››› Mexico – portfolio inflows finance a large portion of the current account deficit

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One Pager

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This year Mexico is expected to record a moderate growth of real gross domestic product of 2.4 %. As an oil-producing country and because of its close connection to the US economy, Mexico's economy is facing a difficult external environment. The low oil price, rising US interest rates and the sluggish US industrial sector have immediate negative impacts.

Long-term current account deficit

In 2014 Mexico was the world's tenth largest oil producer. Up to then it also exported more oil than it imported, despite the fact that lately the oil balance as a proportion of GDP has been low in comparison with other oil producers. In 2015, however, oil imports exceeded oil exports for the first time since the statistics began in 1993. This increased the existing current account deficit. However, the government had hedged its oil revenues at an oil price assumed in the budget, as it did in the past.

What is striking is the relatively high positive secondary income balance, which includes a major portion of the transfers made by migrant workers to Mexico as personal transfers. In 2015 these remittances exceeded revenues from oil exports for the first time (USD 24.8 billion vs. USD 23.4 billion).

Strong inflow of portfolio investments in a low-interest rate environment

The current account deficit demands that foreign investors are active in the country. Mexico received significantly more portfolio investment under the industrialised countries' low-interest policy, as was the case for the emerging and developing countries overall. To a substantial degree, these flowed into peso-denominated government securities. In 2012 net inflows reached a peak but in 2015 they dropped by nearly half on the two preceding stable years in response to a revised risk assessment for emerging economies in general.

Net foreign direct investments (FDIs) made the biggest contribution prior to the economic and financial crisis of 2008/2009. In the past years they became somewhat less important, partly because Mexico was investing more strongly abroad. In 2012 Mexican FDIs abroad even exceeded FDI inflows. E.g. the opening of the oil sector to foreign private investors in the wake of structural reforms is expected to increase inflows.

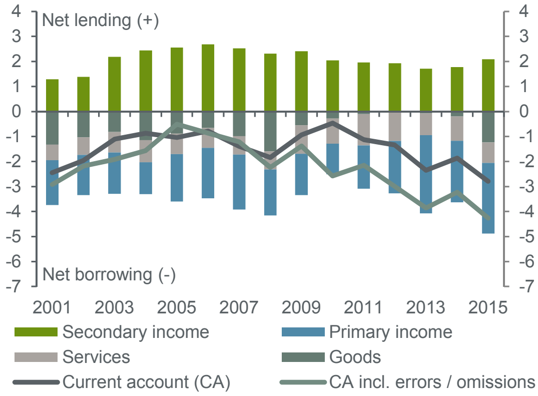
Outflows of reserves in 2015 were primarily due to foreign exchange market interventions by the central bank and lower allocations by the state oil company PEMEX, after a still adequate buffer of reserves had been continuously built up in the years before. The net errors and omissions evening out differences between current account balance and the financial account balance has been substantial since 2010, averaging -1.5 % of GDP.

No micromanagement of inflows

Mexico is addressing the strong increases in portfolio inflows primarily by mitigating possible negative effects, such as excessive domestic lending, asset price distortions and the possible reversion of capital flows. That includes a flexible IMF credit line and sufficient international reserves, improved banking regulation and the Financial System Stability Council, which was created in 2010 with the aim of monitoring relevant risks, as well as recommending and coordinating measures. In this regard, Mexico is as successful as with its macroeconomic and reform policies in general. ■

Figure 1: Components of the current account

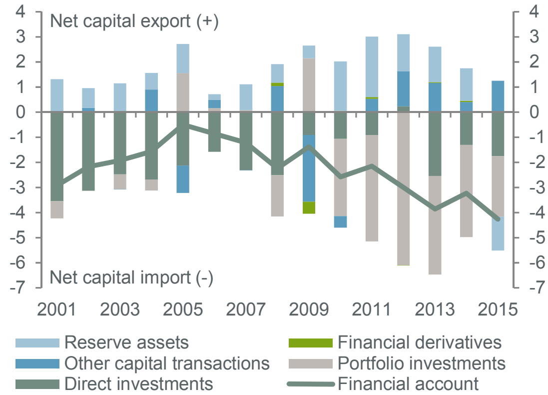
(in per cent of GDP)



Data according to the BPM6. Source: IMF, Banco de México, own calculations.

Figure 2: Components of the financial account

(in per cent of GDP)



Data according to the BPM6. Source: IMF, Banco de México, own calculations.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.