Current account – Deficit driven by the trade balance results

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- **Current account (3Q22): -US$5.5 billion (1.6% of GDP); Banorte: -US$4.5bn; consensus: -US$5.7bn (range: -US$9.2bn to US$1.0bn); previous: -US$504.1mn**
- **Inside, goods and services (-US$16.6 billion) added a seventh quarter in deficit, along with a negative balance in primary income (-US$4.3 billion). These were partially offset by a surplus in secondary income (US$15.4 billion)**
- **The capital account posted a US$52.6 million deficit. Hence, the total between the latter and the current account came in at -US$5.6bn**
- **The financial account showed net borrowing (*i.e.* inflows) of US$6.0 billion. Inside, we highlight inflows in 'other investments' and FDI**
- **During 3Q22, domestic demand had a better performance, mainly reflected in greater dynamism in imports –especially non-oil. We believe this was supported by better conditions in international trade. In addition, we highlight a drop in oil exports, explained by lower prices**
- **We anticipate a more modest current account deficit in 4T22 as a result of: (1) Higher remittances; (2) larger inflows due to foreign tourism; and (3) non-oil exports supporting by the resilience in the US demand**

Higher current account deficit in 3Q22. The balance was -US$5,505.2 million, equivalent to 1.6% of GDP, higher than both the 0.2% of the previous quarter and the 1.4% last year. In 3Q22, concerns about the global economy persisted due to the war in Ukraine and COVID-zero policies in China. In addition, another driver for flows could have been as the decisions from the US to rethink its production and supply of semiconductors, among others. In this context, for Mexico's balance of payments, some of the relevant factors that defined the performance include: (1) Resilience in demand from the US despite signs of weakness elsewhere; (2) a fall in international energy prices due to fears of a global recession in 2023, with the Mexican oil mix averaging 87.8 US$/bbl (previous: 105.0 US$/bbl); (3) a stronger Mexican peso (averaging: 20.2 MXN/USD) in a context of higher financial volatility; and (5) improving supply chains, with less evidence of stress, according to the *Fed's Global Supply Chain Pressures Index*.

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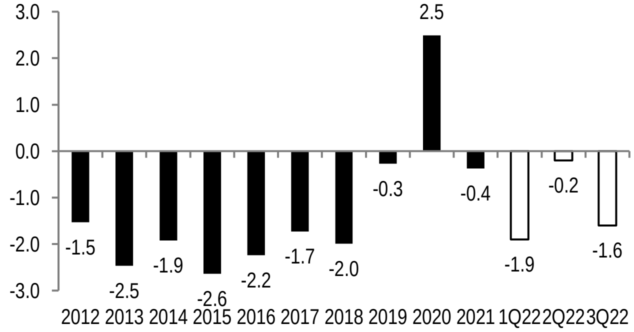
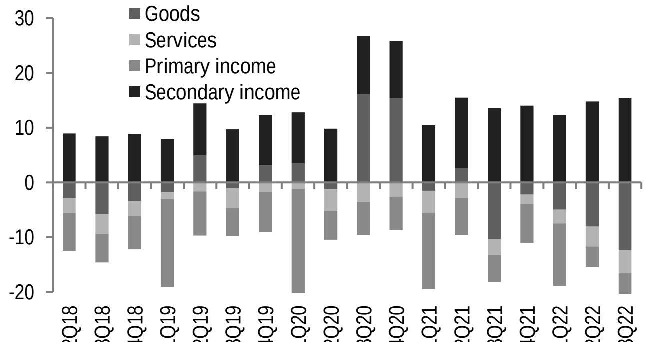
Current account
% of GDP



Source: Banxico

Current account composition (sum of balances)
US$ billion



Source: Banxico

Goods post their largest deficit so far this year. According to this quarter's results, goods and services, as primary income, once again reported deficits. On the other hand, secondary income had a surplus. By order of magnitude, we highlight the following moves. Goods and services had a negative balance of US$16.6 billion, mainly explained by the deficit in goods (US$12.4 billion). Within the latter, two specific events deepened the deficit: (1) Exports showed less dynamism, with oil-related contracting relative to the previous quarter –which can be explained by lower prices; (2) higher imports, favored by the appreciation of the Mexican peso and resilience in domestic demand. Meanwhile, services were also in deficit by US$4.2 billion, registering net inflow from international travelers (US$4.7 billion), which was compensated by payments related to transportation services (-US$5.9 billion), despite a drop in shipping costs. In addition, this balance closes its net deficit with negative figures in 'other services' (-US$1.9 billion). 'insurance and pensions' (-US$618 million) and 'financial services' (-US$406 million).

Regarding primary income, this again posted a deficit (-US$4.3 billion), with a higher magnitude considering that the flows related to 'earnings and dividends' (-US$862 million) continue to accelerate. On the contrary, 'interest', moderated its proportion within the balance, although it maintains a sustained deficit –mainly due to the differential between local interest rates and the equivalent rates in non-emerging economies (mainly the US). On the contrary, secondary income –which includes remittances– had a surplus of US$15.4 billion, which is a new historical high, the second in a row. A positive performance that reflects the strength of the US labor market –and employment opportunities for Mexican migrants– in a more uncertain backdrop. Lastly, the capital account had a US$52.6 million deficit.

Balance of payments
US$ billion

	3Q22	2Q22	3Q21	2Q21	Jan-Sep'22	Jan-Sep'21
Current account	-5.5	-0.5	-4.3	6.0	-15.3	-7.7
Balance on goods and services	-16.6	-11.2	-13.1	0.0	-35.8	-18.5
Balance on goods	-12.4	-8.1	-10.0	2.8	-25.5	-8.7
Balance on services	-4.2	-3.1	-3.1	-2.8	-10.3	-9.9
Balance on primary income	-4.3	-4.1	-4.9	-6.9	-22.1	-26.3
Balance on secondary income	15.4	14.9	13.7	13.0	42.6	37.2
Capital account	-0.1	0.0	0.0	0.0	-0.1	0.0
Financial account	-6.0	-0.1	-2.6	8.1	-16.3	-1.5
Financial account excluding reserve assets	-6.7	3.4	-15.5	-2.3	-17.5	-16.0

Source: Banxico

All categories in the financial account showed net inflows. The financial account showed net borrowing (inflows) of US$6.0 billion in the period, which can be interpreted as a source of financing for the current account deficit. According to the current financial conditions, the balance of the financial account is explained, among other factors, by: (1) The interest in established productive chains in our country; (2) a stronger Mexican peso with higher operability and better cost-benefit for hedging –being the third largest globally operated EM currency, according to the BIS; (3) higher fears of a global recession that triggered volatility and risk aversion into financial markets; (4) a sustained rate spread between the US and Mexican funding rates; and (5) a stronger USD vs EUR at the end of the quarter.

By accounts, we with highlight direct investment, which continues to benefit from nearshoring –especially in the manufacturing industry. Thus, the net borrowing balance of this stood at US$2.0 billion, with inflows of US$6.2 billion and outflows of US$4.2 billion. Portfolio investment accumulated a net inflow of US$135 million (with US$4.4 billion in outflows and US$4.5 billion in inflow). This is surprising considering a trend of outflows in the last nine quarters, albeit somewhat consistent with the perception of strength of domestic assets amid higher risk aversion and climbing global rates. Moreover, 'other investments' showed inflows of US$4.4 billion, albeit with no relevant outflows. Lastly, errors and omissions had net inflows of US$441 million.

Financial account
US$ billion

	3Q22	2Q22	3Q21	2Q21	Jan-**Sep'22**	Jan-**Sep'21**
Financial account	-6.0	-0.1	-2.6	8.1	-16.3	-1.5
Direct investment	-1.9	-2.5	-5.3	-5.6	-20.6	-25.3
Portfolio investment	-0.1	5.2	14.6	6.9	7.8	27.1
Financial derivatives	-0.2	2.5	0.2	0.3	2.0	1.3
Other investment	-4.4	-1.9	-25.0	6.8	-6.7	-19.0
Reserve assets	0.7	-3.5	12.9	-0.3	1.2	14.4

Source: Banxico

Current account balance at the end of the year to be defined by the performance of goods and secondary income. Based on the results of first three quarters of the year, in our view, the balance of payments will continue to show adequate deficit levels and without debt stress. Thus, during 4Q22 we anticipate that trade balance will be the main driver for flows. Factors that in our view will drive the latter include some related to resilience in US demand, such as: (1) A moderation in price pressures in the US; (2) lower prices of oil and its derivatives; and (3) an improvement in confidence of US consumers. On the other hand, considering the year-end seasonality, it is to be expected that remittances –accounted in secondary income– and by international tourism services, will continue to offset for some of the outflows, especially as domestic demand remains resilient, likely resulting in strength in imports.

Regarding the financial account, we will pay attention to the Fed's and Banxico's tightening cycles. This considering growing expectations of the end of the hiking cycle and a possible decoupling from the Fed by Banxico. Although in our call this would not be seen until 3Q23, financial markets can inject volatility and uncertainty in terms of portfolio composition and the preference for local bonds or foreign bonds, which could influence flows in 'portfolio investment' and/or 'financial derivatives' accounts. Finally, we anticipate that direct investment will continue to be the largest given the inflows of new investments and boosted by nearshoring.

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