Current Account – Deficit in 1Q22, driven by seasonality in primary income

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- **Current Account (1Q22): -US$6.5 billion (1.9% of GDP); Banorte: -US$9.4bn; consensus: -US$3.6bn (range: -US$12.4bn to US$10.9bn); previous: US$2.7bn**
- **Both goods and services and the primary income balances resulted in deficits of -US$7.5 billion and -US$11.4 billion, respectively. Meanwhile, the secondary income balance recorded a US$12.3billion surplus**
- **The capital account posted a US6.2 million deficit. The sum of the latter and the current account came in at -US$6.5bn**
- **Hence, the financial account showed net borrowing with the rest of the world of US$6.7bn. The quarter was characterized by extraordinary inflows in the direct investment account, as well as lower outflows in 'portfolio investments'**
- **The gradual strengthening of global economic activity, high prices (including oil) and the tightening of global financial conditions set the pattern for flows in 1Q22**
- **We expect a lower current account deficit in 2Q22 due to some seasonal effects, such as in remittances and earnings. Nevertheless, we do not rule out that progress in monetary restriction and supply shocks continue to translate into distortions for international trade and capital flows**

Current account deficit in 1Q22. The quarterly balance came in at -US$6.5bn, equivalent to 1.9% of GDP. This took place in a backdrop of: (1) Gradual strengthening of global economic activity, especially in the US; (2) higher prices of oil and other commodities due to the start of the war in Ukraine in mid-February, pushing the Mexican oil mix to a quarterly average of US$98/bbl (not seen since 2014); (3) international market volatility and higher risk aversion; (4) inflationary pressures that prompted various countries to accelerate their monetary tightening; and (5) a mixed performance of the Mexican peso.

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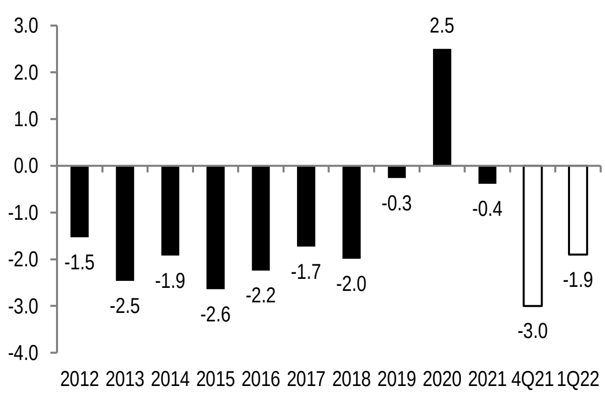
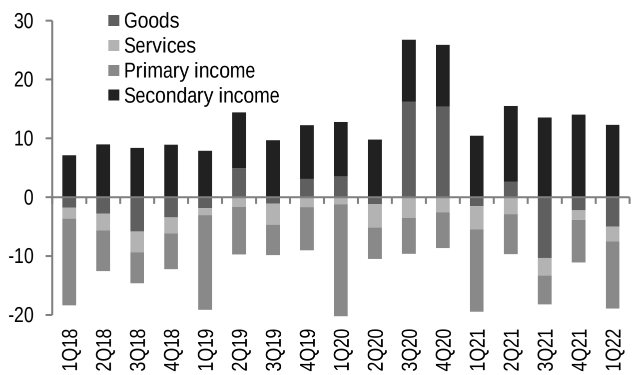
Current account
% of GDP



Source: Banxico

Current account composition (balances sum)
US$ billion



Source: Banxico

Deficits in trade and primary income, partially offset by remittances inflows. The current account deficit stems from larger deficits in the trade and primary income balances, as well as a smaller surplus in secondary income. By order of magnitude, we highlight the following moves. Primary income had a negative balance of US$11.4bn, with an important seasonal effect related to the payment of 'earnings and dividends', equivalent to -US$7.6bn, in addition to net payments interest payable abroad at -US$4.3bn. Within the goods balance, oil-related goods had a deficit of US$5.7bn –slightly lower than in the previous quarter– which more than compensated for the surplus in non-oil goods (US$842mn). The latter is significantly lower vs the previous quarter given the typical slowdown in domestic production and exports at the beginning of the year. In our view, part of this reflects a heterogeneous economic recovery between our trading partners and Mexico. In addition, high international oil prices and inflationary pressures caused volatility in nominal terms, although mainly boosting results upwards. The services balance accumulated a US$2.5bn deficit, with the surplus of travelers from abroad coming to Mexico being the most relevant, continuing its recovery after the pandemic and reaching a total of US$5.5bn. Nevertheless, this was more than offset by payments related to transportation (-US$4.8bn) and 'others' (-US$1.5bn), among other categories. The secondary income balance had a US$12.3bn surplus, lower than in the previous quarter, but in line with the seasonality of remittances inflows in the period. Finally, the capital account had a US$6.2 million deficit.

Balance of payments
US$ billion

	1Q22	4Q21	1Q21	4Q21	2021	2020
Current account	-6.52	2.74	-9.28	17.56	-4.98	27.17
Balance on goods and services	-7.48	-4.01	-5.39	13.03	-22.47	22.86
Balance on goods	-4.94	-2.26	-1.42	15.59	-10.91	34.15
Balance on services	-2.54	-1.74	-3.97	-2.56	-11.56	-11.30
Balance on primary income	-11.37	-7.28	-14.35	-6.15	-33.44	-36.62
Balance on secondary income	12.32	14.02	10.47	10.68	50.94	40.94
Capital account	-0.01	-0.01	-0.01	-0.01	-0.05	-0.01
Financial account	-6.72	0.57	-6.61	9.00	-0.07	21.93
Financial account excluding reserve assets	-10.65	18.78	-8.42	10.18	-21.01	9.94

Source: Banxico

Moderation in portfolio outflows, but with strength in inflows from direct investments. The financial account reported net borrowing of US$6.7bn in the period, with enough resources to finance the current account deficit. This was achieved despite heightened international market volatility due to the beginning of the war in Ukraine at the middle of the quarter. Moreover, it remained high on greater risk aversion on fears of stronger monetary tightening, lower global economic growth and inflationary pressures. The net borrowing implied inflows of US$21.3bn and outflows of US$14.6bn.

In the detail, net borrowing was driven by foreign direct investment (US$14.0 billion in inflows), which continued with a favorable trend. This is partly supported by companies' nearshoring efforts. However, we must say that extraordinary inflows were accounted because of the merger between some Univisión and Televisa subsidiaries, as well as Aeromexico's debt restructuring. Meanwhile, portfolio investment accumulated a US$1.6 billion outflow.

We saw higher appetite for Mexican longer-term government debt, even despite a more challenging environment. Nevertheless, the overall balance is explained by an even stronger interest by residents for foreign instruments.

Financial account
US$ billion

	1Q22	4Q21	1Q21	4Q21	2021	2020
Financial account	-6.7	0.6	-6.6	-6.6	-0.1	21.9
Direct investment	-14.0	-7.8	-14.1	-5.6	-32.4	-25.2
Portfolio investment	1.6	14.4	5.6	3.7	41.5	10.3
Financial derivatives	-0.6	0.8	0.7	-1.8	2.1	-1.8
Other investment	2.3	-2.7	-0.7	13.9	-21.6	26.8
Reserve assets	3.9	-4.2	1.8	-1.2	10.3	12.0

Source: Banxico

Current account reflects relative strength both locally and abroad, although highlighting risks ahead. We anticipate the recovery in global economic activity to continue in 2Q22. However, some signs point to a slowdown, with volatility in international financial markets exacerbating. Some of them could reduce international trade, and therefore affect the current account in the short-term, including: (1) The war in Ukraine and the related trade sanctions against Russia; (2) China's zero-Covid policy that has triggered lockdowns at important cities; (3) constant input price increases (*e.g.* fertilizers, metals), food (*e.g.* wheat, cooking oil, sugar) and energy; (4) the implementation of exports restrictions in some countries –such as wheat and sugar in India–.On a more positive note, some balances could provide added stability. Among them, we highlight remittances (with our full-year forecast at +US56.5 billion), as well as net inflows from the 'travelers' as fear of COVID-19 recedes further.

On the financial account, risks of an economic slowdown and higher volatility prevail. This could limit the recovery of demand for debt securities issued by EM countries, as seen in this first quarter. In this sense, the tightening pace of the local monetary policy may be an element that strengthens marginal demand for such instruments. Meanwhile, we expect a sequential drop in direct investment inflows due to a challenging base and extraordinary items, although still recovering in annual terms.

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