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Creating Opportunities

Economic Analysis

Current account confirms economic weakness in first quarter of 2020

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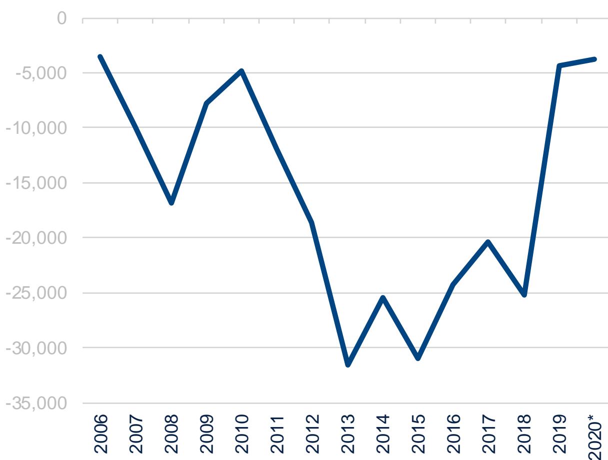
- **Net foreign direct investment plunged 20.1% in annual terms in the first quarter of 2020**
- **The current account deficit fell by USD 10.2 billion in the first quarter of 2020 compared to the same period of the previous year, mainly due to a higher surplus in the trade balance on non-oil goods**

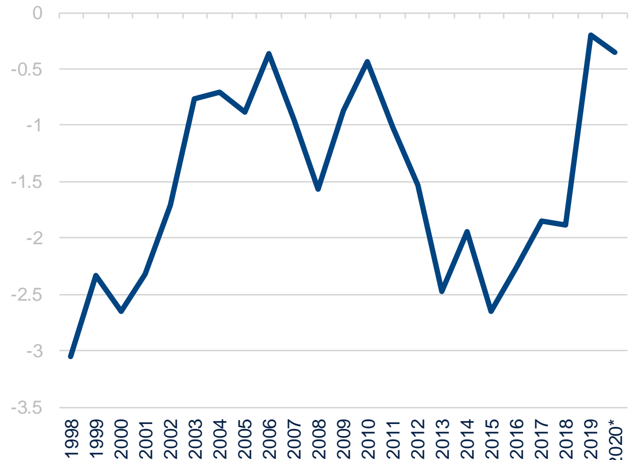
After reaching USD 25.3 billion in 2018, the current account deficit fell significantly to USD 4.3 billion in 2019 (Figure 1). The current account deficit stood at 0.2% of GDP (Figure 2). Information corresponding to the first quarter of 2020 indicates that the current account deficit was USD 982 million, which equates to 0.3% of GDP on an annualized basis. We forecast that the 2020 current account deficit will be approximately USD 3.7 billion (0.4% of GDP).

Figure 1. **Current account** (USD millions)



*/Forecast
Source: BBVA Research with Banxico data

Figure 2. **Current account** (% of GDP)



*/Forecast
Source: BBVA Research with Banxico data

Analysis of current account behavior corresponding to the first quarter of 2020 shows a deficit as opposed to the surplus registered in the fourth quarter of 2019 (Table 1). This is mainly due to the higher primary income deficit. Comparing the performance of the current account deficit in the first quarter of 2020 to the same period in the previous year, the USD 10.2 billion decrease is mainly due to the higher surplus in the trade balance on non-oil goods. The lower deficit in the trade balance on primary income was the second driver (Table 2).

Table 1. **Current account and its components in 1Q20 and 4Q19**
(USD millions)

	Oct–Dec 19 (A)	Jan–Mar 20 (B)	Difference (B–A)
Current account	3,198	-982	-4,180
Bal. on goods and services	1,720	2,523	803
Balance on goods	3,165	3,689	524
Bal. on oil products	-5,313	-5,483	-170
Bal. on non-oil products	8,526	9,205	679
Bal. on goods procured in ports by carriers	-48	-33	15
Balance on services	-1,445	-1,166	279
Bal. on primary income	-7,427	-12,640	-5,213
Bal. on secondary income	8,905	9,135	230

Source: BBVA Research with Banxico data

Table 2. **Current account and its components in 1Q20 and 1Q19**
(USD millions)

	Jan–Mar 19 (A)	Jan–Mar 20 (B)	Difference (B–A)
Current account	-11,142	-982	10,160
Bal. on goods and services	-3,081	2,523	5,604
Balance on goods	-1,815	3,689	5,504
Bal. on oil products	-4,693	-5,483	-790
Bal. on non-oil products	2,920	9,205	6,285
Bal. on goods procured in ports by carriers	-42	-33	9
Balance on services	-1,265	-1,166	99
Bal. on primary income	-15,741	-12,640	3,101
Bal. on secondary income	7,680	9,135	1,455

Source: BBVA Research with Banxico data

Net Foreign Direct Investment (NFDI) was USD 9.06 billion in the first quarter of 2020 compared to USD 11.34 billion during the same quarter of the previous year. In other words, NFDI contracted 20.1% year-on-year. This first quarter NFDI contraction is the fourth largest recorded in data analyzed back to 2006. The previous largest first quarter contraction occurred in 2015 when NFDI fell 21.4% year-on-year.

The much lower current account deficit in the first quarter of 2020 compared to the same period in 2019 in conjunction with the significant annual contraction in NFDI, show that Mexico's economic weakness continued during the first three months of the year. The significant economic contraction forecast for 2020, coupled with a new public policy environment that is slowing private investment, will make it difficult for NFDI to recover despite the entry into force of the United States–Mexico–Canada Agreement (USMCA) in July this year.

Conclusions

Our forecast for a current account deficit of 0.4% of GDP for 2020 implies that Mexico will enter a phase of significant economic contraction where goods imports will fall more in annual terms than exports (-6.60% vs. -4.80%). However, this near-zero deficit does not suggest vulnerability due to external shocks caused by the COVID-19 pandemic. Even though we expect a significant decline in foreign capital flows for 2020 since foreign holdings of portfolio investment, remittances and international tourism revenues will go down by USD 9 billion, USD 11.9 billion and USD 6.7 billion, respectively, we do not anticipate a balance-of-payments problem. This favorable expectation is due to Bank of Mexico's large international reserves (USD 186.92 billion as of May 15), the IMF's flexible credit line of USD 62 billion and the fact that the low current account deficit as a percentage of GDP does not imply financing problems. Our

prevailing belief is that this absence of external imbalances will see the peso appreciate once global risk aversion begins to decline.

The poor NFDI performance since 2019 could be due to local factors associated with the uncertainty around public policy (e.g. the cancellations of the Texcoco airport and the Constellation Brands brewery plant, the legal controversy over gas pipeline contracts and the unfavorable new rules governing investment in renewable energy). To a lesser extent, external factors related to USMCA and a slowing global manufacturing growth might be coming into play. Helping increase direct foreign investment flows into Mexico in the coming years will require a reversal of the signs of uncertainty that have been passed on to investors, which are only discouraging foreign and domestic private investment.

We do not think there is a structural problem with financing the current account deficit. A return of the deficit to levels of around 2.0% of GDP in the coming years would be due to a recovery in economic activity, which in turn would be accompanied by higher NFDI and portfolio investment levels. Moreover, near-zero current account deficits might be comfortably financed by NFDI and international remittances, even in the case of them falling significantly due to the COVID-19 pandemic.

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