

## A Diversified Adjustment

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- The Brazilian current account balance registered a significant adjustment in 2020, with the country's deficit declining to USD12.5 billion from an imbalance of USD50.7 billion in 2019 as the COVID-19 pandemic hit the expenditure side harder than it hit the revenue side.
- The adjustment was more disseminated among the components of the current account balance than on other occasions, which in our view indicates that future currency moves should have a more rapid impact on potential deficits/surpluses.
- As for the financial account, direct investments in the country continued to be more than enough to finance the Brazilian current account deficit, and portfolio flows have continued to point toward the return of money to the country.
- All in all, we think today's data add to the set of signals that BRL weakness is related to something other than the fundamentals of the Brazilian balance of payments.

### The Greater the Sensitivity, the Faster/Stronger the Impact

The USD5.4 billion deficit registered by the current account balance in December 2020 came in slightly better than our estimate (USD5.7 billion deficit) and led the annual imbalance to reach USD12.5 billion in 2020 from a USD50.7 billion deficit in 2019. The large imbalance observed last month in the Brazilian current account was associated with the USD4.7 billion import of oil platforms, which was the reason for the USD1.0 billion deficit observed in the trade balance in the period. (Details in the link<sup>1</sup>.) It is well known that these operations are accounting adjustments related to changes in taxation, and they do not change the positive outlook for the balance of payments in the coming years, in our opinion.

Unlike previous occasions in which we witnessed strong adjustment cycles when trade surpluses accounted for the bulk of the improvement observed in the Brazilian current account balance, this time the shrinkage had to do more with the contraction of outlays in the services account—mainly those related to tourism—and the decline in the remittance of profits and dividends. The trade balance also contributed to the adjustment, even though export revenue receded as the COVID-19 pandemic hit import outlays harder. In our view, the more diversified nature of the adjustment in the current account balance helps to explain why it took much less time for it to equal the improvement observed between August 2001 and May 2005 and to reach half of the change seen between December 2014 and December 2017. We believe the greater integration of the Brazilian economy with the global one has increased the sensitivity of its balance of payments to international trade and financial flows, which tends to make it easier for currency moves to feed through the system. Hence, reversals of deficits or surpluses require smaller FX rate moves to materialize, and they tend to occur in a shorter period of time, which theoretically helps to stabilize currency moves with less pain for the country.

<sup>1</sup> Santander Brazil External Sector – “Trade Balance – December 2020” – January 4, 2021- Available on: <http://bit.ly/Sant-trad-blc-Dec20>

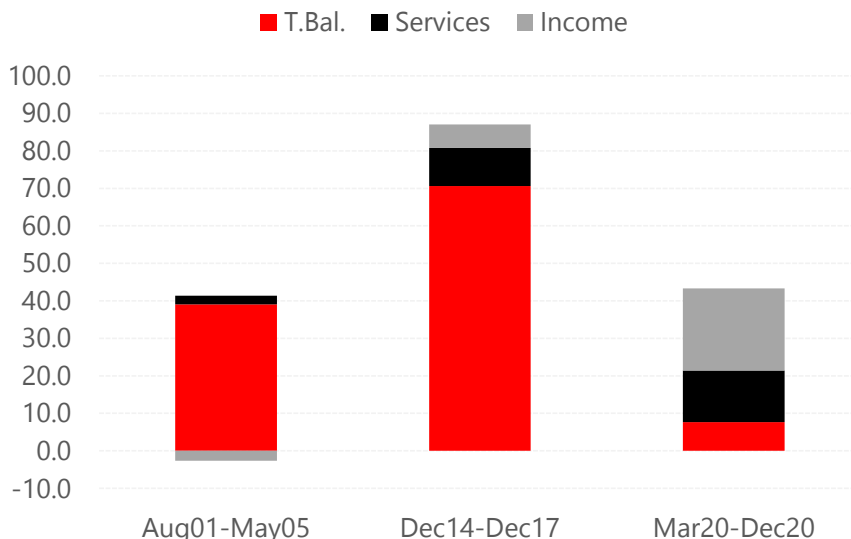
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**Figure 1 – Brazilian Current Account Adjustment Cycles (USD billion)**

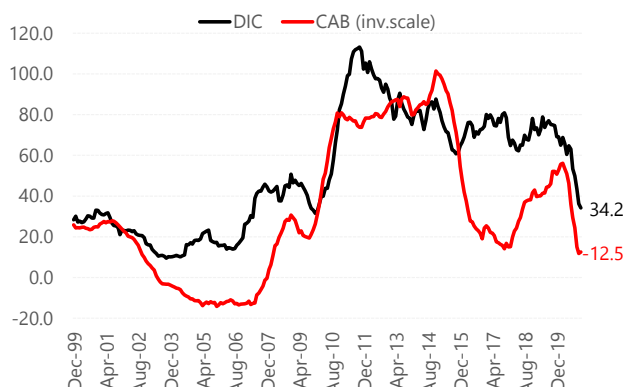


Source: Brazilian Central Bank, Santander.

In addition to this more endogenous mechanism of adjustment in the current account balance, it is important to note the maintenance of a constructive outlook for the financial account as well. Although the volume of direct investments in the country (DIC) fell short of our expectation (USD0.7 billion versus USD3.0 billion, respectively), the USD34.2 billion amassed in 2020 continued to be more than enough to finance the current account gap, which means the country continues to be in a comfortable situation as far as its external financing needs are concerned. Incidentally, the bulk of the negative surprise in DIC was associated with the payment of intercompany loans, which we think may have to do with the over-hedge issue related to financial institutions. In the past, intercompany loans were the counterpart of a capital injection in offshore subsidiaries. Hence, the repatriation of capital registered in December 2020 (USD1.8 billion) may be related to the payment of intercompany loans, in our opinion.

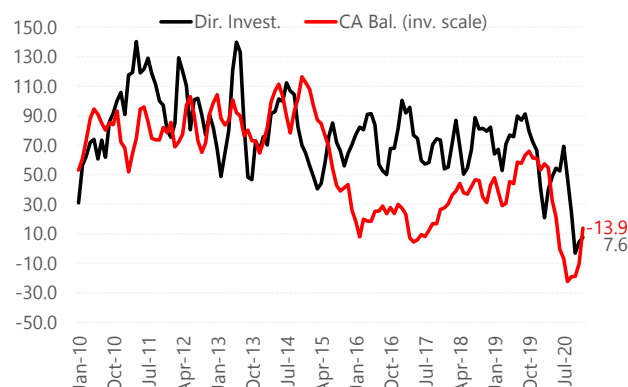
It is true that the 3MMA-saar figures of the current account balance and DIC have pointed to some deterioration in that relationship, but it is important to bear in mind that the former was affected by the distortion caused by the import of oil platforms. Although we do expect the current account deficit to worsen as the Brazilian economy gains momentum ahead, the gradual recovery we envisage for the coming quarters should turn into a measured pace of deterioration as well. Moreover, this normalization of the economy should also translate into a larger volume of direct investments in the country, in our view. Consequently, we believe external financing needs should continue to experience a tranquil environment.

**Figure 2 – Curr. Acct. Balance versus Dir. Invest. in the Country (USD billion, 12M-to-date)**



Sources: Brazilian Central Bank, Santander.

**Figure 3 – Current Acct. Balance versus Dir. Invest. in the Country (USD billion, 3MMA-saar)**



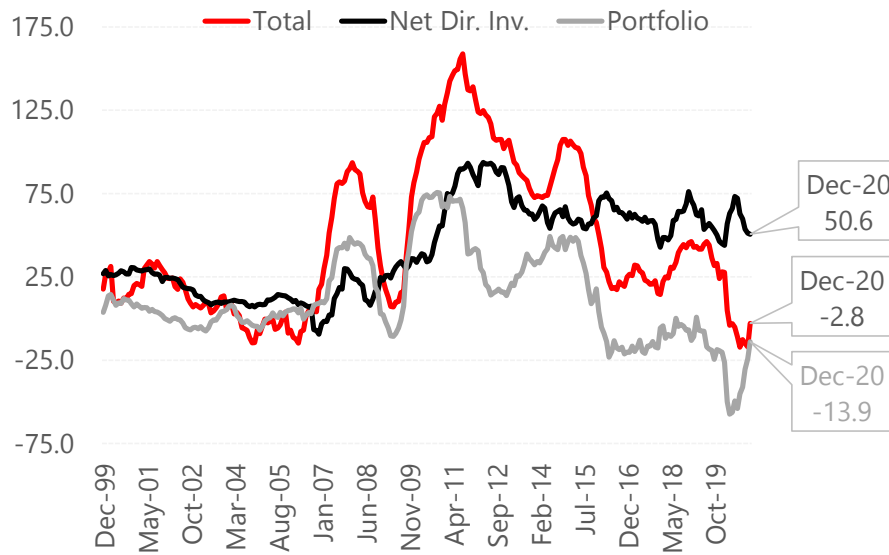
Sources: Brazilian Central Bank, Santander.

Another development that has also brought some relief with respect to the dynamics of the financial account was foreign portfolio flows directed to the acquisition of Brazilian assets in the domestic market, as that number registered the seventh positive reading in a row in December 2020 (USD6.3 billion). Adding up the USD3.0 billion



of Brazilian fixed income bonds bought by foreigners offshore, the sizeable volume of portfolio flows give us an idea about the potential for the flow of money into the country if Brazil resumes discussions about structural reforms. The global liquidity conditions are there and should continue to make it easy for the country to maintain the sound fundamentals of its balance of payments, in our view.

**Figure 4 – Financial Account (USD billion, 12M-to-date)**



Sources: Brazilian Central Bank, Santander.



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