Current account – Lower deficit in 2Q22, offset by secondary income

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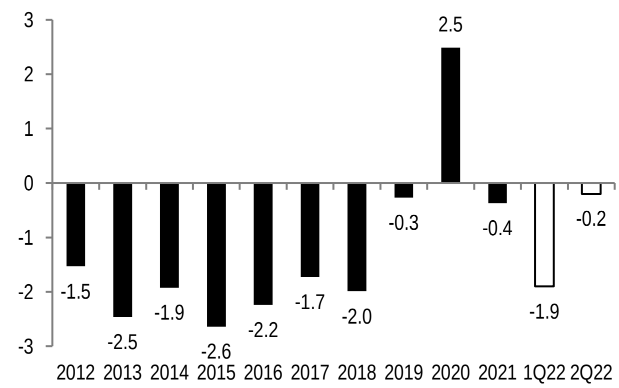
- **Current account (2Q22): -US$703.5 million (0.2% of GDP); Banorte: -US$2.7bn; consensus: -US$2.9bn (range: -US$7.0bn to -US$1.2bn); previous: -US$6.5bn**
- **We highlight deficits in the goods and services balance (-US$11.7 billion) as well as primary income (-US$3.8 billion). However, secondary income –where remittances are accounted for, among others– recorded a US$14.8 billion surplus**
- **The capital account posted a US$1.9 million deficit. Hence, the total between the latter and the current account came in at -US$705.4bn**
- **The financial account showed net borrowing (*i.e.* inflows) of US$114.7 million. These were concentrated in foreign direct investment and other investment, with outflows mostly in portfolio investment**
- **During 2Q22, domestic economic activity remained positive despite important global distortions such as Chinese lockdowns, financial sanctions against Russia, tighter monetary policy, and the high cost of oil**
- **We anticipate another deficit in the current account in 3Q22, with attention centered on energy prices as well as other headwinds that could skew the flows of goods. However, we believe remittances will remain as a strong source of income**

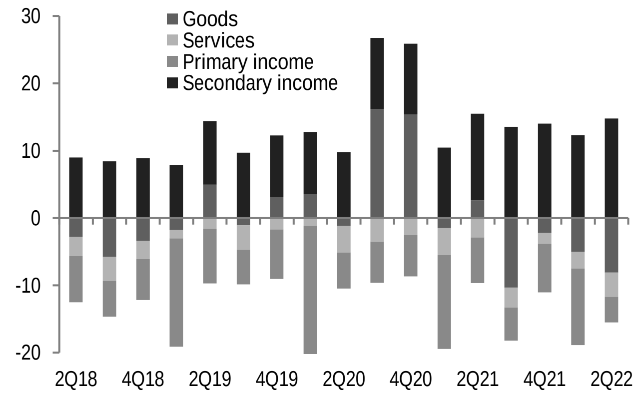
Current account with a more modest deficit in 2Q22. The balance was -US$705.3 million, equivalent to 0.2% of GDP, its lowest level since 3Q19. During the quarter, several factors that influenced the balance within the current account, highlighting: (1) High oil prices (quarterly average of the Mexican oil mix at 105 US$/bbl from 98 US$/bbl in 1Q22); (2) additional disruptions in international trade, although with a favorable evolution towards the end of the quarter; (3) Mexican peso strength (20.04 MXN/USD average); (4) an acceleration in global monetary tightening due to the persistence of inflationary pressures; and (5) higher risk aversion due to fears of a global economic recession.

Current account
% of GDP



Source: Banxico

Current account composition (sum of balances)
US$ billion



Source: Banxico

Trade and primary income deficits. The current account balance for 2Q22 is constructed from deficits in its partial trade and primary income balances, although partially offset by a larger surplus in secondary income. By order of magnitude, we highlight the following moves. Goods and services had a negative balance of US$11.7 billion. Within goods, the aggregate balance of oil-related goods had US$10.2 billion deficit. In our opinion, high oil prices –and its derivatives– are exacerbating the level of flows in this balance –considering distortions as figures are expressed in nominal terms. On the other hand, non-oil goods had a US$2.1 billion net surplus, with growth in both imports and exports, without ruling out a marginal impact on the latter given the strength of the Mexican peso in the period. Regarding services, one of the main drivers was once again tourism-related activities, with a net surplus (reflecting foreign currency inflows) of US$5.3 billion, probably driven by higher mobility and less fears about the virus. However, this was offset by transportation-related payments (-US$5.5 billion) that continued to be pressured by international freight costs. In this backdrop, the services balance accumulated a US$3.6 billion deficit, made up also by negative figures in insurance (-US$1.3bn) and 'others' (-US$1.9bn).

Primary income was also negative (US$3.8 billion deficit), although with a lower proportion of the total balance due to a decrease in flows in items such as 'earnings and dividends', remembering that these are usually paid in the first quarter. However, the higher level 'interest' flows stood out (with net payments abroad), in line with the already described monetary policy tightening cycle. For its part, secondary income had a whopping surplus of US$14.8 billion, reaching a new historical high and in line with remittances' favorable seasonality in the period, but also highlighting greater intrinsic dynamism in flows. Lastly, the capital account had a US$1.9 million deficit.

Balance of payments
US$ billion

	2Q22	1Q22	2Q21	1Q21	Jan-**Jun'22**	Jan-**Jun'21**
Current account	-0.70	-8.09	6.00	-9.31	-8.80	-3.31
Balance on goods and services	-11.73	-7.99	-0.03	-5.38	-19.71	-5.42
Balance on goods	-8.13	-4.94	2.81	-1.42	-13.06	1.39
Balance on services	-3.60	-3.05	-2.84	-3.96	-6.65	-6.80
Balance on primary income	-3.83	-12.48	-6.92	-14.48	-16.31	-21.40
Balance on secondary income	14.85	12.38	12.95	10.55	27.23	23.51
Capital account	0.00	-0.01	-0.01	-0.01	-0.01	-0.02
Financial account	-0.11	-7.59	8.07	-7.09	-7.71	0.98
Financial account excluding reserve assets	3.34	-11.52	8.34	-8.90	-8.18	-0.56

Source: Banxico

Lower foreign direct investment inflows, as well as portfolio investment outflows. The financial account showed net borrowing of US$115 million in the period, which represents a net inflow of resources which partially financed the current account deficit. Financial volatility and risk aversion were constant in the period, driven by: (1) Uncertainty due to sanctions imposed on Russia; (2) inflationary pressures; (3) broad USD gains; (4) Fed's monetary policy, with hikes not seen in several decades; (5) fears of a possible recession in the US and the Eurozone; and (6) commodity price volatility. The result implies US$3.1 billion in inflows and US$3.0 billion in outflows.

Meanwhile, direct investments had a net borrowing (net inflows) of US$2.1 billion, with US$6.4 billion in inflows. As has been mentioned in other reports, this likely reflects the impact of nearshoring –with several companies in different industries migrating from Asia to Mexico. On the contrary, outflows stood at US$4.3 billion.

Meanwhile, there were net outflows in terms of portfolio investment of US$5.1 billion, similar to the level in 1Q21. We believe this is a sign of global risk aversion and not because of domestic economic instability. Inside, local's purchases of foreign assets totaled US$402 million, while sales of domestic titles by foreigners reached US$ 4.7 billion. Meanwhile, 'other investment' implies inflows of US$3.0 billion, highlighting commercial banks deposits. Lastly, errors and omissions had inflows of US$591 million.

Financial account
US$ billion

	2Q22	1Q22	2Q21	1Q21	Jan-**Jun'22**	Jan-**Jun'21**
Financial account	-0.1	-7.6	8.1	-7.1	-7.7	1.0
Direct investment	-2.1	-15.4	-5.7	-14.4	-17.4	-20.1
Portfolio investment	5.1	2.7	6.9	5.6	7.8	12.5
Financial derivatives	3.3	-0.4	0.3	0.7	2.9	1.1
Other investment	-3.0	1.5	6.8	-0.8	-1.4	5.9
Reserve assets	-3.5	3.9	-0.3	1.8	0.5	1.5

Source: Banxico

Likely current account deficit in 3Q22 with higher challenges for flows, especially in goods. In our view, current account flows and its associated financing will remain healthy during the rest of the year. So far, its evolution does not give any indication of significant imbalances or risks. Nonetheless, some risks could materialize or deepen. First, a deceleration in US demand –coupled with a stronger Mexican peso– could impact Mexican exports. On the other hand, some supply chains disruptions (*e.g.* new shutdowns of Chinese plants due to high temperatures or greater pressures on electricity grids), as well as high inflation –which we believe will continue in the third quarter– could generate distortions on the trade balance. Lastly, we remain watchful on the evolution of energy prices that can impact the balance of goods. However, other inflows –such as remittances and spending by foreign tourists in our country– will keep offsetting such moves, at least to to some extent.

In the financial account, we are awaiting progress of the consultation period due to the commercial dispute presented by the US and Canada to Mexico within the framework of the USMCA because of differences in the energy sector. Based on the deadlines, results in this step could be finalized by 4Q22. If a panel is established, this could be delayed until 2023. Depending on the moment in which this is resolved, it is not possible to rule out an effect in investment flows to certain industries. However, the latter remains unlikely. According to statements by the Economy Minister, Tatiana Clouthier, Mexico is willing to adjust its policies to provide fair conditions to foreign companies in the national energy market without damaging Pemex and without losing sovereignty. Hence, we consider that controversies may be resolved positively for the three concerned parties during the consultation period. Lastly, we anticipate that foreign direct investment inflows will keep strengthening in the short-term due to nearshoring and the normalization of the auto industry.

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