

CITY of  
SOUTH PADRE ISLAND  
ECONOMIC INDEX

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PREPARED FOR  
SOUTH PADRE ISLAND ECONOMIC DEVELOPMENT CORPORATION  
BY



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## EXECUTIVE SUMMARY

After outperforming other states when oil prices were high and rising, the economic growth of Texas, the nation's largest oil-producing state, has hit a soft patch and is slowing as oil is trading for less than half what it traded for two years ago. According to Moody's Analytics, some petroleum dependent states' economies, Alaska and North Dakota, have contracted and are in a recession. While others, Oklahoma and Louisiana are edging closer to a recession. After growing by 3.0 percent in 2015, Texas' real GDP is expected to slow to 1.6 percent in 2016. The resilience of the Texas economy is largely due to the strong gains the state is seeing outside of the energy sector. Texas employment grew an annualized 2.2 percent in October 2015 nearly matching the nation's 2.3 percent increase. Texas gained 21,800 jobs in October after adding 15,100 in September. Current Texas employment stands at 11.9 million, according to the Current Employment Statistics payroll survey.

The external and internal economic factors identified in previous reports are analyzed. External economic drivers indicate that the economies of Texas, the U.S. and Mexico will continue to grow in the short and medium term. The Conference Board Leading Economic indices for the U.S. and Mexico and the Federal Reserve Bank of Dallas Leading Economic index show that the U.S. will grow at 1.4 percent in 2016 and 1.9 percent in 2017. The economic outlook for Mexico is 3 percent growth in 2017.

South Padre Island's most important economic drivers – hospitality and tourism and real estate continue to improve. South Padre Island's Occupancy tax revenue grew modestly in spite of a decrease in visitors' spending. Current data show that the real estate sector in Texas and South Padre Island continues to improve. Average home sale prices for 2015 and 2016 have been trending upward. The real estate data also show continuous decline in month inventory since 2011.

In our previous report Aaron used tourism and hospitality data from Port Aransas Galveston and Texas as benchmarks to evaluate South Padre Island economic performance. Our analysis shows that the Island outperforms Port Aransas but is lagging Galveston and Texas.

The four performance indicators Aaron use to measure the Island's performance are expected to continue to show short and medium term overall annual growth with the marked disparities between peak and off-peak months to remain unchanged in the short term. The variability might change as the various economic development projects proposed are implemented; including Liquefied Natural Gas projects and various light and heavy manufacturing projects, Space X project, Matamoros maquila innovation center, and other proposed project at South Padre Island could help smooth out some of the off-season variability. Aaron also expect the variability in economic activity to improve as South Padre Island leadership continues to develop strategies to market and attract a different demographic during the off-peak months. The expected change in the four indicators will be around 2.3 percent for the occupancy tax revenue, between 2.55 and 5.39 percent for Sales Tax revenue, and between 1.63 and 3.76 percent for bank deposits. Building permits are expected to increase by between 3.21 and 5.43 between 2016 and 2018.

## 1. Introduction

In evaluating the 2017 economic performance of the city of South Padre Island, Texas Aaron kept 2007 as a base year for comparative consistency. In this report Aaron emphasizes the importance of hospitality and tourism, and real estate as fundamental economic drivers for South Padre Island as a premier tourist destination. The report is divided into two broad sections, an external factors section that addresses the external economic drivers and reports their forecasts, and an economic performance section that analyzes local performance indicators and provides a forecast for each indicator. As in previous reports, Aaron discusses the state of the economy in Texas, in the U.S, and in Mexico, three external macroeconomic factors that affect the economy of South Padre Island. Tourism as an export industry is dependent on overall economic condition of originating regions. South Padre Island economy is primarily dependent on the state of Texas' economy, and to a relatively lesser extent on those of the U.S. and Mexico. In previous reports Aaron stated that according to the Office of the Governor of Texas' tourism data show that the Texas contributes the largest share, approximately two thirds, of visitors to South Padre Island, and Mexico and the rest of the U.S. contribute the remaining one third. Aaron relies the Federal Reserve Bank of Dallas' Texas Leading Economic Index, and the Conference Board's Leading Economic Indices for the U.S., and Mexico, as comprehensive leading composite indices to forecast the economic outlook in each of these three originating areas. In addition, Aaron uses other external indicators to support information contained in the leading economic indices.

The second part of the report focuses on the city of South Padre Island, Texas' economic performance and forecasts. Key local economic indicators: occupancy tax, sales tax, building permits, bank deposits measure the economic performance of South Padre Island, and are used to forecast the economic performance for the following two years.

Economic performance reports provide important information to stakeholders about periodic economic performance of their city or region. They show if the economy of a city or region is expanding or contracting, whether the city's economic growth rates meets expected growth rates and if a city's tax revenues are stable. Economic performance reports provide the basis for setting sound economic planning decisions and economic objectives, tracking and benchmarking performances and progress, and identifying weak performing areas. In short, economic index reports can be valuable management and policy tools. They help identify opportunities and threats a community may face, and assess strengths and weaknesses in order to take advantage of identified opportunities and protect from threats by leveraging the community's strengths and mitigating its weaknesses. Economic performance reports measure the effectiveness of past policies and help in crafting effective economic development policies.

Aaron also compares the Island's economic performance to other Texas Gulf Coast destinations. Comparative analysis offers a useful way of benchmarking the Island's economic performance to those of Port Aransas, Galveston, and Texas. Benchmarking helps show if South Padre Island is under-performing, performing at the same level, or over performing Texas and other Texas Gulf Coast destinations.

## 2. Methodology and Data

Aaron kept the same approach used in previous reports when analyzing the South Padre Island's impact factors for ease of comparison across different years. Aaron used time series data provided by South Padre Island Economic Development Corporation (SPI-EDC) to analyze last year's performance and to identify trends and make the next two years forecasts. Aaron corrected for the effects of seasonality, and then deflated the data using the Consumer Price Index with 2007 as a base year to compute each performance factor's index. The percentage change computed for all indices are relative to base year 2007. An index of 90 indicates a 10

percent decline in that economic activity, whereas an index value of 110 shows a 10 percent increase of economic activity measured by the index.

To analyze the external factors Aaron obtained data from The Conference Board, the Federal Reserve Bank of Dallas, the Bureau of Labor Statistics, the U.S. Department of Commerce, Bureau of Economic Analysis, and [www.city-data.com](http://www.city-data.com), INEGI, Banco De Mexico. Local performance data was obtained from South Padre Island Economic Development Corporation (Occupancy Tax, Sales Tax, Bank Deposits, and Building Permits), Texas Department of Tourism, Texas A&M Real Estate Center, the National Association of Realtors, and the Federal Reserve Bank of Dallas. The data is for the period January 1994 to December 2015.

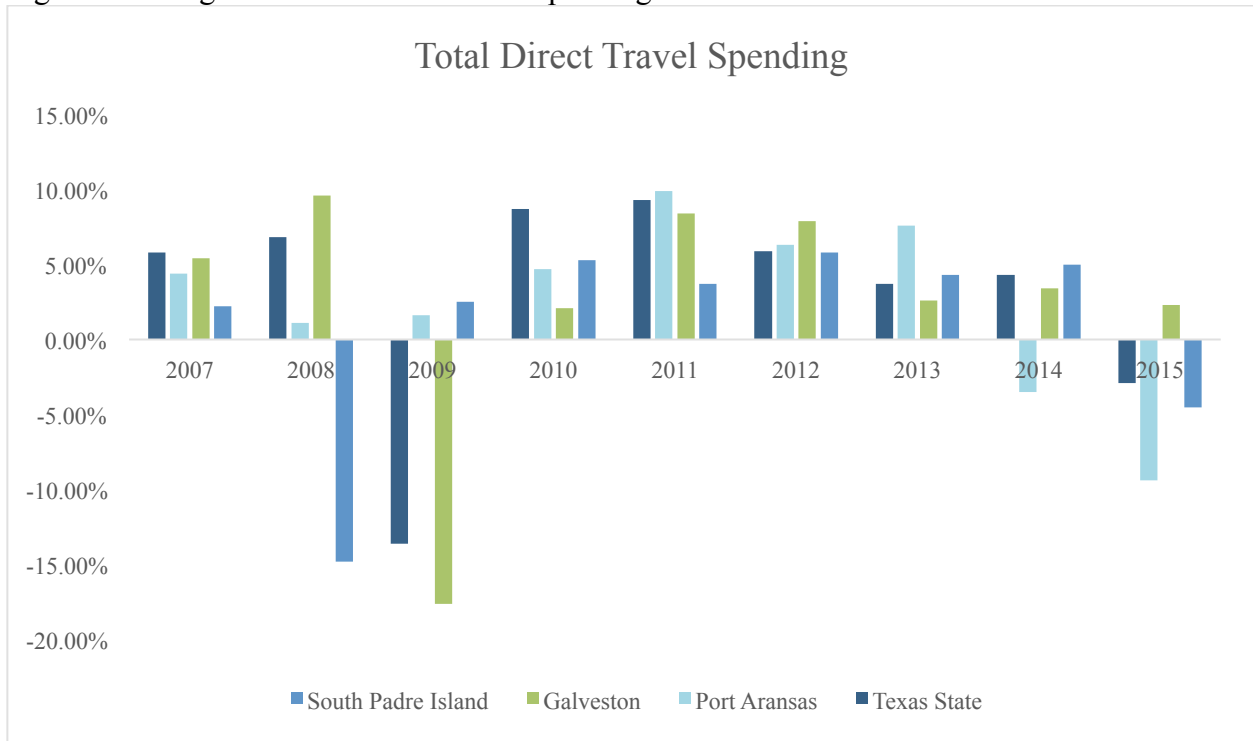
### 3. South Padre Island

#### *Total Direct Visitor Spending*

South Padre Island's total direct visitor spending declined by 4.5 percent in 2015. South Padre Island's total direct visitor spending grew for the sixth consecutive years before declining in 2015. The growth rate for 2014 is the highest growth rate in total direct visitors spending for all 4 destinations Port Aransas, Galveston, and Texas (-9.4%, 2.3%, and -2.9% respectively). South Padre Island total direct visitor spending increased from \$359million in 2014 to \$343 million in 2015. Total direct visitor spending is still above the pre-recession level of \$325 million in 2007.



Figure 1: Change in Total Direct Visitor Spending

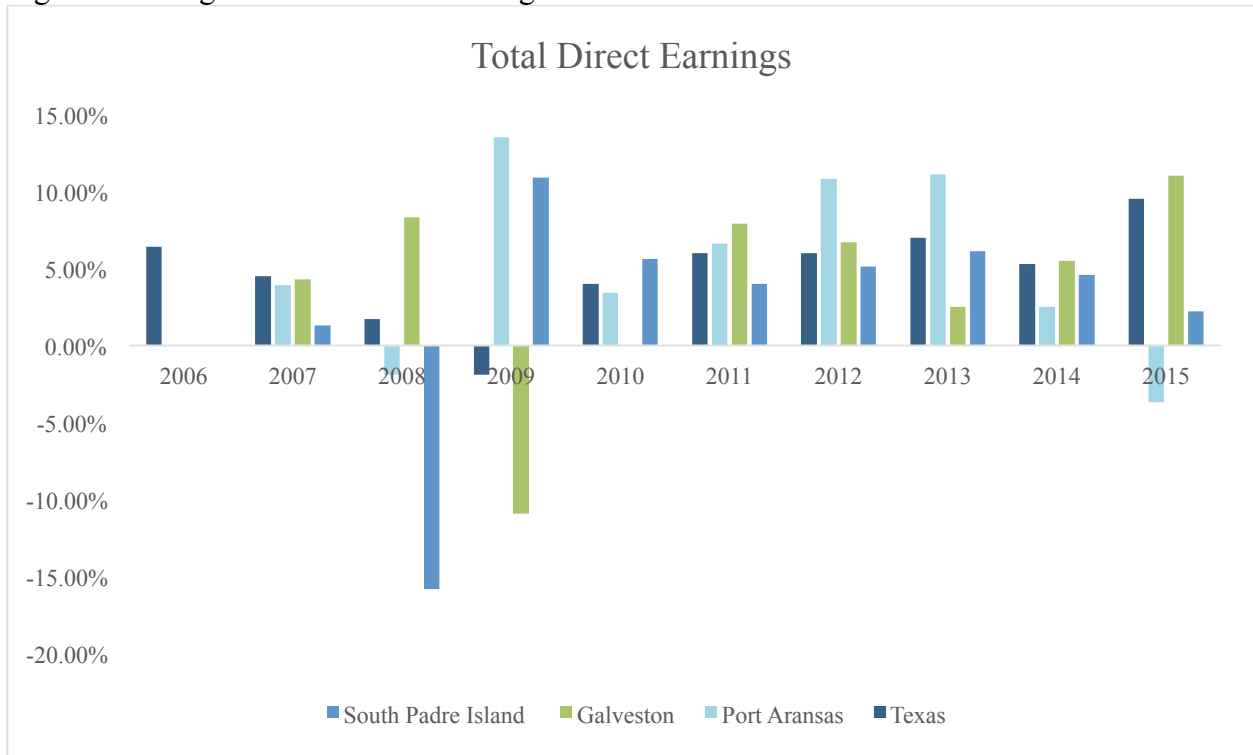


Source: Office of the Governor, Economic Development and Tourism

### *Total Direct Earning*

Total direct earnings in South Padre Island grew for the seventh consecutive year at an annual rate of 2.2 percent. Although, total direct spending declined in 2015, total direct earning grew in 2015. The Island’s total direct earning growth was the third trailing behind Galveston and Texas but ahead of Port Aransas. South Padre Island’s total direct earnings increased from \$91 million in 2014 to \$93 million in 2015. Figure 2 shows the change in total direct earning between 2006 and 2015.

Figure 2: Change in Total Direct Earning

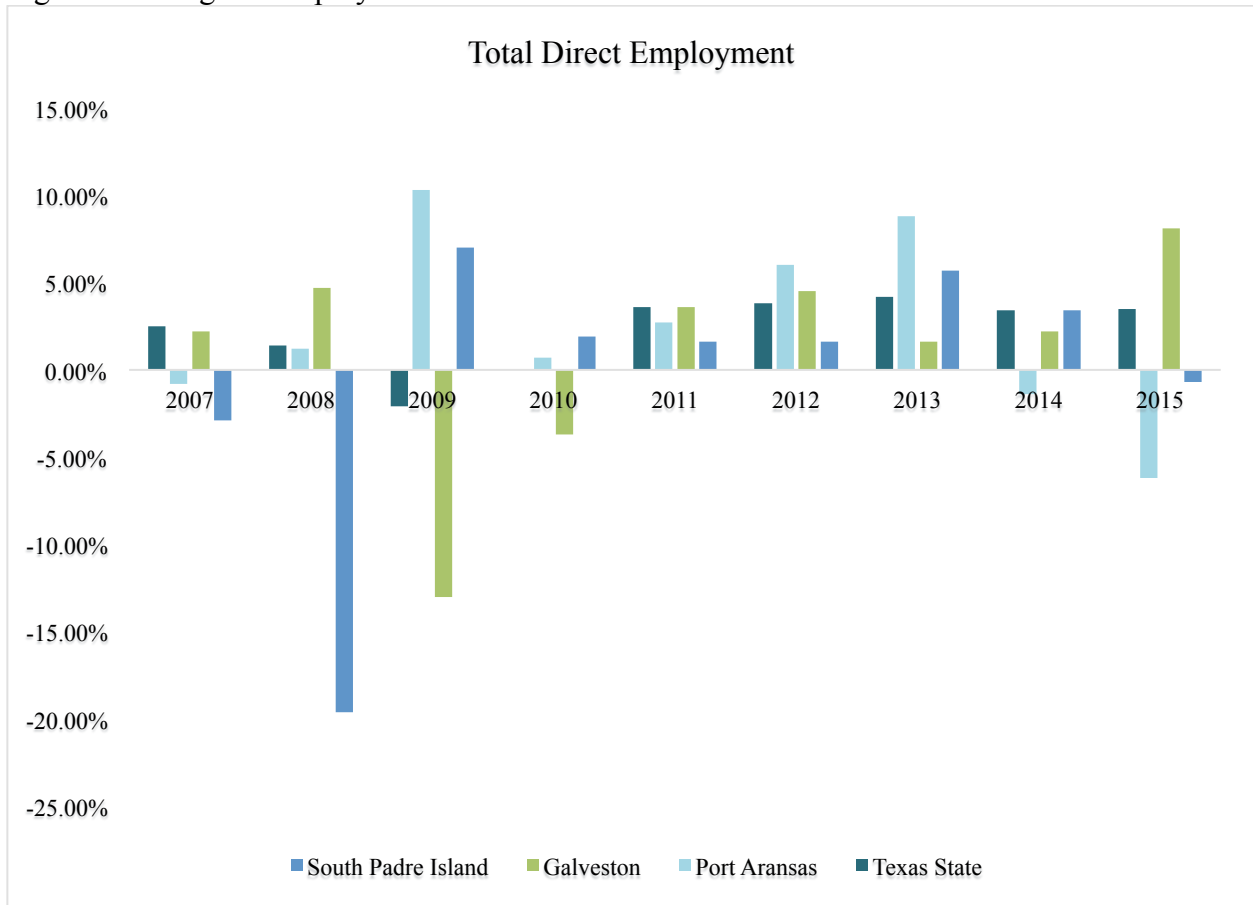


Source: Office of the Governor, Economic Development and Tourism

### *Annual Change in Employment*

Hospitality and Tourism employment in South Padre Island remains relatively unchanged between 2014 and 2015 with 4,200 jobs. Data from Dean Runyan Associates show that employment grew for six consecutive years from 2009 to 2014 and declined in 2015 by 0.7 percent. Employment in South Padre Island grew at a faster rate than in other Gulf Coast destinations between 2009 and 2014 but lagged behind Galveston and Texas. From 2013 to 2014 it grew by 3.2 percent at the Island, -1.5 percent in Port Aransas, 2.2 percent in Galveston, and 3.3 percent in Texas. From 2014 to 2015 employment declined by 0.7 percent at the Island, -6.2 percent in Port Aransas, and grew by 8.1 percent in Galveston, and 3.1 percent in Texas.

Figure 3: Change in Employment

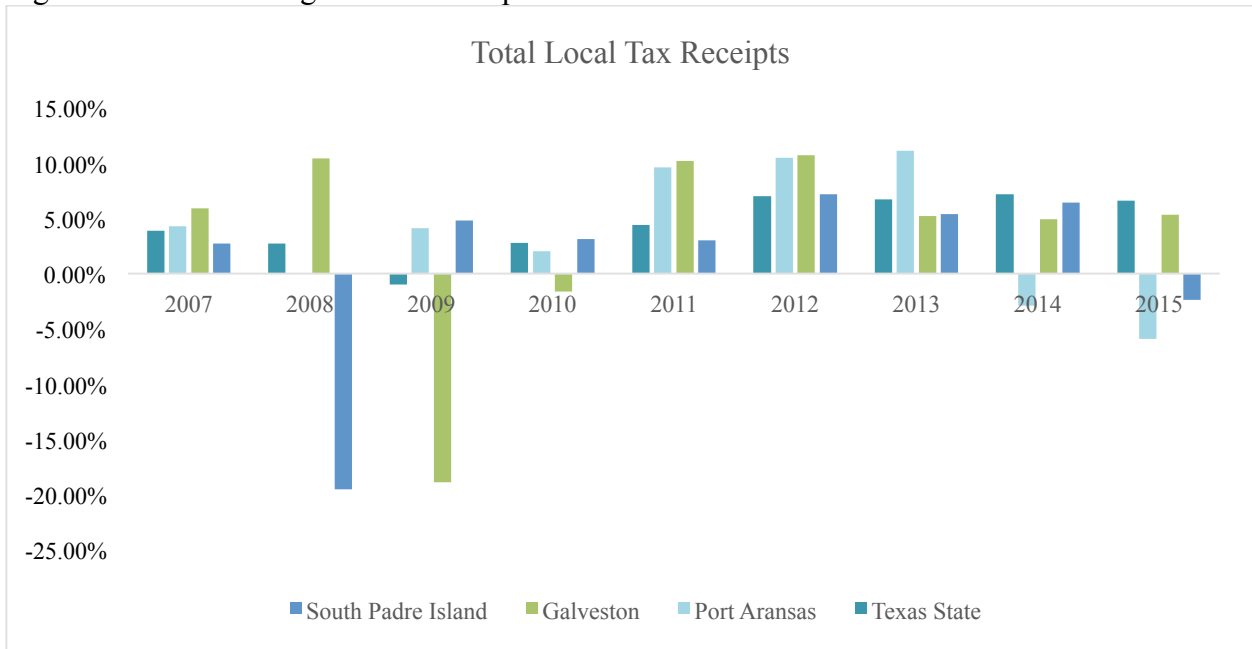


Source: Office of the Governor, Economic Development and Tourism

### *Annual Change in Tax Receipts*

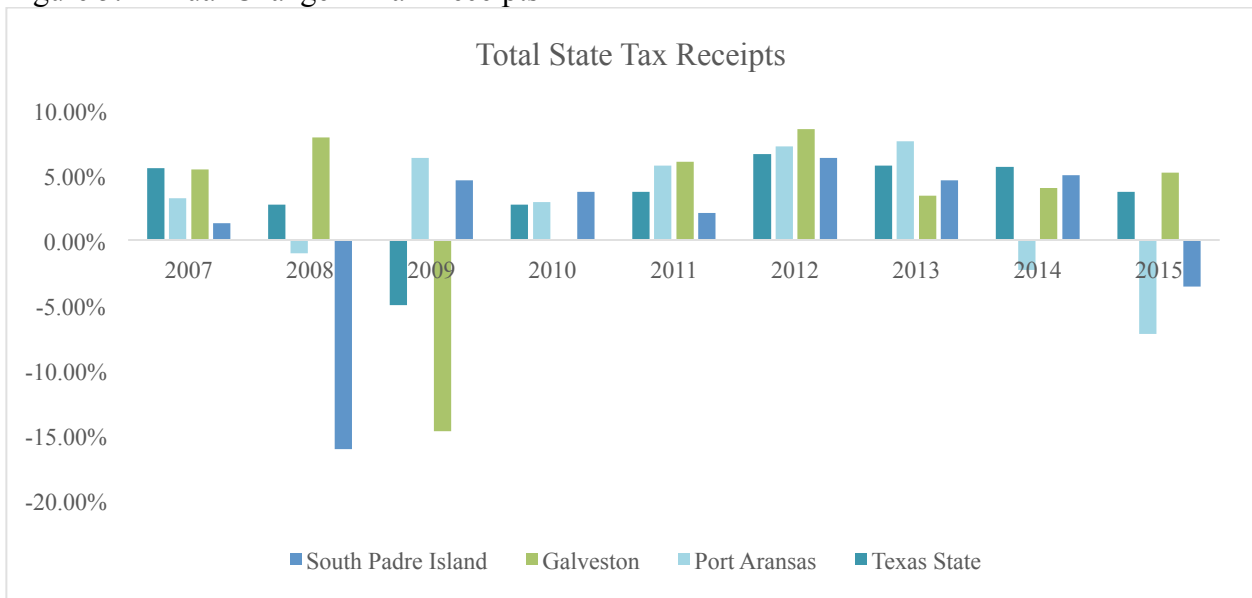
South Padre Island's tax receipts grew by 7.2 percent in 2012, 6.8 percent in 2013, and 6.3 percent in 2014 but declined in 2015 by 2.4 percent. Growth rates in tax receipts for the Island went from being the lowest in 2011 and 2012 at 4.5 percent and 7.2 percent, to the second highest in 2014 ahead of Port Aransas and Galveston but behind Texas. However, in 2015 they declined along with tax receipts in Port Aransas while those of Galveston and Texas increased.

Figure 4: Annual Change in Tax Receipts



Source: Office of the Governor, Economic Development and Tourism

Figure 5: Annual Change in Tax Receipts



Source: Office of the Governor, Economic Development and Tourism

## *Winter Texans*

Winter Texans are an important demographic for the Rio Grande Valley. Although, their contribution to the Island's city revenues is not significant, they are nevertheless an important and vital demographic for the Island property rental business during off-peak months. According to a 2012 study by the University of Texas Pan-American Winter Texans spent 11 percent less in 2013 than in 2009-2010. The study also found that Winter Texans are getting older with an average age of 71.2 in 2012 compared with 70 in 2010, 69.5 in 2008 and 68.7 in 2006. Furthermore, the study found that only 4 percent of Winter Texans were younger than 60 compared to nearly 10 percent in 2006. When comparing the average number of years respondents have been coming to the Rio Grande Valley the study shows that in 2012 the average number of years they have been coming to the Rio Grande Valley was 10.4 years up from 9.1 years in 2010 and 2008, and 8.8 years in 2006. These responses suggest that there may not be new Winter Texans coming to the Rio Grande Valley but the same Winter Texans are returning to the Rio Grande Valley year after year.

#### 4. South Padre Island's External Economic Drivers

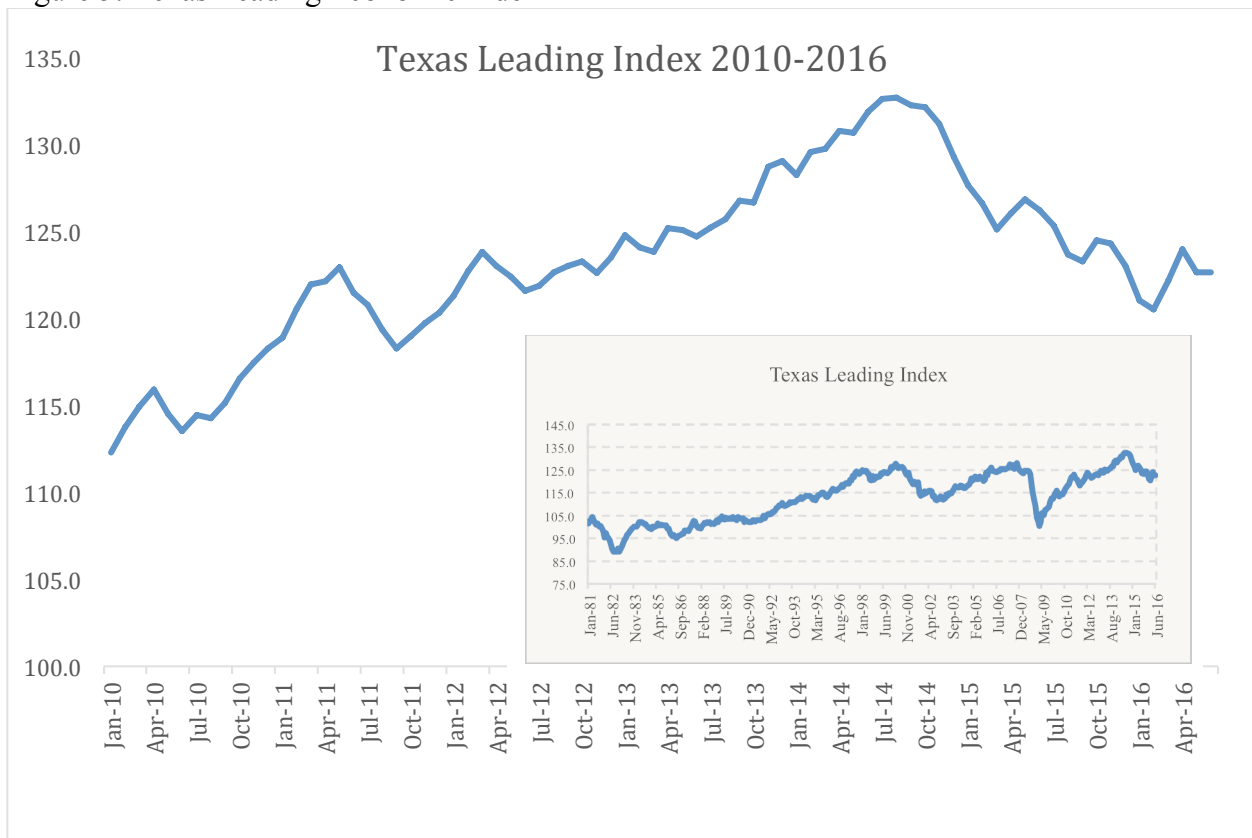
Leading economic indices are intended to predict future economic activity. Usually, three consecutive monthly changes in the Leading Economic Index (LEI) signal a possible change in economic activity, three months of negative LEI reading signals a possible recession. Leading economic indices are designed to signal business cycles peaks and troughs. They are basically composite weighted averages of several individual leading indicators that are constructed to indicate common changing patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components.

*STATE FACTORS*

*Texas Leading Economic Index*

The Texas Leading Index is composed of eight leading indicators that indicate potential future changes to the state's economic activity. The eight leading indicators that make up the index, are indicators that tend to precede change in the overall economy, thus signaling a possible change before it happens. The Texas Leading Index includes the Texas value of the dollar, U.S. leading index, real oil price, well permits, and initial claims for unemployment insurance, Texas stock index, help-wanted index and average weekly hours worked in manufacturing.

Figure 5: Texas Leading Economic Index



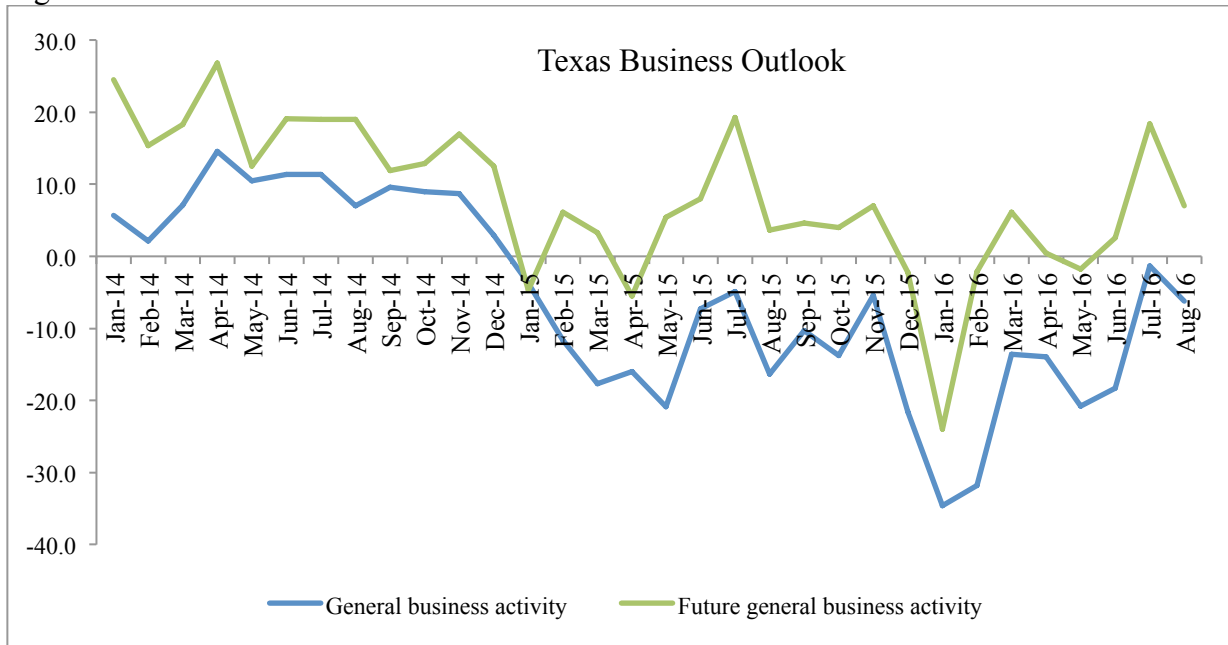
Source: Federal Reserve Bank of Dallas

Texas Leading Index in Figure 5 shows that while Texas' economy trended upward after the recession, the LEI shows that after August 2014 the trend reversed signaling a slowing economy. The Texas LEI indicates a moderate expected growth for Texas mainly due to falling oil and gas prices and a strengthening dollar. Although, the oil and gas related industries are important industries in Texas, the state economy is not overly reliant on the petroleum sector. In 2014 Texas economic growth was broad based across all sectors including energy, construction, business services, health care, and exports and tourism strong. Low oil prices and labor market tightness in 2015 has restrained growth while a strong dollar may have dampen exports leading to a slower growth rate.

Texas Leading Index rose by 1.83 percent in 2012, 2.58 percent in 2013, and 4.06 percent in 2014 and declined by 4.35 in 2015. The decline in the LEI were due to falling oil prices and rising unemployment claims but were mitigated somewhat by a pickup in the U.S. leading index and help-wanted advertising.

While October job growth exceeded expectations, the Texas employment forecast continues to predict slightly less than 1 percent growth during the last two months of 2015. At this rate, overall growth for 2015 would be 1.3 percent, still positive but far below the 3.6 percent gain seen in 2014. The Federal Reserve Bank of Dallas revised its employment growth forecast for 2016 from 1.3 percent to 0.5 percent. Lower energy prices and a steep increase in the value of the dollar remain the principal risk factor. Over 90 percent of exports from Texas are manufactured products. The increase in the value of the dollar since the middle of 2014 have weakened export and further declines in exports could spell more weakness for the manufacturing sector.

Figure 8: Texas Business Outlook



Source: Federal Reserve Bank of Dallas

### *Texas Manufacturing Outlook*

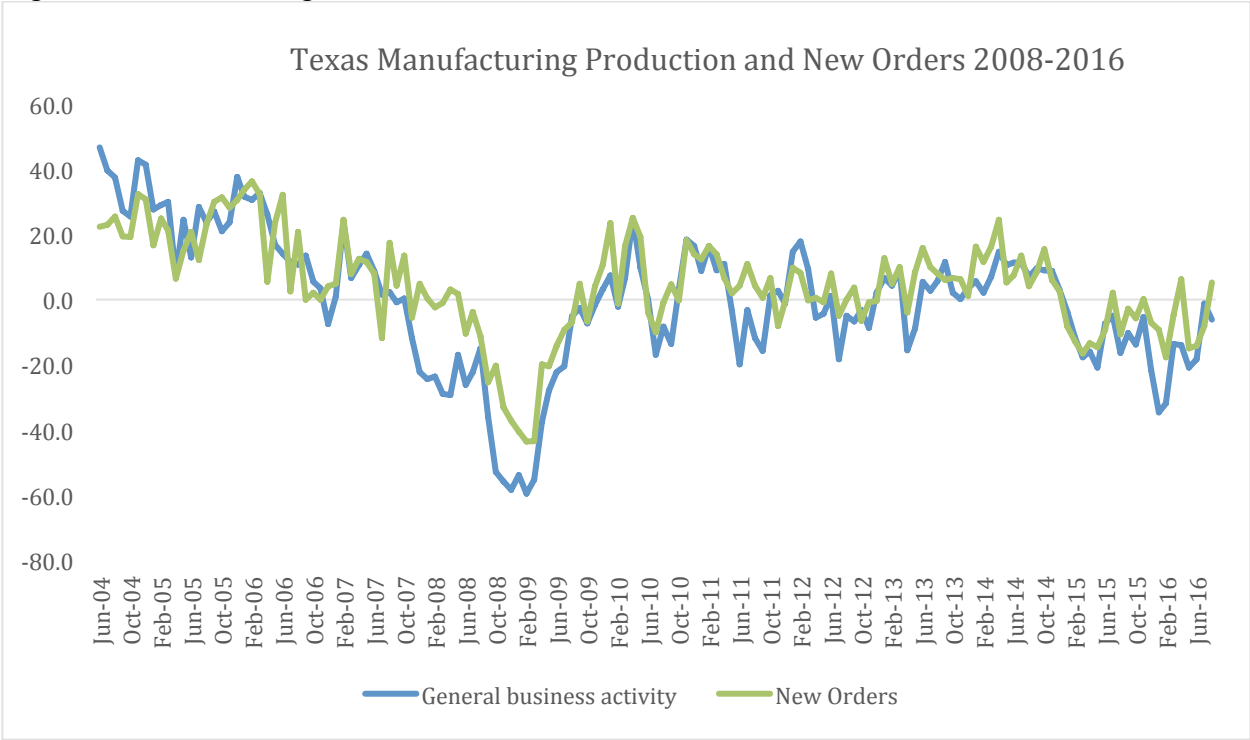
The Federal Reserve Bank of Dallas conducts the monthly Texas Manufacturing Outlook Survey (TMOS) to assess factory activity. The production index increased in June 2014 relative to the previous month but has declined towards the end of 2014 and early 2015. The new orders index also experienced a decline relative to the levels seen the previous year. According to business executives responding to the Texas Manufacturing Outlook Survey, Texas factory activity increased for a third month in a row in December 2015. The production index, a key measure of state manufacturing conditions, rose from 5.2 to 13.4, indicating stronger growth in output. Texas factory activity is expected to fall in January 2016, according to business executives responding to the Texas Manufacturing Outlook Survey.



The survey's demand measures showed continued weakness in spite of current manufacturing activity indices showing growth in December. The growth rate of orders index has been negative for more than a year and dipped 7 points to -14.3 this month. Meanwhile, the capacity utilization and shipments indices posted their fourth positive readings in a row and inched up to 7.8 and 7.6, respectively.

Perceptions of broader business conditions weakened markedly in December. The general business activity index has been negative throughout 2015 and plunged to -20.1.

Figure 5: Texas Leading Economic Index

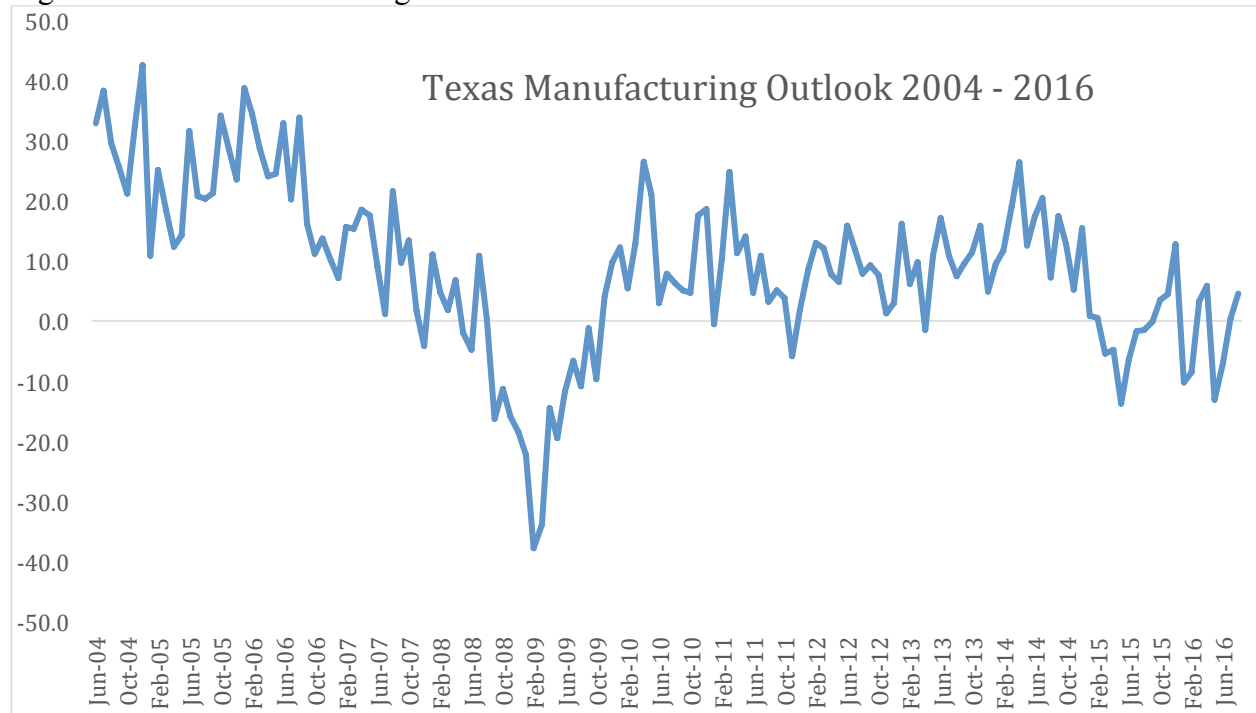


Source: Federal Reserve Bank of Dallas

Manufacturing activity increased for 8 consecutive months from May 2015 to December 2015 before declining in January 2016 because of a drop in future orders in 2015. Manufacturing activity during the first two quarters of 2016 followed a seesaw pattern, decreasing in January,

increasing in February and March before dropping again in April and May, and increasing again in June, July and August.

Figure 7: Texas Manufacturing



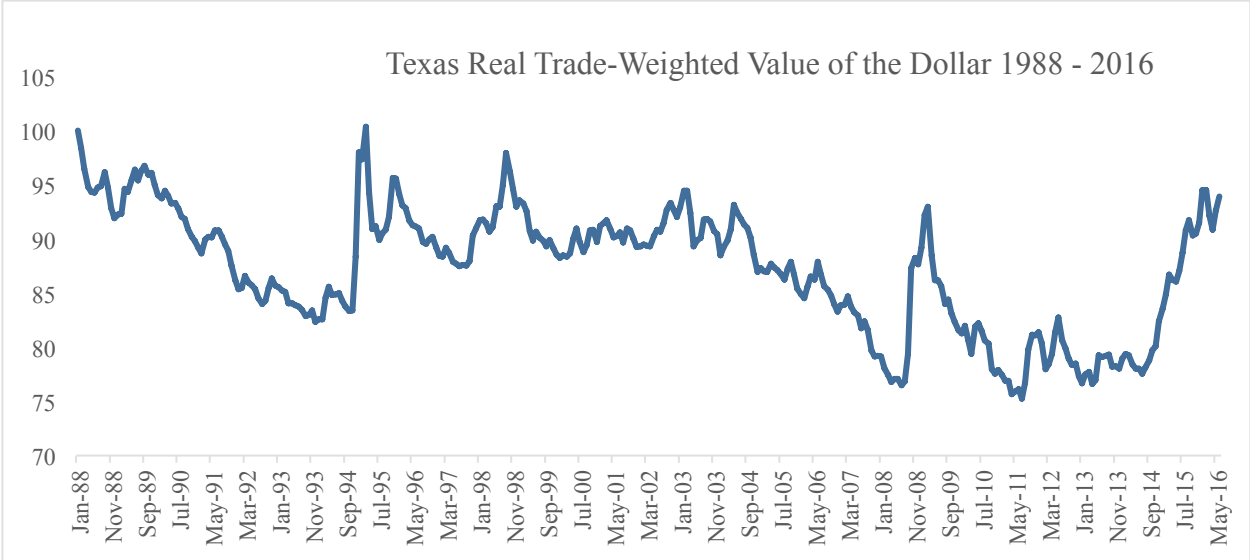
Source: Federal Reserve Bank of Dallas

### *Texas Value of the Dollar*

The Texas Value of the Dollar (TXVD) is an effective exchange rate index that assigns a fixed weight based on the size of each country’s exports history with Texas. The TXVD index includes data from 48 countries with each country assigned an index weight based on that country’s importance as a Texas trading partner. Mexico, Texas’ largest trading partner, is assigned an index’s weight of 35.9 percent. Changes in the value of the Mexican peso affect the TXVD more than changes in the currencies of any other single trading partner.

The TXVD is inversely related to the Texas Leading Index. An increase in the value of the index indicates that Texas exports are more expensive, and results in an increase in the volume of Texas exports. Conversely a decrease in the value of the index indicates that Texas exports are less expensive, and leads to an increase in the volume of Texas exports. The TXVD is the Texas equivalent of the U.S. Trade-weighted Value of the Dollar (TWVD).

Figure 8: Texas Value of Dollar



Source: Federal Reserve Bank of Dallas

The Federal Reserve Bank of Dallas trade-weighted value of the dollar (TWVD) historical data show that the TWVD increased 18.24% from its post-recession low on July, 2013, to July, 2016.

The strengthening of the U.S. dollar has two effect: 1- A strong dollar tends to make the foreign price of Texas products higher, as for foreign consumers must convert greater amounts of their currency to get the same value in dollars. 2- Consequently a strong dollar tends to lower the domestic price of imported goods in the United States, since American consumers need fewer dollars to pay for the same amount of goods or services.

Figure 8 maps historical data of TWVD. TWVD appreciation makes Texas' exports and destinations relatively more expensive to international importers and visitors. This appreciation of the dollar relative to the value of Texas' trading partners' currencies hinders the competitiveness of Texas and in general reduces Texas exports, including tourism, and increases Texas foreign imports. These effects and the decreased purchasing power of these currencies in the U.S. should have a relatively smaller trickledown effect on the economy of South Padre Island.

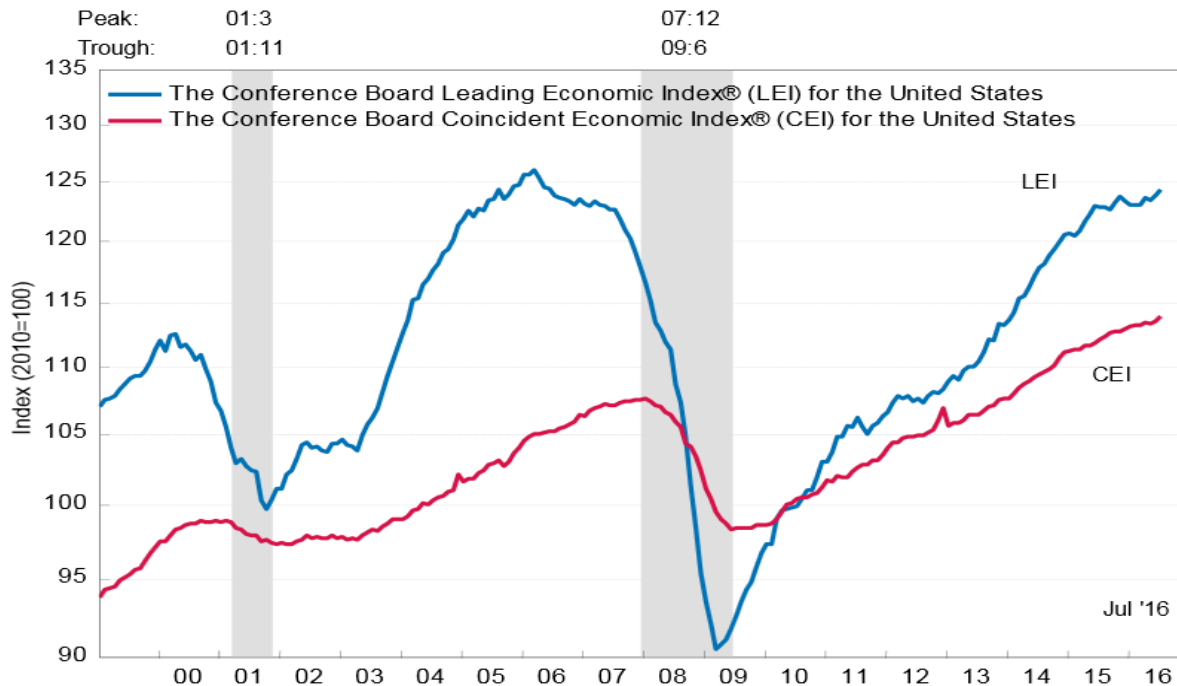
### *NATIONAL FACTORS*

#### *U.S. Leading Economic Index*

The conference board LEI for the U.S. increased 0.5 percent in November to 124.6 using 2010 as a base year (2010=100), following a 0.6 percent increase in October, and no change in September. The U.S. LEI increase in November was due to an increase in building permits, the interest rate spread, and improving stock prices.

The LEI declined 0.3 percent in December 2015 to 123.7, following a 0.5 percent increase in both November and October. It declined by 0.2 percent in January to 123.2. The LEI increased in February, March and April by 0.1, 0.2, and 0.6 percent respectively. The economic outlook for the 2016 remains positive.

Figure 9: U.S. Leading Economic Index



Source: The Conference Board

## MEXICAN FACTORS

### *Mexico Leading Economic Index*

The 2015 Conference Board LEI for Mexico increased in October, and September was revised to a gain. Stock prices, the real exchange rate, and oil prices made the largest positive contributions to the index in October. Despite the gain, the leading economic index declined 2.9 percent an annualized rate of  $-5.8$  percent between April and October 2015. Moreover, the weaknesses among the leading indicators have remained more widespread than the strengths in recent months.

The Conference Board CEI for Mexico, a measure of current economic activity, improved slightly again in October. The coincident economic index increased 1.7 percent or an annualized

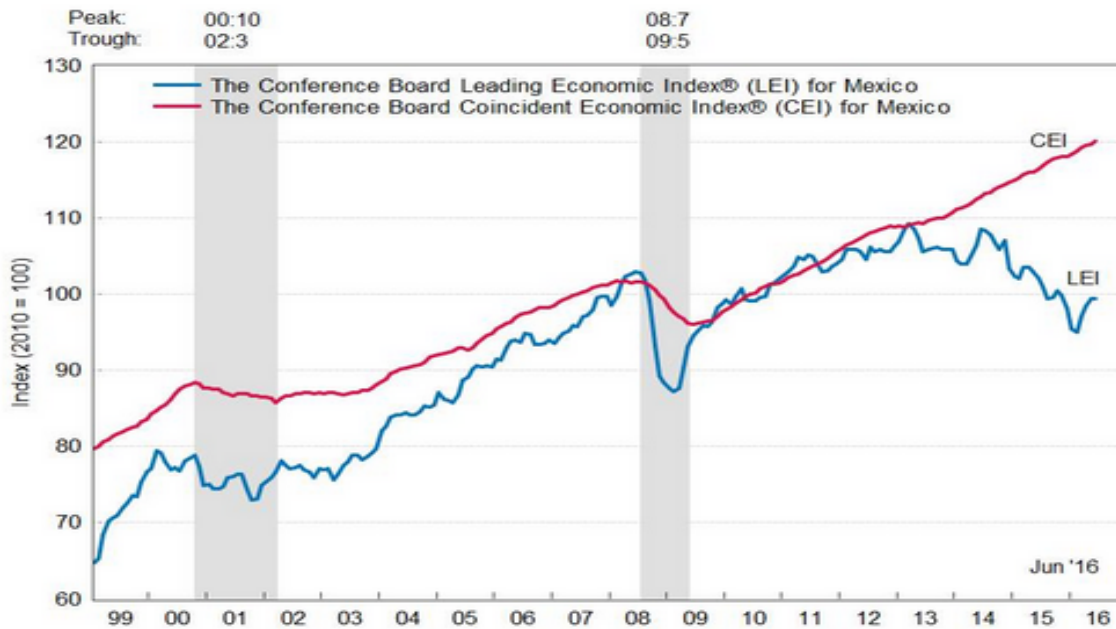
rate of 3.5 percent between April and October 2015, marginally faster than its growth of 1.6 percent over the previous six months. Meanwhile, real GDP expanded by 3.0 percent in the third quarter of 2015, up from 2.5 percent in the second quarter.

The LEI for Mexico increased in October for a second consecutive month. At the same time, the CEI continues to grow at a relatively steady pace. Despite the small improvements in both the LEI and CEI, the persistent weaknesses among the leading indicators over the last six months continue to suggest that Mexico's rate of economic expansion is unlikely to pick up in coming months.

Mexico's LEI aggregates the following indicators: employment trend in manufacturing sector, non-oil exports, Mexican stock exchange index in real terms, real exchange rate, the interbank interest rate, Standard & Poor's 500. The index uses 2008 as a base year with a value of 100.

Economic activity in Mexico rose 2.2 percent between June 2015 and June 2016. The growth was mainly driven by agriculture with 15.1 percent growth rate, followed by manufacturing 2.6 percent and services 0.3 percent. On a monthly basis, the index went up 0.6 percent. LEI in Mexico averaged 2.60 percent from 1994 until 2016, reaching an all time high of 11.65 percent in October of 1996 and a record low of -9.51 percent in April of 2009. However, Mexico's economic activity slowed in the second quarter, as expected. Mexico's GDP estimate for the first part of 2016 shows that GDP increased 2.4% year-on-year in the second quarter but on a quarterly basis it contracted a seasonally-adjusted 0.3%, which suggests a sharper economic deterioration.

Figure 10: Mexico Leading Economic Index



Source: The Conference Board

### *Exchange Rates Mexican Peso to Dollar*

The Mexican peso's exchange rate to the U.S. dollar was relatively stable against the U.S. dollar trading between 12 and less than 14 pesos per dollar. However, the peso has lost 47.5 percent of its value against the dollar between January 2014 and September 2016. After January 2015, the depreciation rate of the peso relative to the dollar accelerated averaging 16.5 pesos per dollar in August, up from 15.9 pesos in July. The current exchange rate between the peso and the dollar is over 19 pesos per dollar. The widening exchange rate means it has become nearly twice as expensive for Mexicans to travel to the U.S. or buy U.S. goods.

The Mexican peso was one of the hardest-hit currencies in the emerging markets especially when Mexico's economy did not show any real signs of weakness. The Mexican economy grew at a 2.5% annual rate in 2015 compared with 1% annual growth rate for the rest of Latin America. The Organization for Economic Co-operation and Development (OECD) is

forecasting real GDP growth in excess of 3% in both 2016 and 2017, while the International Monetary Fund (IMF) is growth forecast for Mexico is 2.6% for 2016.

On February 17, Mexico's central bank, Banco de Mexico, introduced measures to stop the devaluation of the peso relative to the dollar. Banco de Mexico raised the country's interest rates by 100 basis points and announced that it would begin to sell American dollars directly to buyers in the marketplace.

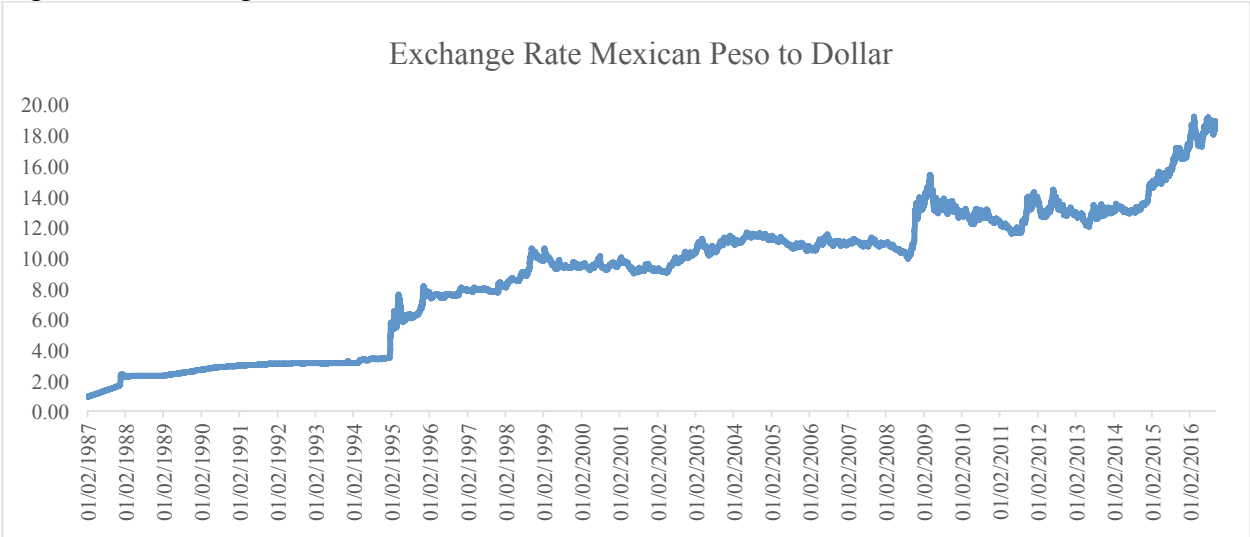
More than a depreciation of the peso, what has happened is an increase in volatility of international financial markets and an appreciation of the dollar versus a number of other currencies, due to the recovery of the U.S. economy following the great recession and the resulting changes in monetary policy. In addition, more investors seeking higher interest rates in the U.S. are demanding U.S. dollars and pushing the value of the dollar up relative to other currencies. Also the risk level for Mexico and other countries whose budgets are highly dependent on oil revenues continues to grow as a result of the decline in the price of crude.

Moreover, the Mexican peso is the most highly traded currency in emerging markets. The current depreciation of the peso is also due to the fact that it is often used as a hedge when currency markets are very volatile. International investors prefer to use the peso for protection, because it is traded twenty-four hours a day, five days a week, which make it more exposed to the ups and downs when markets are highly volatile.

The depreciation of the Mexican peso makes Mexican exports more competitive in its main market, principally the U.S., and it makes Mexico more attractive as an investment destination. At first glance, Mexico stands to benefit from the dynamics in global currency markets at the present time. However, more currency weakness in China would eliminate part of the Mexican gains because Mexico competes directly with China for exports of similar commodities to the U.S. market.



Figure 11: Exchange Rates Mexican Peso to Dollar



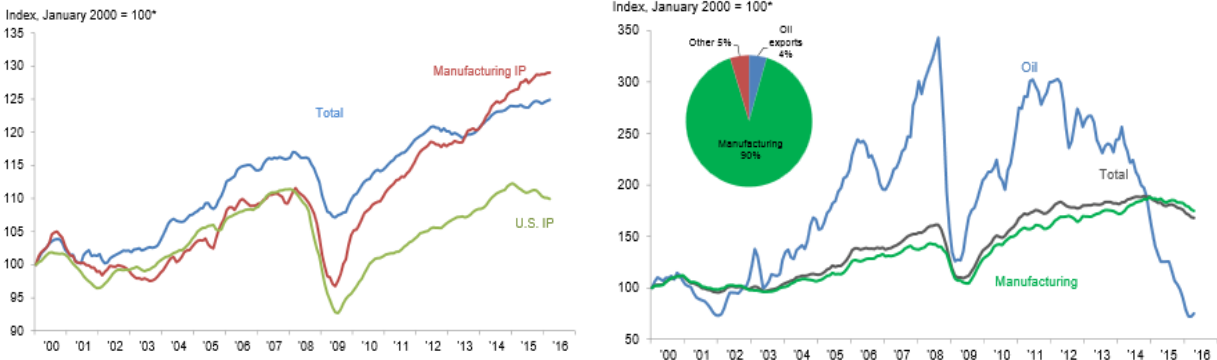
Source: Banco de Mexico

Despite Mexico's optimistic economic outlook of a growth rate more than double that of the United States high volatility and general panic brought the peso to lows against the dollar comparable to those of 1994 when the peso was devalued and traded for 20 pesos per dollar. The U.S. is Mexico's largest trade partner and Mexico is the U.S.'s third largest trade partner. So the dollar to peso relationship is critical to both countries. South Padre Island's economy will benefit from a stronger U.S. economy. However, the large depreciation of the Mexican peso would make visits to the Island by Mexican nationals almost twice as expensive compared to two years ago. In addition, the depreciation of the peso would make Mexican goods significantly cheaper relative to American and Texas made goods, which would result in an increase in Mexican imports and a decrease of U.S. and Texas exports to Mexico. Mexico's business climate has improved significantly over the last two years as a result of important reforms that the country, including reforms that address environmental problems and foreign investment in the energy sector. Consequently, both domestic and international investments are picking up, and manufacturing activity is gradually accelerating, supporting a robust formal job market, boosting

household incomes and consumption growth. Mexico’s real GDP grew by 2.3% in 2015, and is projected to grow in excess of 3% in both 2016 and 2017.

Mexico’s industrial production has recorded three positive readings in 2016 in the first four months on a year-on-year basis. However, the output growth has been declining since then. March experienced the slowest growth as all the major sectors of industrial output declined. As a result, industrial output expansion is growing very slowly as compared to the second half of 2015. IP is not expected to contract especially if exports grow stronger. However IP growth in 2016 is expected to be meek relative to 2015.

Figure 12: U.S. and Mexico Manufacturing IP



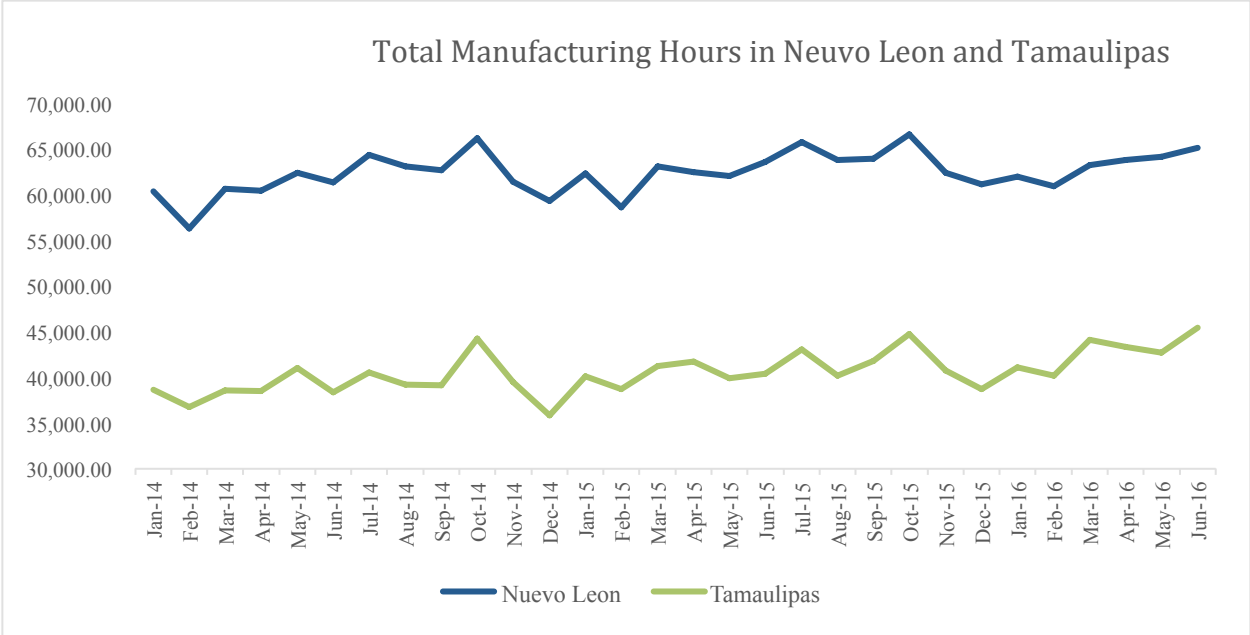
Sources: INEGI (Instituto Nacional de Estadística Geografía e Informática) and Federal Reserve Board

*Nuevo-Leon, Tamaulipas Manufacturing Employment*

Mexico continues to experience success in attracting foreign manufacturing and expanding its industrial capacities and capabilities especially in the interior of the country. Changes in maquiladora employment and hours worked are important indicators of economic health in Nuevo Leon and Tamaulipas, Mexico. Increasing employment levels and number of working hours in the maquiladora has positive externalities on the economies of Texas border cities.

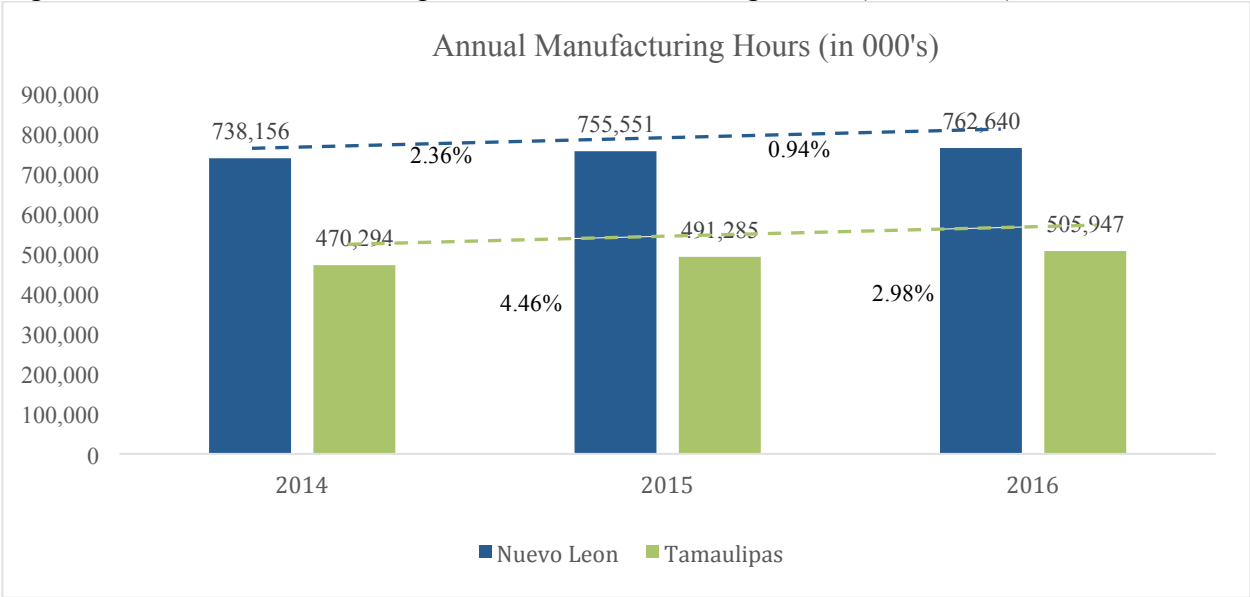
In the states of Nuevo Leon, and Tamaulipas, Mexico the formal-sector employment in manufacturing, jobs with government benefits and pensions, rose at an annualized rate of 2.65 percent in Nuevo Leon and 4.86 in Tamaulipas between January 2014 and December 2015. Year to date, employment is up an annualized 0.66 percent in Nuevo Leon and 1.89 percent in Tamaulipas.

Figure 13: Nuevo Leon-Tamaulipas Monthly Manufacturing Hours (2013-2015)



Sources: INEGI (Instituto Nacional de Estadística Geografía e Informática)

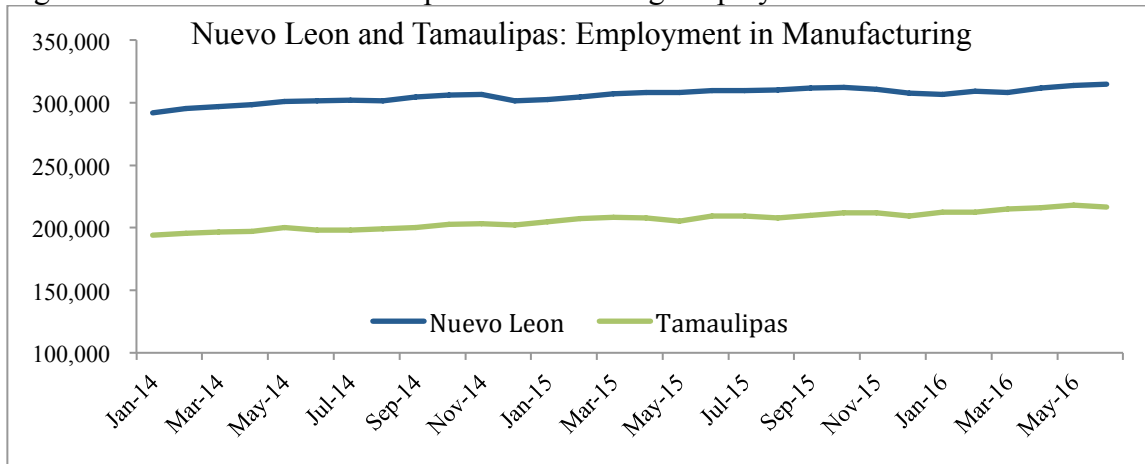
Figure 14: Nuevo Leon-Tamaulipas Annual Manufacturing Hours (2013-2015)



Sources: INEGI (Instituto Nacional de Estadística Geografía e Informática)

In our previous report Aaron selected the states of Nuevo Leon and Tamaulipas because of their immediate proximity and the strong economic, historic, and cultural ties to our area. Figures 13 14 and 15 show that the level of manufacturing employment has increased. Between 2014 and 2015 annual manufacturing hours increased by 2.36 percent in Nuevo Leon and 4.46 percent in Tamaulipas, and by 0.94 percent in Nuevo Leon and 2.98 percent in Tamaulipas between 2015 and 2016.

Figure 15: Nuevo Leon-Tamaulipas Manufacturing Employment



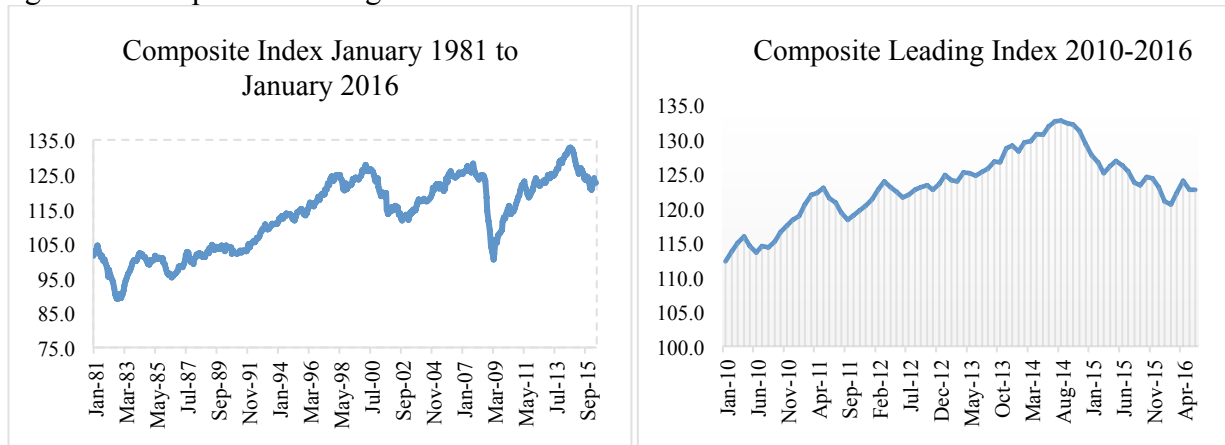
Source: INEGI (Instituto Nacional de Estadística Geografía e Informática)

### *COMPOSITE LEADING ECONOMIC INDEX*

Aaron computes the composite leading economic index using the weighted combined of the three leading economic indexes, U.S., Mexico, and Texas. Although the three LEIs forecast changes of three different economies, the economy of Texas has the biggest impact on the City of South Padre Island. The Island’s economic activity contracts and expands at rates closer to those of Texas.

Texas’ Leading Economic Index influences the shape of the composite leading economic index. Figure 15 shows a downturn in the composite LEI starting in the third quarter 2014 signaling another round of deterioration from the recent fall in oil prices, although the slippage is smaller than it was earlier this year. Exports are down year over year, and the strengthening of the U.S. dollar and some global uncertainty pose additional downside risks to the U.S. and Texas economies. However, the positive outlook for Mexico’s economy and both the U.S. and Texas still adding jobs, indicates that there will be positive and perhaps moderate growth for the coming year.

Figure 15 Composite Leading Economic Index



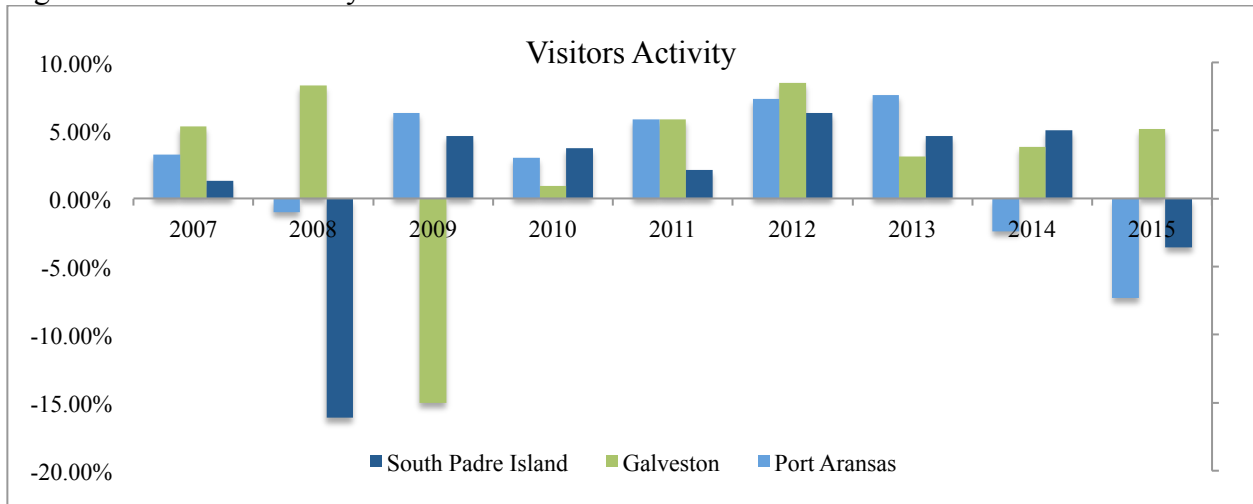
Source: Federal Reserve Bank of Dallas, Conference Board, INEGI (Instituto Nacional de Estadística Geografía e Informática)

## 5. South Padre Island - Internal Factors

Aaron uses current and historical data to analyze South Padre Island’s current economic performance. The analysis identifies trends forecasts economic changes for the next two years. The report also includes comparative data and figures from Port Aransas and Galveston to benchmark South Padre Island’s performance.

Aaron standardized the data and created indices that remove the impact of size of each economy to be able to measure the economic performance of cities of different sizes. Figure 16 show that South Padre Island outperformed both Port Aransas and Galveston in 2014 but lagged Galveston in 2015. South Padre Island’s visitors’ activity declined in 2015 by 3.60 percent.

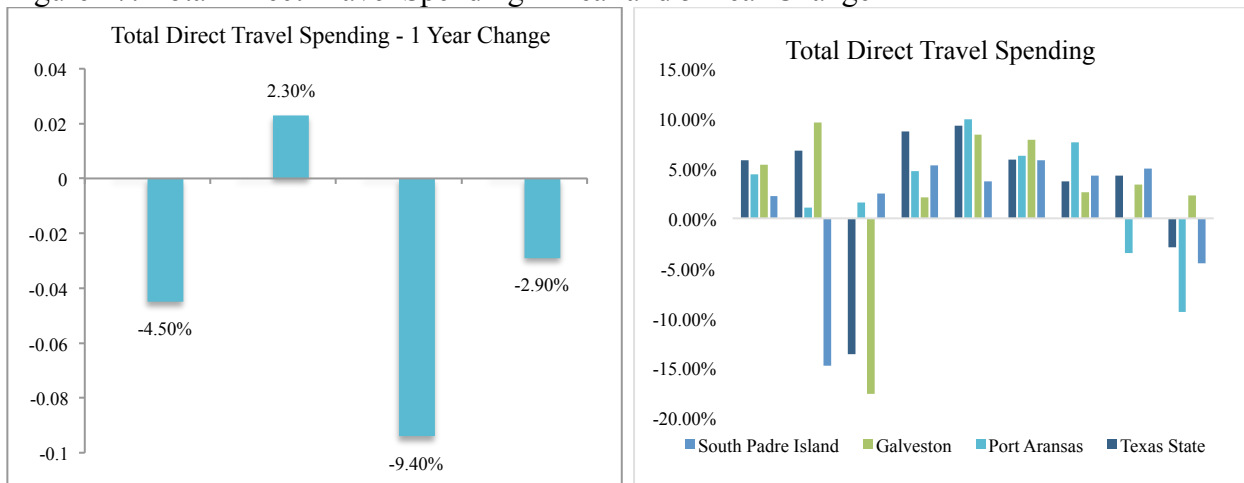
Figure 16: Visitors Activity in South Padre Island - Port Aransas - Galveston



Source: Texas Destinations, Office of Governor, Economic Development Tourism Division

Figure 17 shows that in 2015 South Padre Island’s visitor spending decreased at 4.50 percent only Port Aransas fared worse with a decline of 9.40 percent, Texas visitor spending declined by 2.90 percent, while Galveston’s increased by 2.30 percent. Figure 17 also shows the 5 year change in total direct visitor spending. The five years data in Figure 17 shows that South Padre Island experienced a relatively stable and constant growth over five of the last six years.

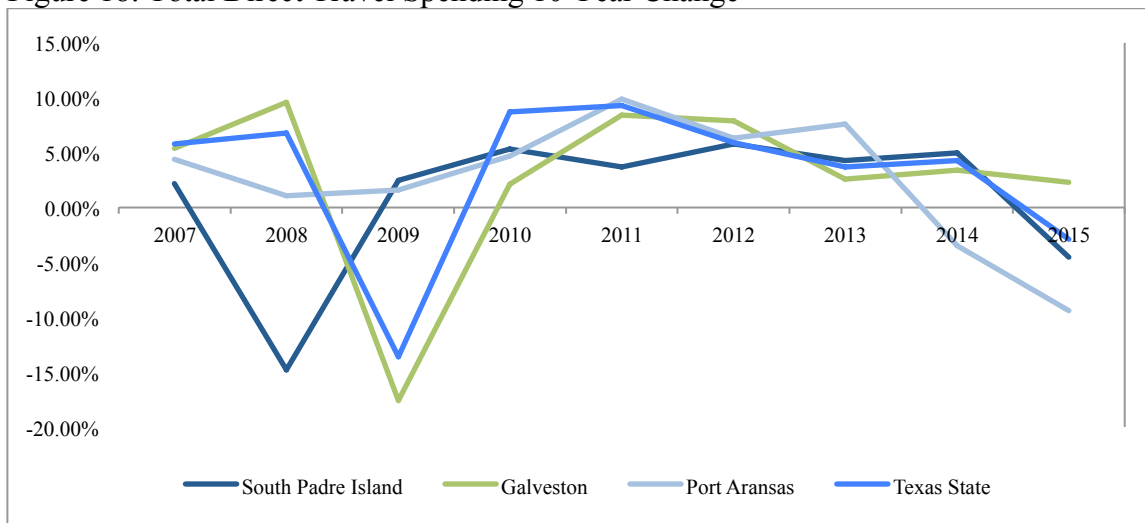
Figure 17: Total Direct Travel Spending 1 Year and 5 Year Change



Source: Texas Destinations, Office of Governor, Economic Development Tourism Division

Figure 18 shows visitor spending change over a 10 year period. The sharp drop in the data for the Island in 2008 (hurricane Dolly and recession) preceded drops for the other regions in 2009 (recession). Figure 18 shows comparable overall growth to Texas and other tourists destination on Texas Gulf Coast but with less growth volatility. After 2009 the growth rate of South Padre Island was stable around 5 percent annually between 2009 and 2014 and declined in 2015.

Figure 18: Total Direct Travel Spending 10 Year Change



Source: Texas Destinations 2002-2011, Office of Governor, Economic Development Tourism Division

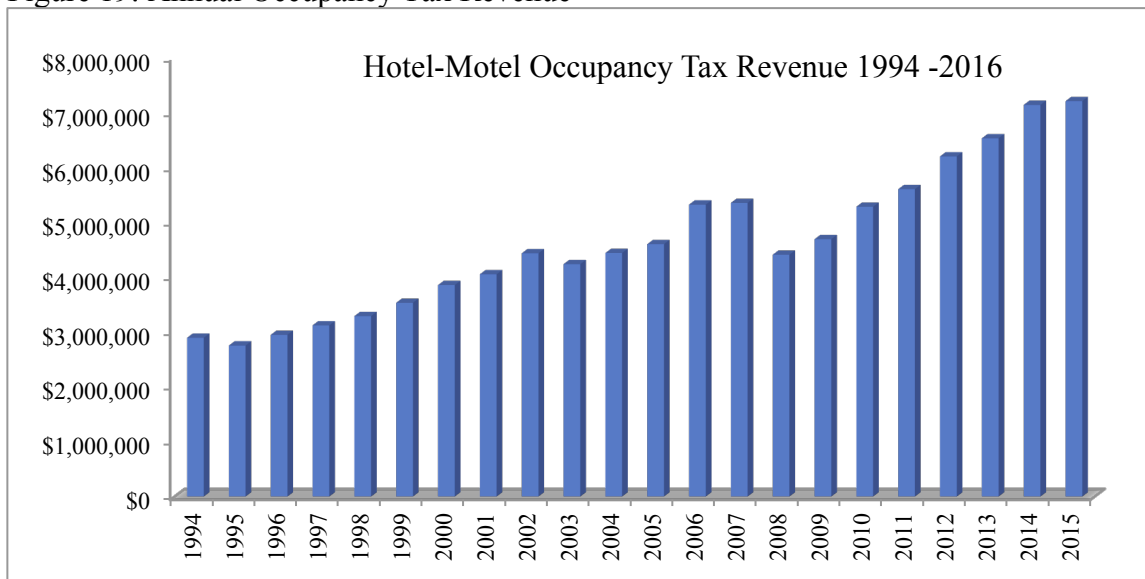
### *HOTEL/MOTEL OCCUPANCY TAX*

Computing the occupancy tax index, first, Aaron deflates the data to remove the effect of changing prices to arrive to change in economic activity. The resulting real occupancy tax, occupancy tax rate adjusted for inflation, provides a more accurate measure of whether there was an improvement in occupancy tax collection or not. Between 1995 and 2007, the occupancy tax index shows that hotel and motel occupancy annualized real growth rate was 2.1 percent. The occupancy tax revenue decreased in 2008 following hurricane Dolly and the great recession, and didn't recover to the pre-recession levels until 2011. Occupancy tax revenues increased steadily



after the initial drop in 2008 at an average annual rate of 4.15 percent between 2008 and 2014. The occupancy tax index shows a decrease of 17.65% in 2008 relative to the 2007 and an average annual increase of 7.28% from 2008 to 2015. Occupancy tax revenue between 2014 and 2015 increased by 0.96 percent. The occupancy tax revenue index for 2014 indicates an 8.0 percent improvement in the nominal occupation tax revenue.

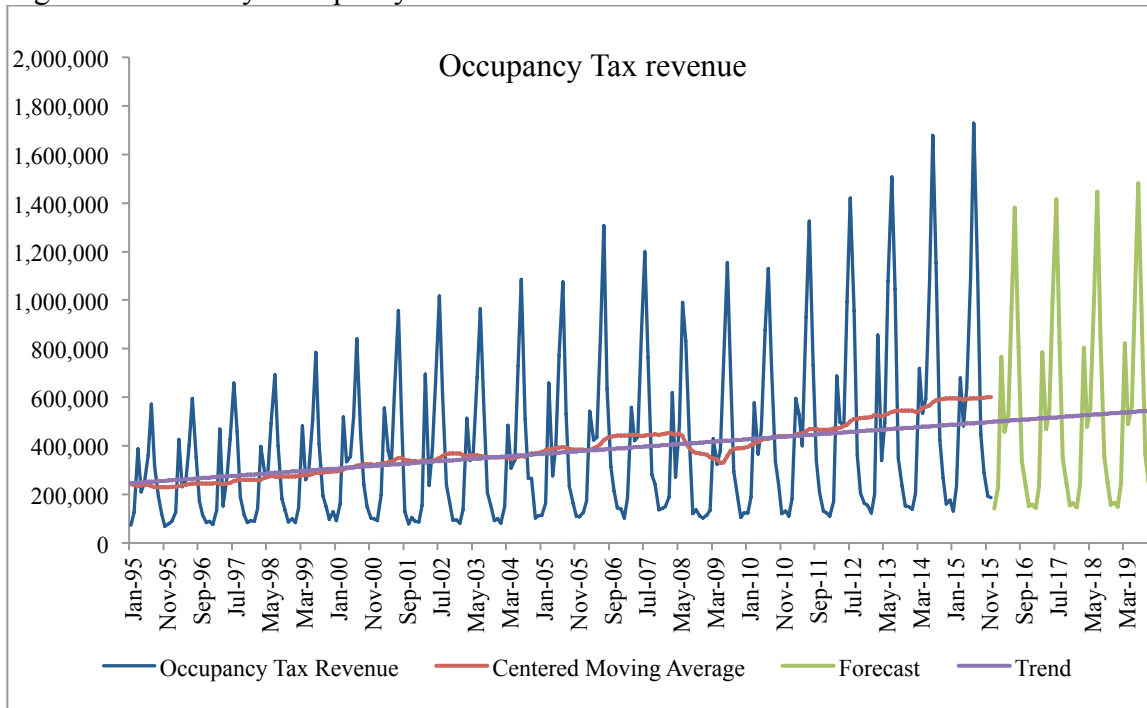
Figure 19: Annual Occupancy Tax Revenue



Source: South Padre Island Economic Development Corporation

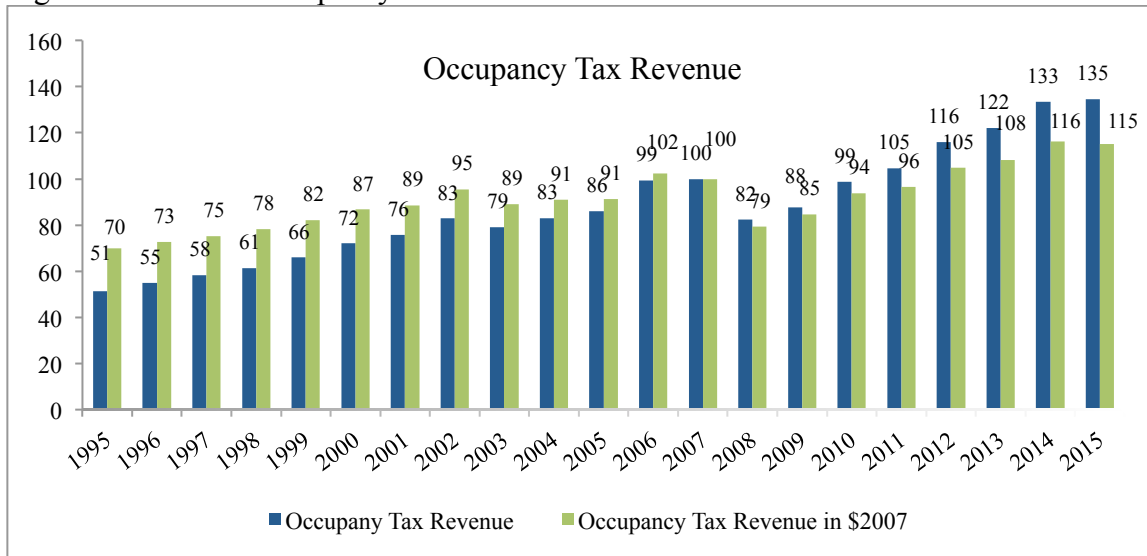
**Forecast:** The leading economic indexes and other leading indicators suggest a slow growth rate within the next two years. South Padre Island has experienced slightly faster growth in total earnings, employment, and tax receipts than Texas between 2008 and 2014. Aaron expects occupancy tax to increase by about 2.39 percent in 2016, around 2.33 percent in 2017, and around 2.28 percent in 2018. Starting in 2017, the proposed development of Liquefied Natural Gas (LNG) at the Port of Brownsville could generate additional activity during the construction phase of the LNG projects.

Figure 20: Monthly Occupancy Tax Index



Source: South Padre Island Economic Development Corporation

Figure 21: Annual Occupancy Tax Index

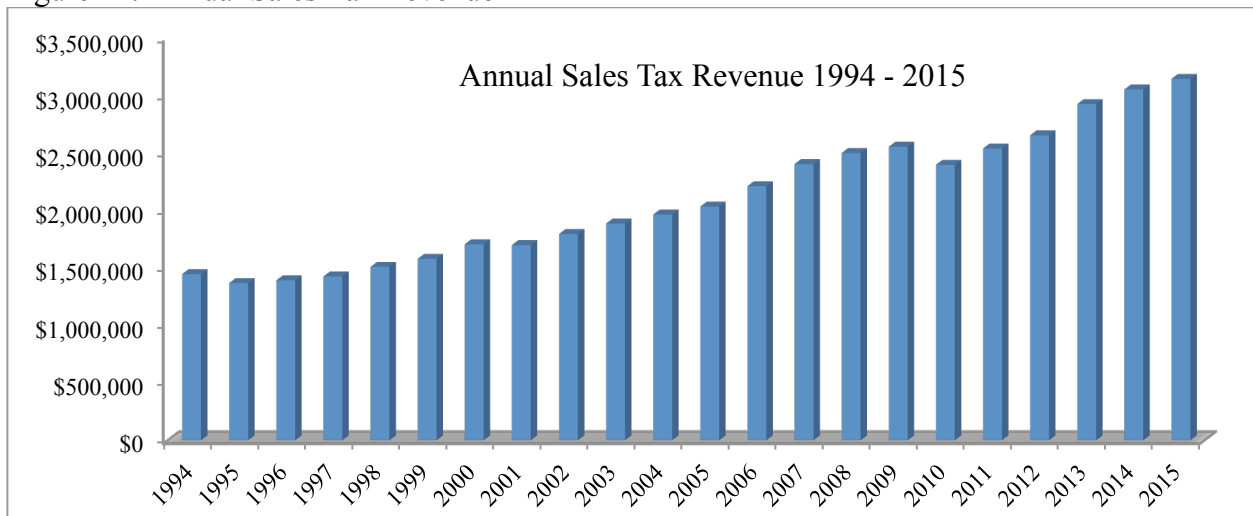


Source: South Padre Island Economic Development Corporation

## SALES TAX

Inflation adjusted sales tax revenue increased by 3.03 percent in 2015. While it is below 2013 and 2014 sales tax growth rates it is still an increase in the city's sales tax revenue given the visitors' activity and spending decreased at the state level. The faster growth rate experienced immediately after the financial crisis of 2008-2009 were a result first of post-hurricane Dolly and after 2009 of post-recession recovery. The average growth rate of sales tax 1998 and 2007 was 5.04 percent and 3.34 percent from 2008 to 2015.

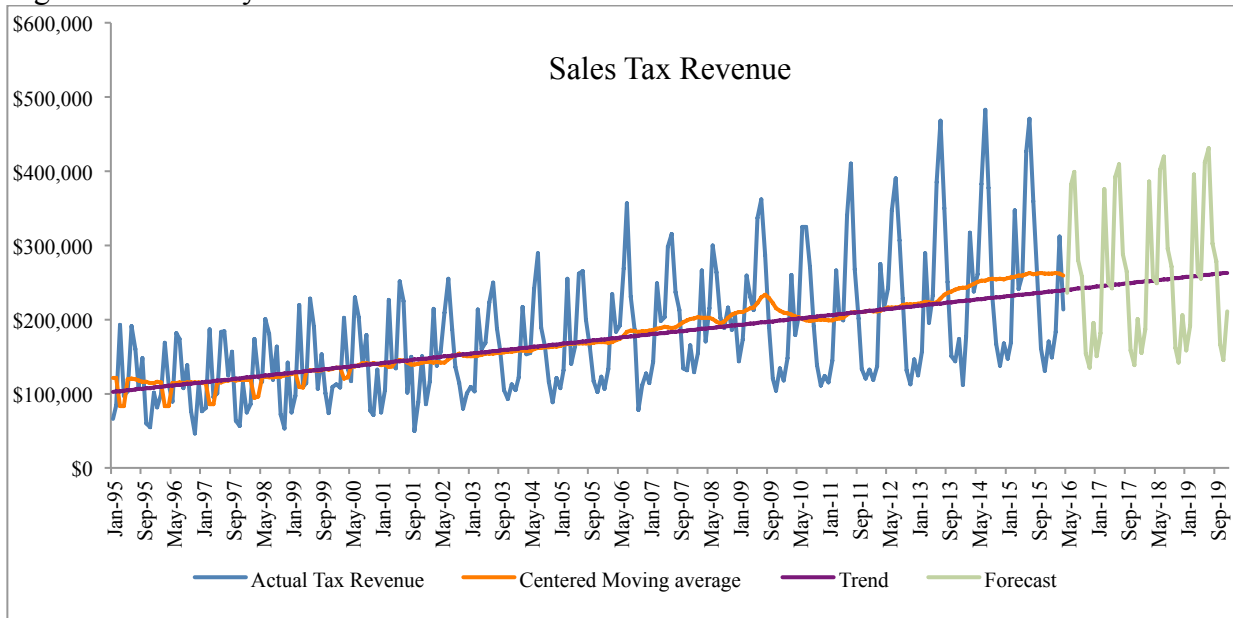
Figure 22: Annual Sales Tax Revenue



South Padre Island Economic Development Corporation

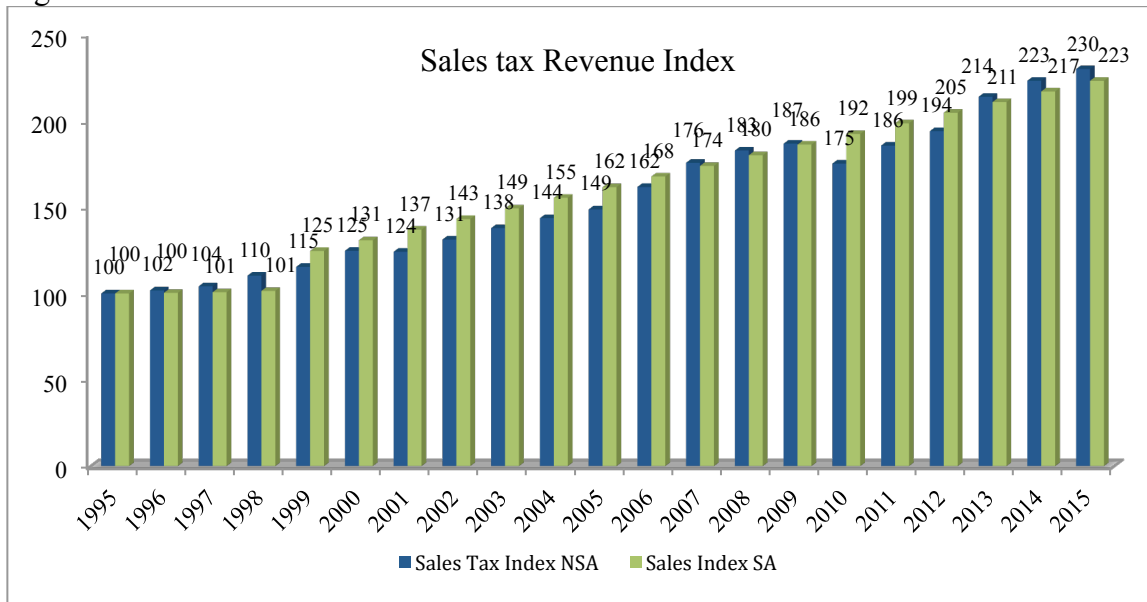
**Forecast:** Data show that factors that affect the economy of South Padre Island are trending slightly downward suggesting slower growth in sales tax revenue for the next two years. Aaron forecast sales tax revenue to increase by about 2.62, 2.55, and 5.39 percent in 2016, 2017 and 2018.

Figure 23: Monthly Sales Tax Index



Source: South Padre Island Economic Development Corporation

Figure 24: Annual Sales Tax Index

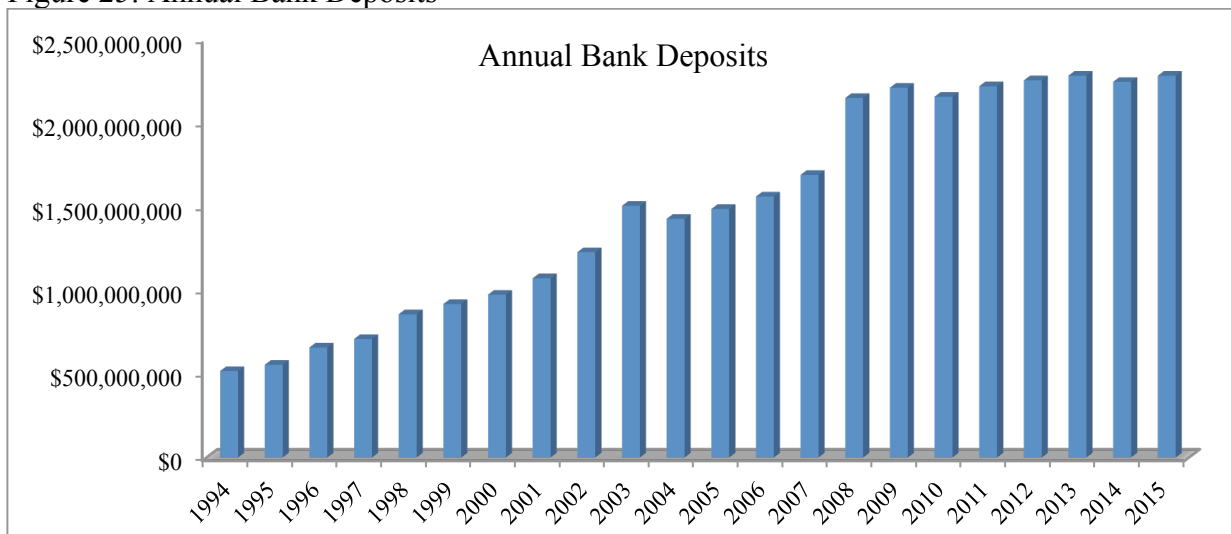


Source: South Padre Island Economic Development Corporation

## BANK DEPOSIT INDEX

The pre-recession period was a period of fast bank deposits growth. In fact, during that period bank deposits doubled every 7 years. Bank deposit increased by 8.32 percent in 2008, and 27.23 percent in 2009. This sharp increase indicates that Mexican nationals moved some of the wealth from Mexico to the U.S. in an attempt to hedge against the drop in the value of the peso. After 2010 bank deposit grew modestly because of the slow recovery. The average annual growth rate in deposits between 2010 and 2015 was 0.88 percent. During that period deposit growth rates alternated between positive and negative growth from one year to the next. The growth rate of bank deposits for 2015 relative to 2014 year is 1.63 percent.

Figure 25: Annual Bank Deposits

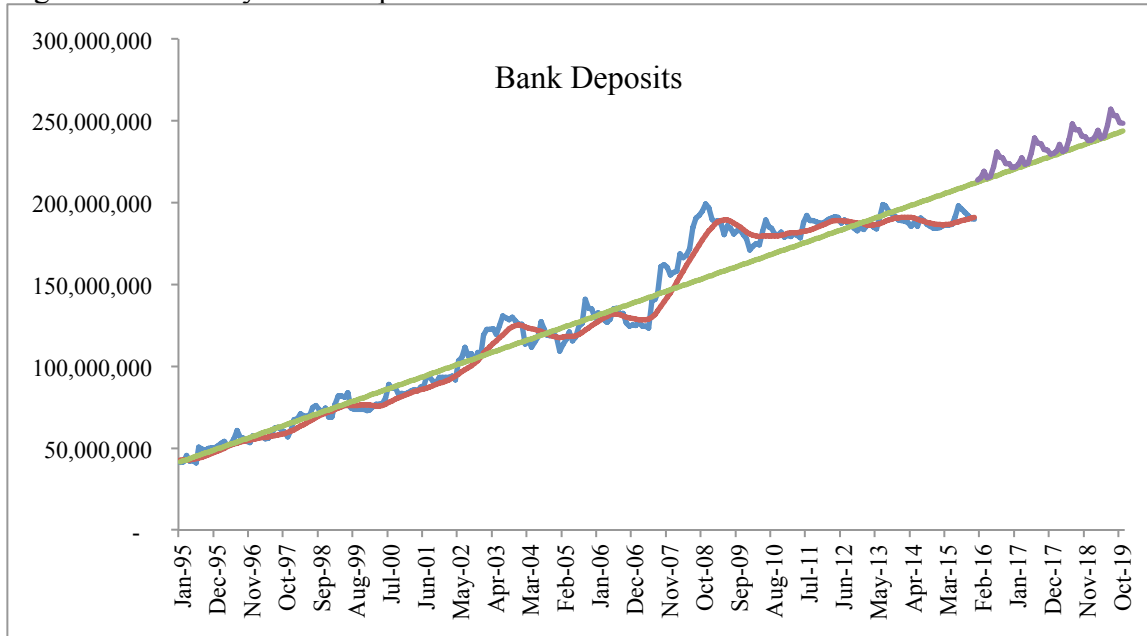


Source: Texas Destinations 2007-2008, Office of Governor, Economic Development Tourism Division

**Forecast:** Dollar appreciation means that Mexican pesos trade for fewer American dollars. The current appreciation of the dollar led to a sharp drop in the value of the peso making visits to the South Padre Island by Mexican nationals almost twice as expensive as two years ago. Aaron expect bank deposits to decline if the appreciation of the dollar stabilizes and to increase if the appreciation of the dollar continues as Mexican nationals will see converting their pesos to

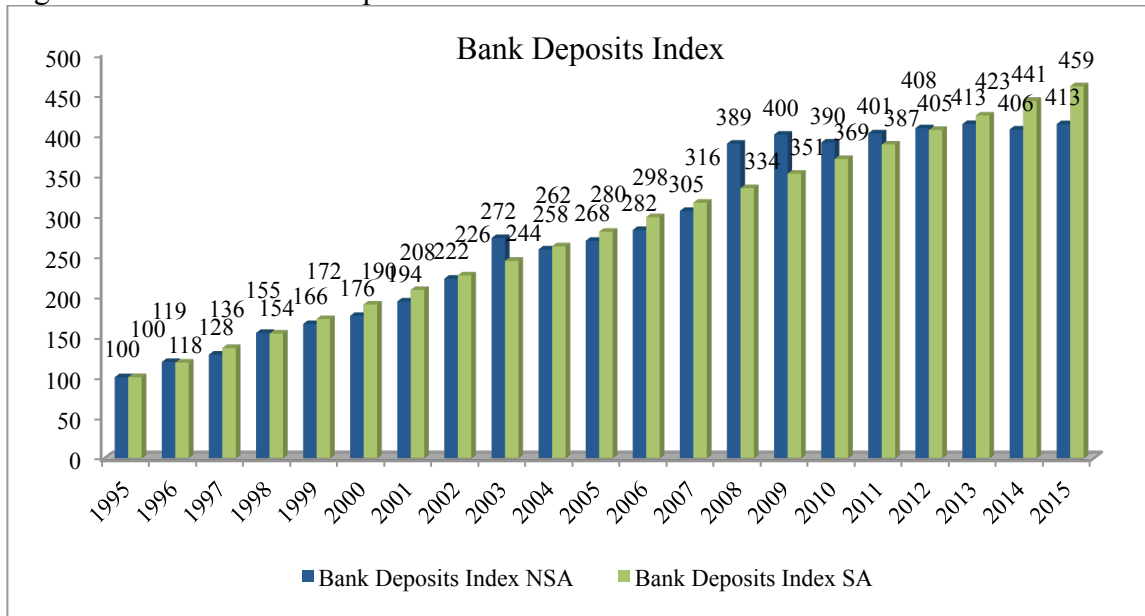
dollars before the appreciation occurs as a way to hedge against a loss in purchasing power. Aaron expects bank deposits to increase by 1.63 percent in 2016, 2.50 percent in 2017, and 3.76 percent in 2018.

Figure 26: Monthly Bank Deposits Index



Source: South Padre Island Economic Development Corporation

Figure 27: Annual Bank Deposits Index

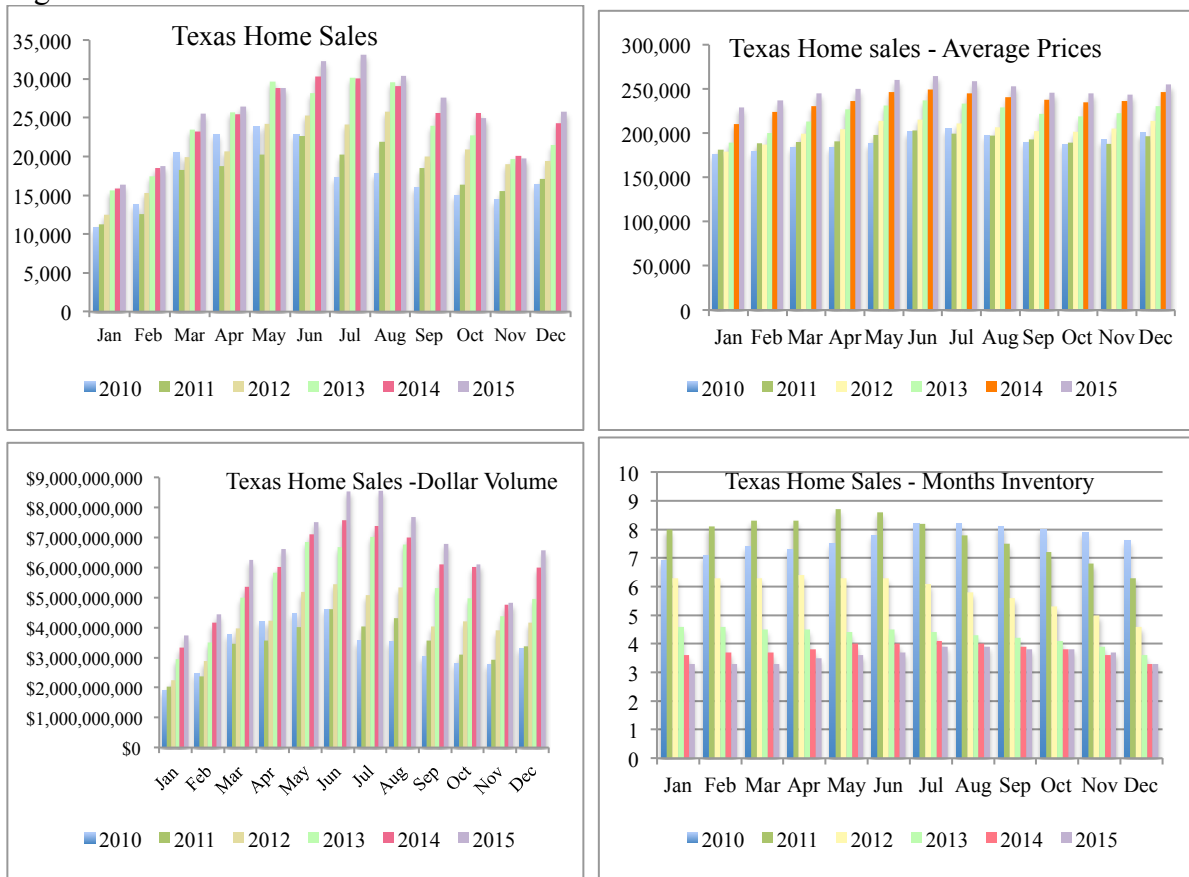


Source: South Padre Island Economic Development Corporation

### *REAL ESTATE IN TEXAS*

According to the Real Estate Center at Texas A&M University, real estate continue its upward trend, Texas monthly home sales, average prices, dollar volume from home sales have increased in 2015. Since June 2011, months inventory for Texas homes has continuously decreased. Months inventory decreased from 8.2 months in June 2011 to 4 months in July 2016. Figure 28 shows key statistics for the Texas real estate market.

Figure 28: Texas Real Estate



Source: Texas A&M University Real Estate Center

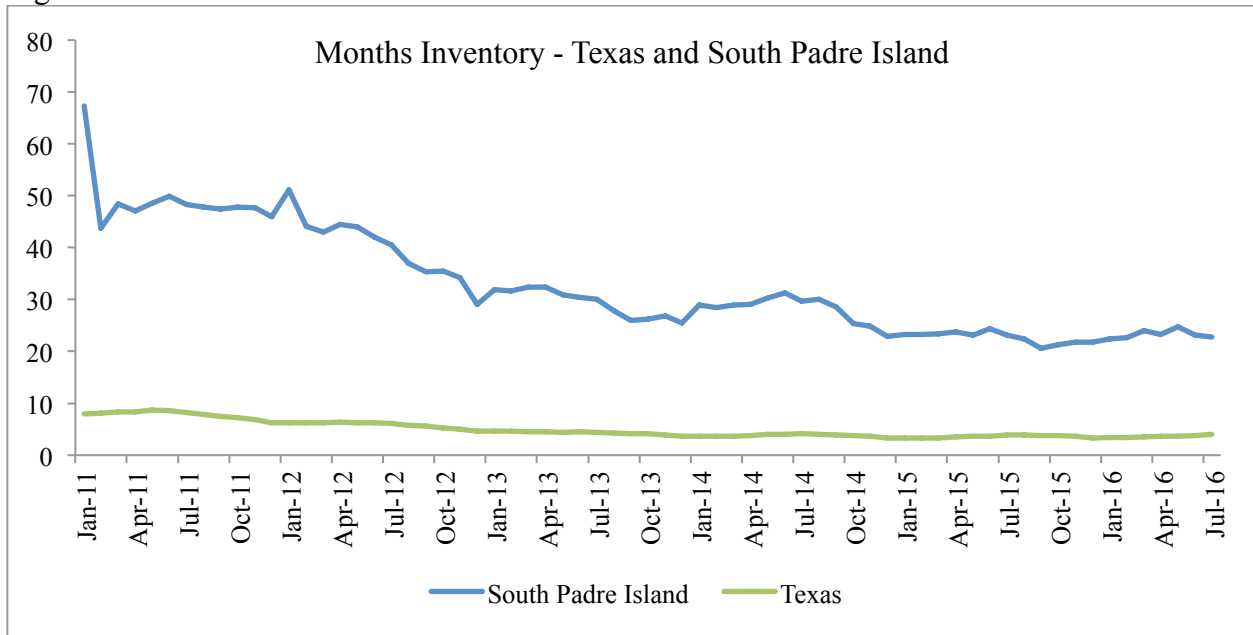
*REAL ESTATE IN SOUTH PADRE ISLAND*

Texas A&M Real Estate Center data shows that South Padre Island’s real estate market has improved significantly after the recession of 2008-2010. All indicators point to an improving real estate market both in Texas and in South Padre Island, home sales, average prices, and dollar volume sales have increased every year since 2011 while number of listings and months inventory have decreased. From 2011 to 2015 average home sales per month increased from 14 to 24 per month, average monthly dollar volume from sales increased from



\$42 million to \$79.2 million, the average number of listings decreased from 787 in 2011 to 576 in 2015 and average months inventory declined from 49 to 23 between 2011 and 2015.

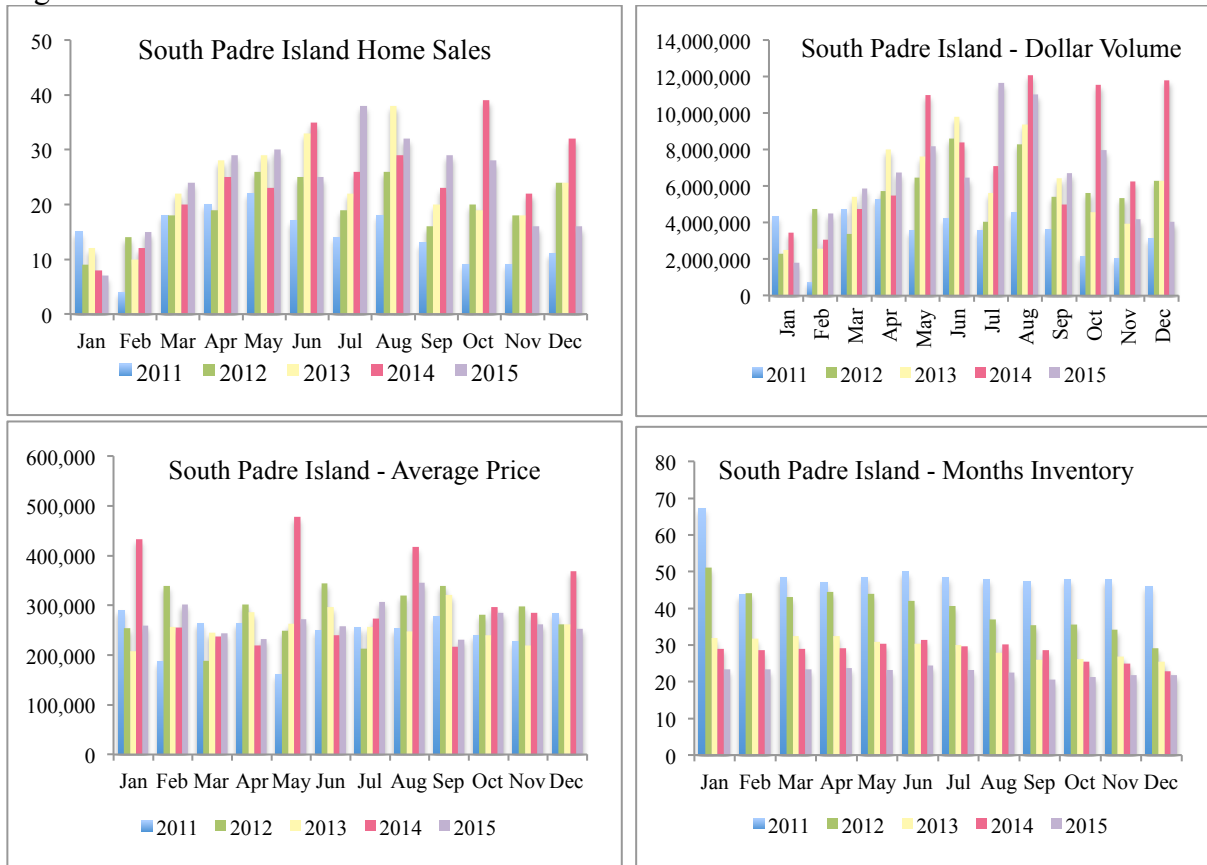
Figure 29: South Padre Island Real Estate



Source: Texas A&M University Real Estate Center

Figure 29 shows that between January 2011 and December 2015, both South Padre Island and Texas month inventory declined dramatically (66.1 percent and 49.3 percent respectively). Month inventory in South Padre Island has declined faster than in Texas.

Figure 30: South Padre Island Real Estate



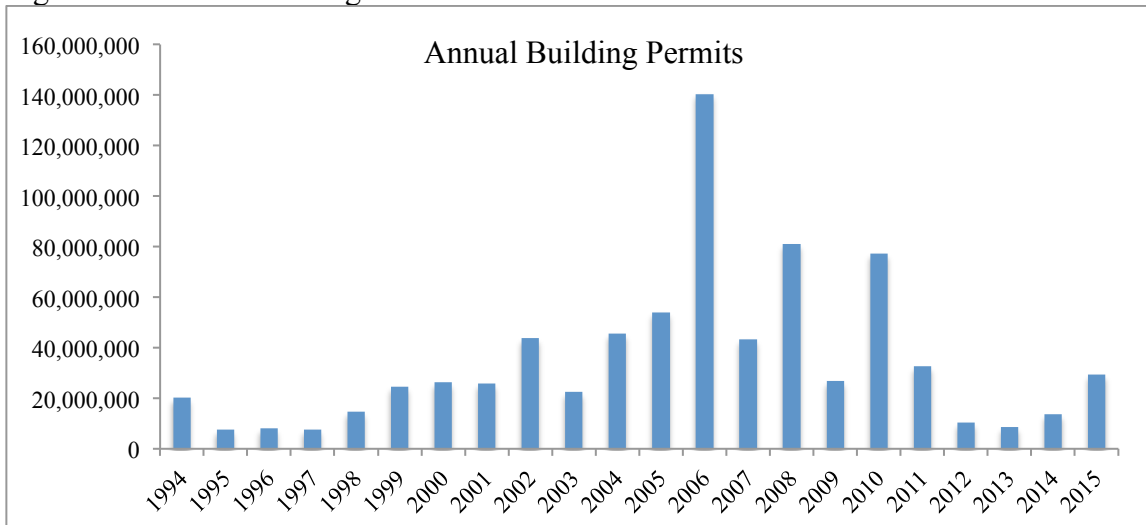
Source: Texas A&M University Real Estate Center

### *BUILDING PERMITS INDEX*

Figure 31 shows that the number of building permits declined between 2010 and 2013 partly due to a relatively large inventory and a slow recovering economy. After 2013, building permits increased slowly. Figure 32 shows that from 1995 to 2001 building permits followed a stable and constant pattern with minimal variability. This pattern indicates that real estate projects were small one or few units' development projects. After 2001 the variability of building permits increased. Figures 31 and 32 show pronounced peaks in 2006, 2008, and 2010 indicating a possible structural shift in real estate sector to periodically very large construction

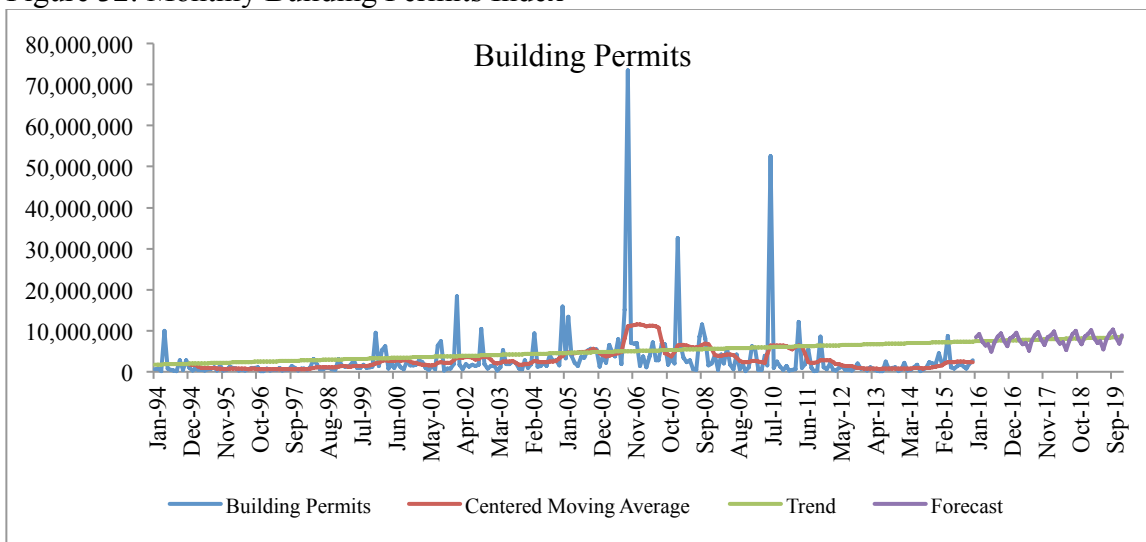
and real estate projects and high-rise projects. These periods of high peaks have been fairly clustered together, second half of 2006, first half of 2008, and second half of 2010. After 2010, there was a decline in the number of building permits. Real estate data for 2013, 2014 and 2015 show that the number of listings declined and average prices increased.

Figure 31: Annual Building Permits



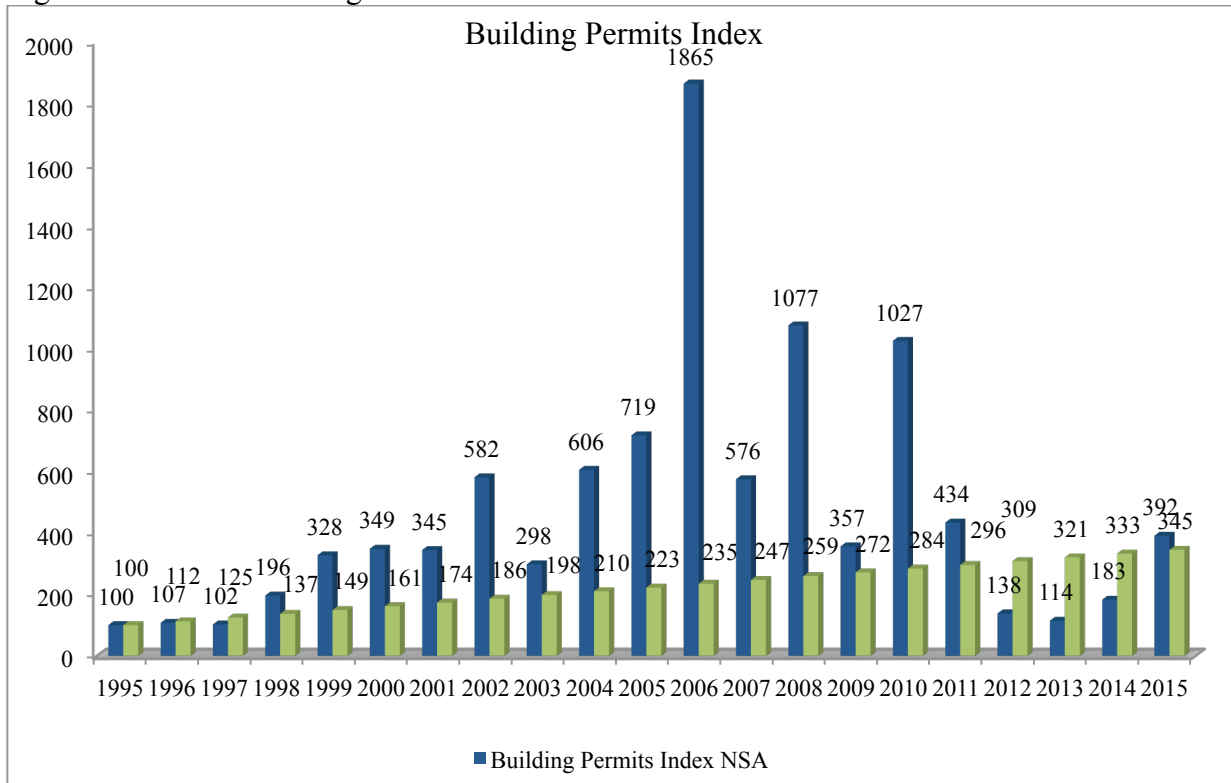
Source: Source: South Padre Island Economic Development Corporation

Figure 32: Monthly Building Permits Index



Source: South Padre Island Economic Development Corporation

Figure 33: Annual Building Permits Index



Source: South Padre Island Economic Development Corporation

Peaks in the data show that large projects lead to a short-term increase in supply of real estate on the Island. The peaks are followed by periods of decreasing building permits, which in turn are followed by other sharp increases in building permits. Mexican investors constitute a significant of percentage of South Padre Island’s real estate buyers. The current depreciation of the Mexican peso has raised the peso equivalent price of American goods including real estate.

**Forecast:** Building permits data show a decline in the number of listings between 2010 and that the number of listing is declining and the average prices increasing. Aaron expects the building permits index to increase moderately at 3.21 percent in 2016, and to increase to 5.43 percent in 2017 and 2018.

## 6. Conclusions

U.S. output remains on a moderate growth trajectory sustained by gains in employment, income and household spending. Recently the labor force participation rate has risen following steady job gains and lower unemployment rate. The U.S. economy will see modest output gains as a relatively sluggish external demand mitigates the impact of a strengthening domestic demand.

The current economic outlook for the U.S. is continued economic growth at around 1.7 percent. Texas economy is forecasted to grow at 2.1 percent and Mexico is forecasted to grow at 3.1 percent. The economic outlook for the U.S. and Texas, and Mexican economy suggest moderate growth in South Padre Island's economic activity. Seasonal disparities in terms of economic activity will continue in the short run and will taper off as South Padre Island develops more attractions to attract more off-peak months visitors.

Sales tax and occupancy tax revenues rose modestly in 2015, and is expected to continue to grow modestly. Texas and South Padre Island real estate data show that home sales, prices, months inventory have surpassed pre-crisis levels indicating that the real estate market has completely recovered. Yet, the number of building permits is relatively low compared to previous years. Aaron expects the number of permits to remain unchanged for the short run especially given the steep drop in the value of the peso relative to the dollar.

A number of upcoming economic development projects in the region will significant spillover effects on surrounding communities including South Padre Island. These projects include manufacturing projects, a natural gas powered power generation plant, and Liquefied Natural Gas (LNG) facilities. The proposed development of LNG facilities at the Port of Brownsville will be the largest taxpayers in Cameron County dwarfing the current top ten taxpayers combined. The LNG facilities projects will provide a significant boost to the region's economy. LNG is the second most traded commodity in the world. These LNG projects will help showcase the region and its many attributes to the world. Some of the LNG facilities are

scheduled to begin construction in 2017. The increased activity at the Port of Brownsville will generate activity in Port Isabel and in South Padre Island.

Crossing data from the Queen Isabella's causeway traffic shows that crossing traffic into the Island is significant even during off-peak months. However, the crossing effectiveness index computed by Aaron shows that this traffic does not translate into sales tax and occupancy tax revenues for the Island.

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The Conference Board

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World Bank

[www.city-data.com](http://www.city-data.com)