

1. Summary

The slowdown in construction has continued with growth of 1.8%, closing 2016 with an increase of 4.2% in building and a decline of 9.4% in civil engineering. To explain the detail of the backlog in the civil engineering sub-sector, which represents a third of the GDP of construction, we have devoted a section to an in-depth look at the performance of infrastructure works. In view of the continuous adjustments to public expenditure, both the budgeted amounts and the number of projects carried out have decreased in this last decade. This trend could be altered by the implementation of the energy reform and the entry of private capital flows into the sub-sector, specifically through public-private partnerships.

In the mortgage market, the amount financed by banks increased by 1.7% in real terms at the end of the year, while the public institutes performed less placement in both real amounts and number of loans. Employment, the main explanatory variable for the demand for housing loans, grew at an annual rate of 4%, which was not enough to sustain the rate of mortgage generation in the face of lower wage growth and a loss of consumer confidence. On the other hand, the composition of the mortgage portfolio changed, with more loans in the middle-income and residential segments, as the credit limit was raised. Likewise, the lower budget for subsidies reduced the total amount granted and in parallel there was a contraction in the share of loans for social interest housing in the portfolio of public institutes.

The number of home construction projects declined compared to the previous two years. Inventories maintained the same trend, avoiding an accumulation of surpluses and producing only what the market could absorb. In addition, increases in the benchmark interest rate by the Bank of Mexico were transferred directly to interest rates on loans for residential construction. As a result, the bridging loan balance registered negative growth rates in the second half of the year, but the delinquency rate continued to fall to levels of between 7% and 8%.

In this area, we have devoted another section to a structural analysis of residential construction cycles, analysing the determining factors of housing supply, such as profit margins and the interest rate, as well as the impact of subsidies, which played a major role in recent years but are now returning to their long-term levels. Through an econometric estimation, we conclude that the margin between price and cost is the main driver of supply, as expected. By comparison, subsidies that should have had an effect only on the demand side had a positive influence on supply. This analysis complements the one conducted in previous issues of the **Mexico Real Estate Outlook**, characterising the sensitivity of housing demand with regard to its main determining factors.

Finally, the housing price index (SHF) reflected levels of appreciation of 8.4% in 2016 in the middle-income and residential segments and we expect that this increase will continue in 2017, but at a rate of around 6% per year. The mortgage market could grow less than the economy, or even remain stagnant for the first time in several years. However, the real estate sector is reacting efficiently to signals, allowing both the consumer and the investor to rethink their strategies and adjust to the new market conditions.

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