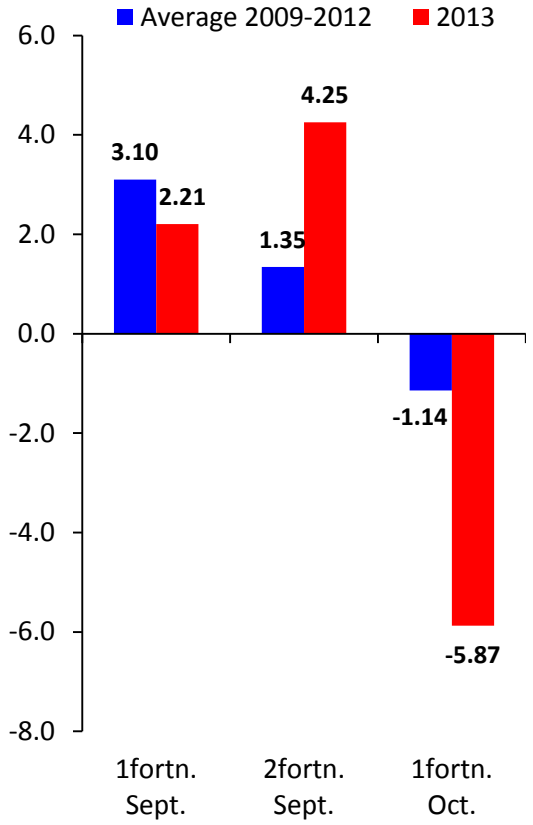
Data in percent



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

Fruit and Vegetables Price Index: Acapulco

Change per fortnight in percent

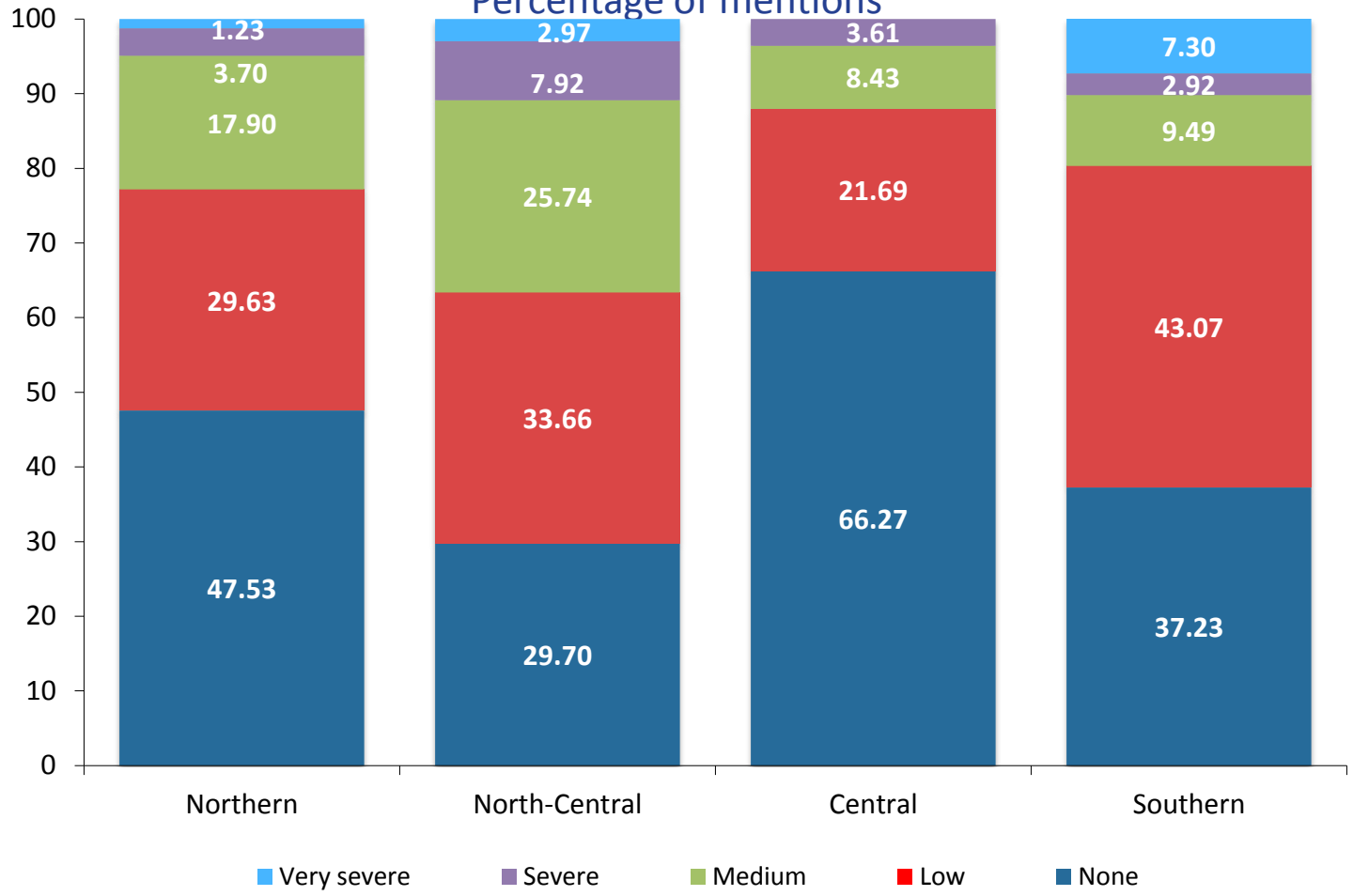


Source: Estimated by Banco de México with data from INEGI and Banco de México.

Box: Impact of the Hurricanes “Ingrid” and “Manuel” on Regional Economies

Business Contacts’ Opinion:
Degree of Impact in their Entity by the Hurricanes “Ingrid” and “Manuel”

Percentage of mentions



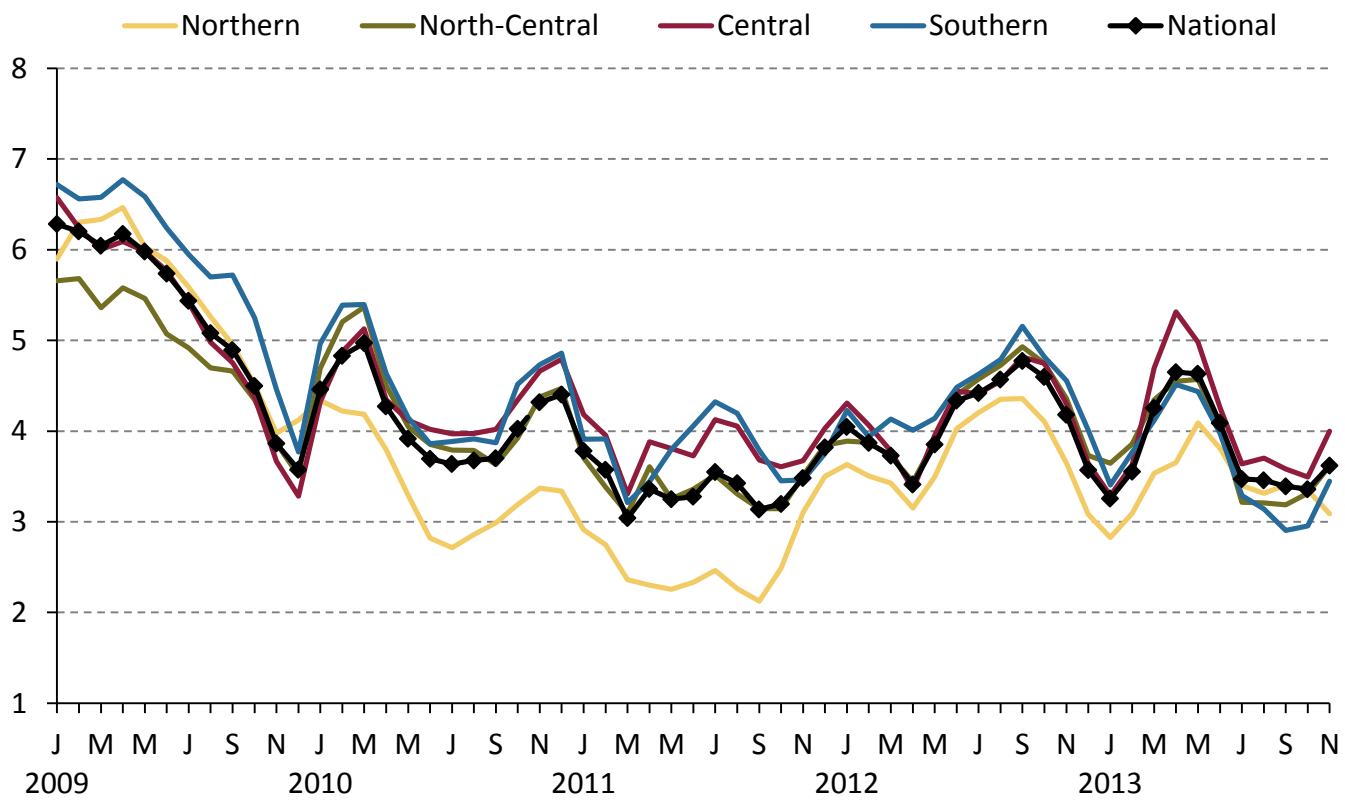
Source: Banco de México.

Inflation

- In 3Q 2013, annual headline inflation in all regional economies maintained a downward trend.
- This was contributed to by a favorable performance of both the core and non-core component.
  - ✓ The downside trajectory of annual core inflation resulted from a lower inflation of the merchandise subindex and from the low level at which the inflation of the services' subindex persisted in all regional economies.
  - ✓ In turn, the reduction of annual non-core inflation was motivated by the fading of the shocks in the agricultural products' prices at the end of 1Q 2013, with this drop more pronounced in the Southern region.

Annual Headline Inflation

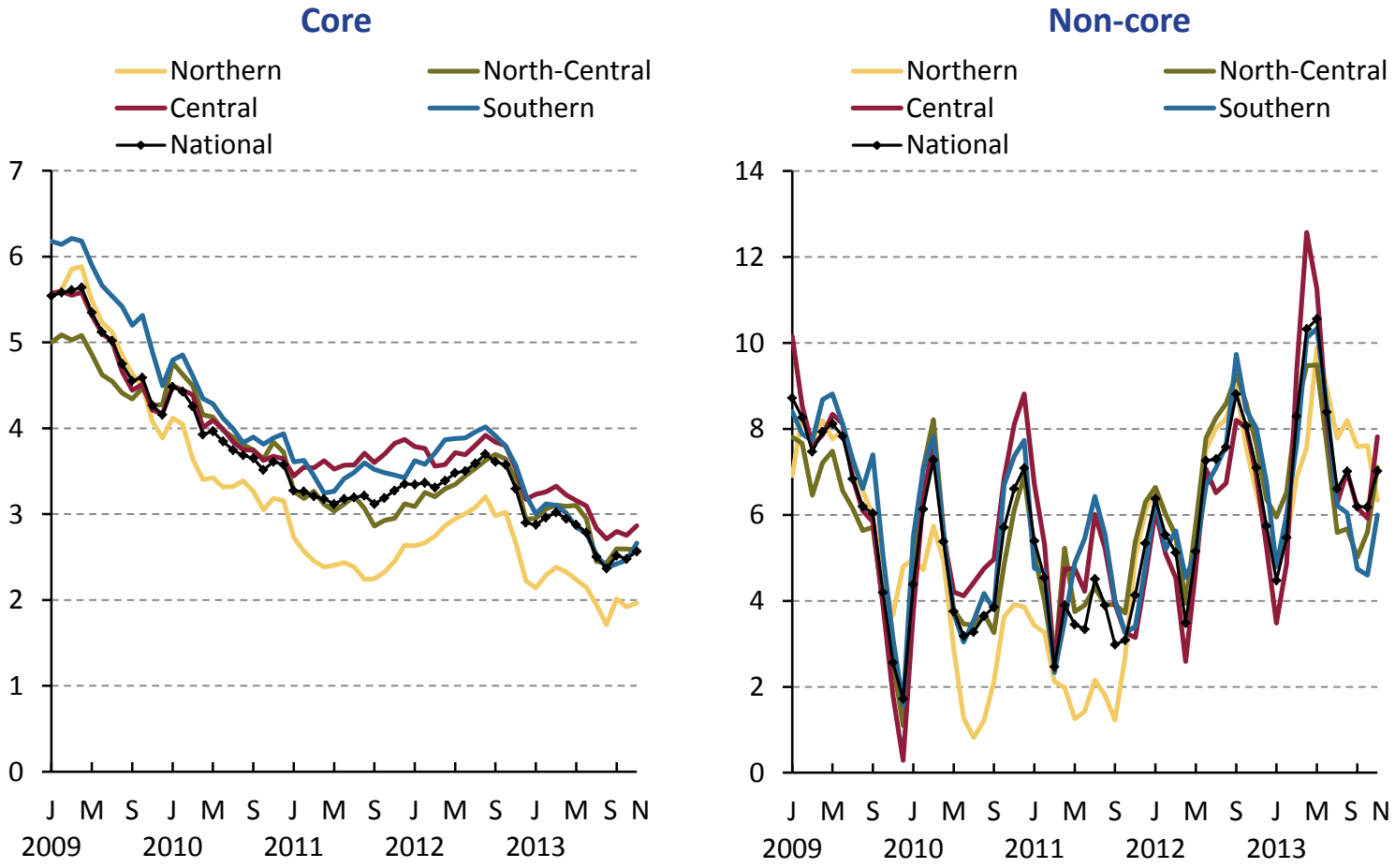
Data in percent



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

Annual Inflation

Data in percent



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

Economic Outlook

- The business contacts interviewed by Banco de México for this Report generally stated that in all regional economies a further recovery of the demand for own products and services over the following 6 and 12 months is anticipated. This expectation is principally based on two factors:
  - ✓ The reactivation of domestic demand, derived from a greater dynamism of public expenditure on infrastructure.
  - ✓ The impulse of external demand, particularly in the U.S., so the economic growth is anticipated to continue moderate.
- As a consequence, the interviewed business agents expect to increase their demand for personnel and the physical capital stock.

Economic Outlook

- According to the interviewed business contacts, among the main downward risks to the economic activity in their regions, the following factors stand out:

External factors

- ✓ The expansion rate of the U.S. economy.
- ✓ New volatility episodes in international financial markets.

Domestic factors

- ✓ A smaller than foreseen impulse generated by the structural reforms.
- ✓ The persistence of the weak private construction for a longer than anticipated period.
- ✓ Deterioration in perceived public safety and the occurrence of adverse weather phenomena.

Economic Outlook

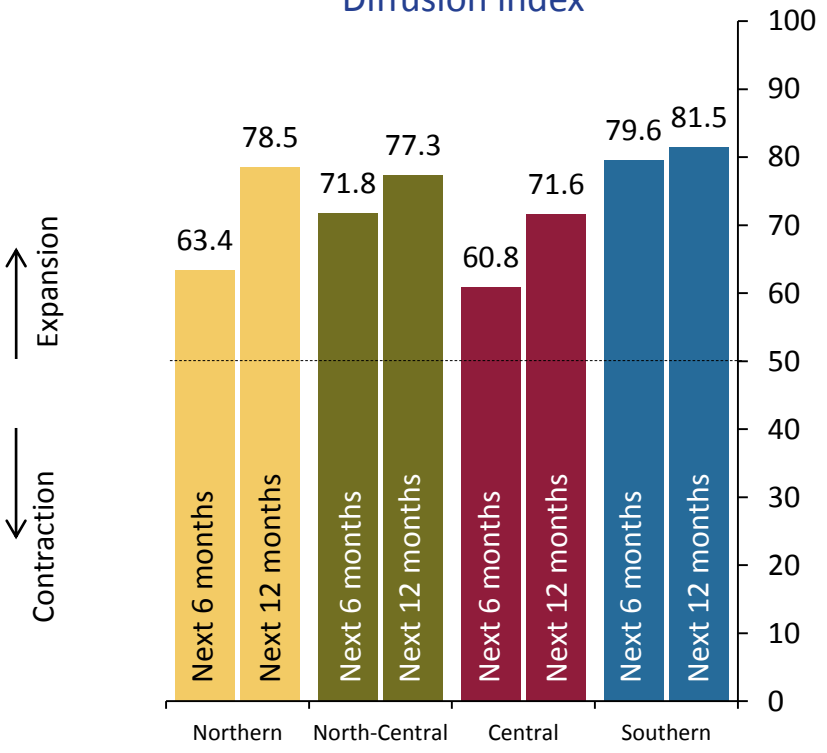
- Finally, regarding inflation expectations, the interviewed business agents revealed that no inflationary pressures on input prices, salary costs and sales' prices are anticipated over the following 6 and 12 months.

- Additionally, they expect the effect of the fiscal modifications on inflation to be transitory and moderate in their respective regions in 2014.

Economic Outlook

Demand as Expected by Business Agents [1/]

Diffusion index

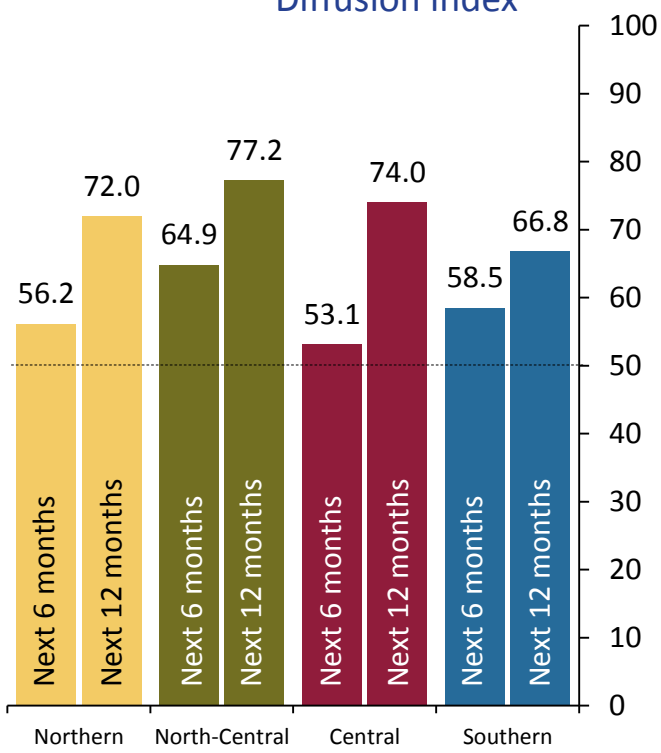


1/ Results obtained from responses to the question: "With respect to the situation in 3Q 2013, how do you expect the demand for your own products and services to change over the next 6 and 12 months?", from the interviews conducted by Banco de México between September 24 and October 25, 2013.

Source: Banco de México.

Personnel Hired as Expected by Business Agents [2/]

Diffusion index



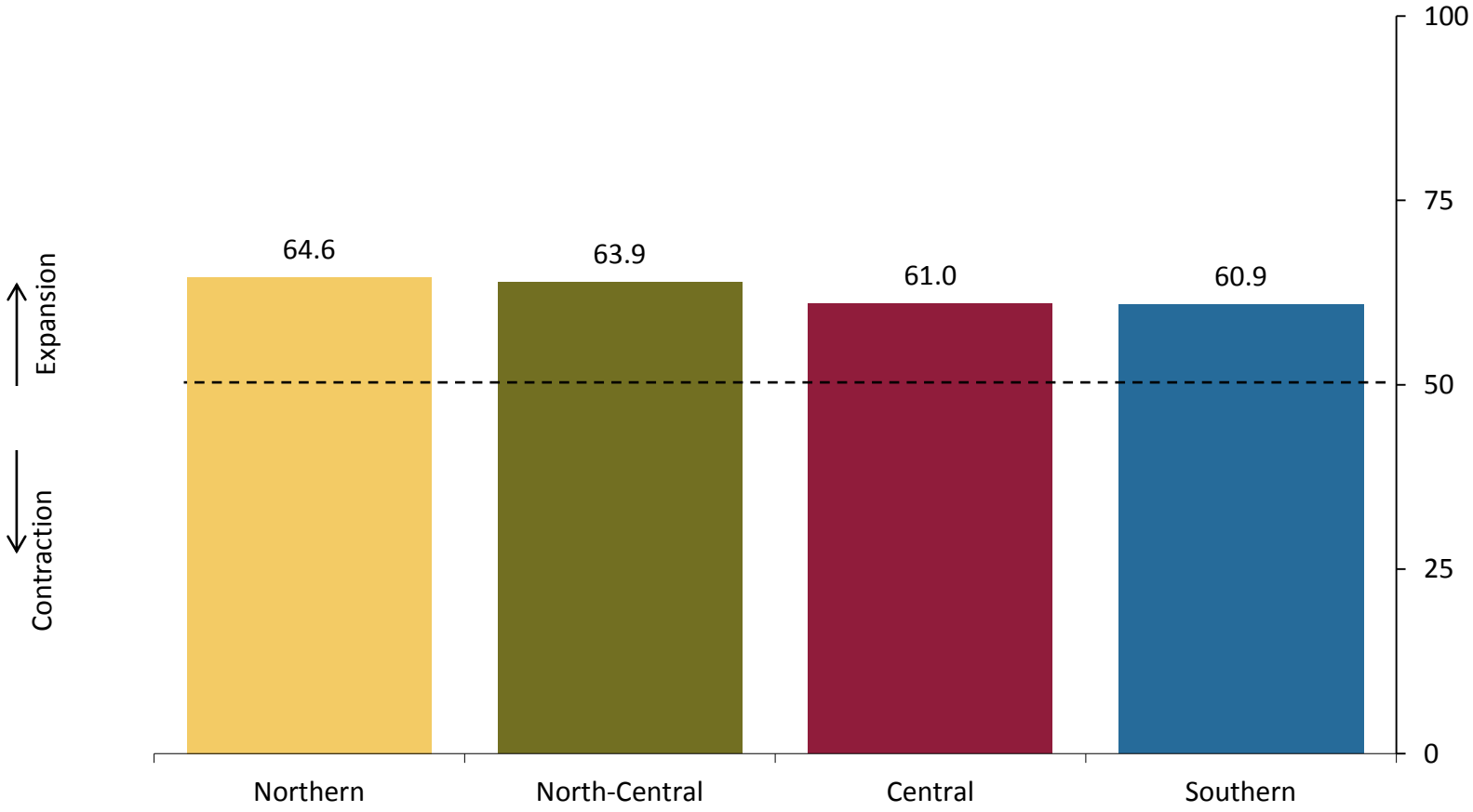
2/ Results obtained from responses to the question: "With respect to the situation in 3Q 2013, how do you expect the personnel hired by your firm to modify over the next 6 and 12 months?", from the interviews conducted by Banco de México between September 24 and October 25, 2013.

Source: Banco de México.

Economic Outlook

Physical Capital Stock as Expected by Business Agents for the Next 12 Months [1/]

Diffusion index



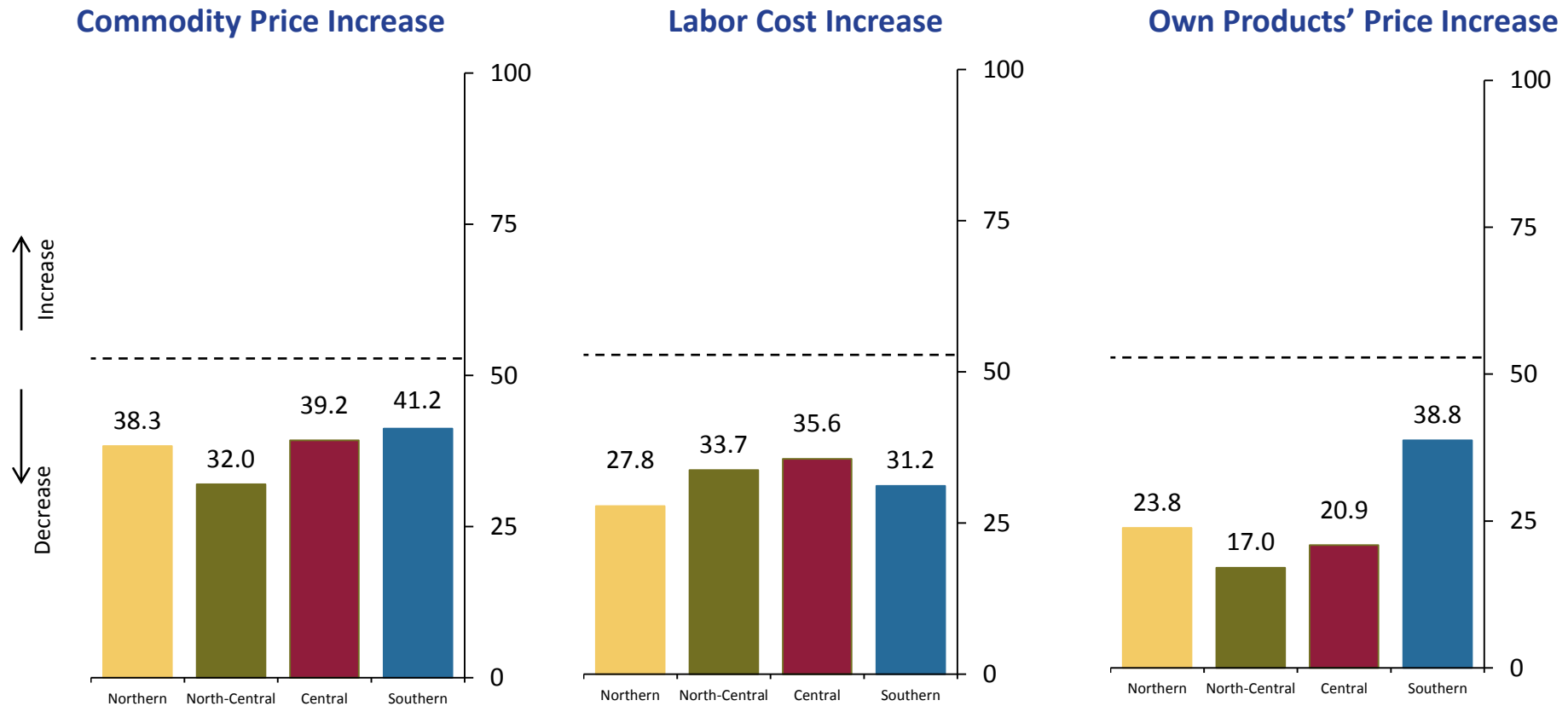
1/ Results obtained from responses to the question: "With respect to the situation in 3Q 2013, how do you expect your firm's physical capital stock to change over the next 12 months?", from the interviews conducted by Banco de México between September 24 and October 25, 2013.

Source: Banco de México.

Economic Outlook

Business Agents' Inflation Expectation, Next 6 Months [1/]

Diffusion index



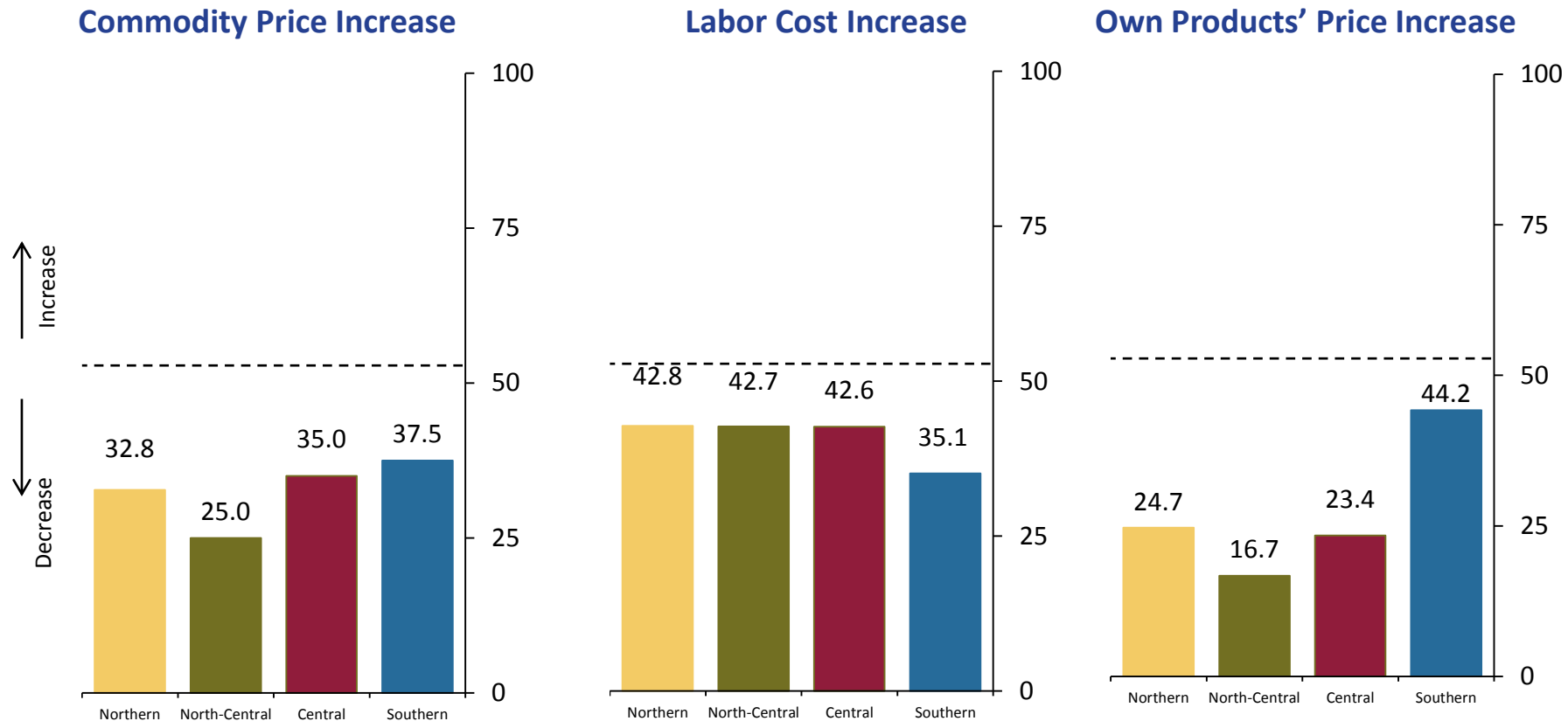
1/ Results obtained from responses to the questions: "With respect to the situation in 3Q 2013, do you expect any adjustment in commodity prices, labor costs and own products and services' prices over the next 6 months?", and "In comparison with the same period of last year, what magnitude of adjustment do you expect? Greater, same or lower?", from the interviews conducted by Banco de México between September 24 and October 25, 2013.

Source: Banco de México.

Economic Outlook

Business Agents' Inflation Expectation, Next 12 Months [1/]

Diffusion index



1/ Results obtained from responses to the questions: "With respect to the situation in 3Q 2013, do you expect any adjustment in commodity prices, labor costs 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 between September 24 and October 25, 2013.

Source: Banco de México.

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Final Considerations

Based on the analysis of the regional economic data and the business agents' opinions, the following stands out:

1. Economic activity observed an incipient recovery in all regional economies in 3Q 2013.
2. Annual headline inflation maintained a downward trend in 3Q 2013. In particular, it is noteworthy that core inflation registered minimum historical values.
3. Business agents interviewed by Banco de México for this Report anticipate a further recovery of the economic activity in their respective regions over the following 6 and 12 months.
4. As regards inflation expectations, business contacts anticipate no significant inflationary pressures in all regions in the referred time span.



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