Santander Macroeconomic Research

BRAZIL MACRO

June 9, 2021

DATA ANALYSIS – EXTERNAL SECTOR

MARKET SENTIMENT MIXED ON BRL OUTLOOK

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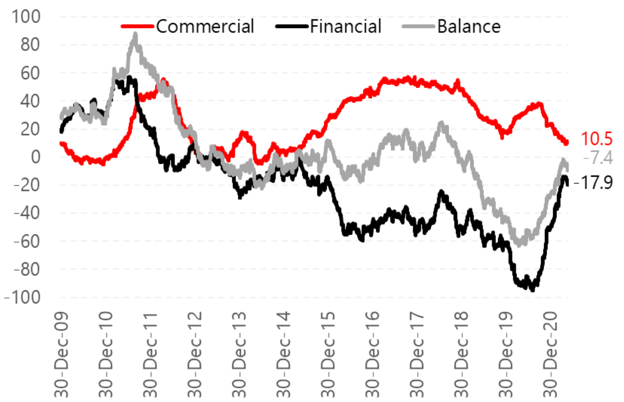
- **The Brazilian spot FX market recorded net outflows of US$0.9 billion in the 22nd week of the year (May 31 to June 4), with the commercial and financial segments recording net outflows of US$0.3 billion and US$0.7 billion, respectively.** So far this year, the Brazilian spot FX market has experienced net inflows of US$10.5 billion on a year-to-date basis and net outflows of US$7.4 billion on a 12M-to-date basis.
- **In seasonally adjusted terms, the daily average data for June 2021 indicates a potential improvement in the spot FX market during the period** (net daily inflows of US$22 million this month from net outflows of US$90 million in May 2021). **However, this does not alter the negative trend that the 3MMA-saar gage has shown of late, which may dim recent optimism on the strengthening of the BRL,** in our view.
- **On the other hand, a positive sign for the BRL is recent data pointing to a decline in the gap between the balance of shipped goods ("physical trade balance") and their financial settlements ("financial trade balance")** to US$47.6 billion on June 4 from US$51.1 billion on May 31 (on a 12M-to-date basis). Nonetheless, we think this narrowing may prove to be a protracted process, given the recent trends of both the physical and financial trade balances.
- **All in all, the Brazilian spot FX flows have stopped improving during 2Q21 in seasonally adjusted terms, in our view, notwithstanding the favorable performance of the BRL in recent weeks.** We believe this fact reinforces our assessment of the limited room for the BRL to register a perennial and substantial strengthening in the absence of progress in the reformist agenda.

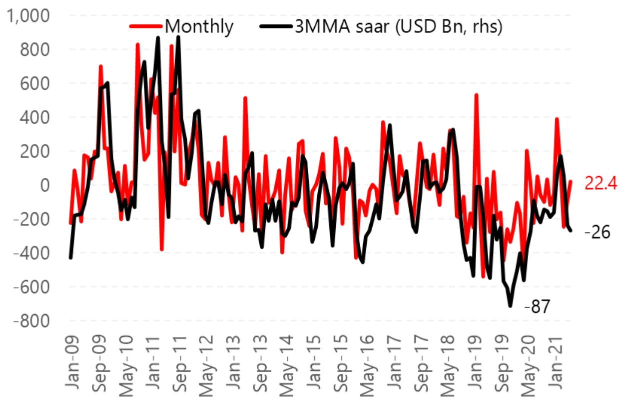
The Brazilian spot FX market recorded net outflows of US$0.9 billion between May 31 and June 4, 2021, with the departure of US$1.8 billion in May 2021 as a whole, marking the end of a four-month streak of positive results. On top of that, inaugural figures for June 2021 indicate the possibility of another negative result this month. However, the picture improves a bit if we adjust data for the number of business days and seasonal patterns, although not strongly enough to reverse the recent downward trend shown by the balance of the Brazilian spot FX market.

Figure 1: Spot FX flows (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander

Figure 2: Net Spot FX flows (USD million, daily avg, sa)

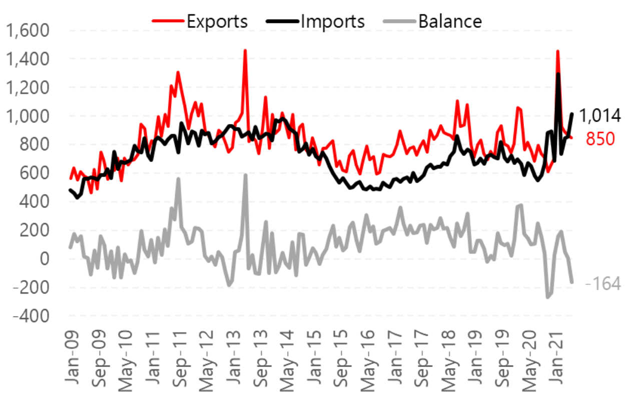


Sources: Brazilian Central Bank, Santander.

Taking a look at the recent data for seasonally adjusted daily average flows of the different components of the spot FX market, we note the anticipation of import payments has increased while the anticipation of export proceeds has dwindled. That is a curious combination in our opinion, as the outlook for exports this year continues to be quite favorable—commodity prices remain high and external demand has positively surprised us lately, among other factors—while prospects for imports remains challenging, especially on the heels of a still weak BRL. However, the data helps explain the gap we have observed between the balance of "shipped goods" and their financial settlements, which reached its historical peak in May 2021 (US$51.1 billion) and declined in the beginning of June 2021 (US$47.6 billion) on a 12M-to-date basis.

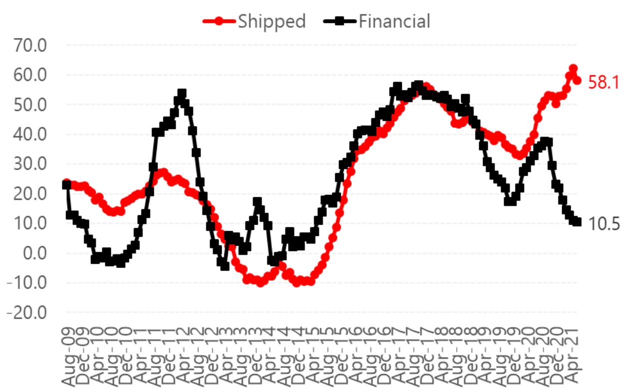
We believe exporters may be more tempted to repatriate some of their money in the near future for the following reasons. First, because of the still relatively weak level of the currency vis-à-vis fundamentals. Then, particularly as the common view is that monetary policy normalization is quite likely to continue in the coming months, which should increase the interest rate differential compared to other economies. Hence, we expect the gap between physical and financial trade balances to narrow ahead. However, this process may be a protracted one, given the speed at which we have seen the physical trade surplus increase lately. Thus, in our opinion, this process may help to curb strong pressures on the BRL in critical moments, while also not leading to a substantial strengthening of the currency anytime soon.

Figure 3: Spot FX Flows – Commercial Segment (USD million, daily avg, s.a.)



Sources: Brazilian Central Bank, Santander.

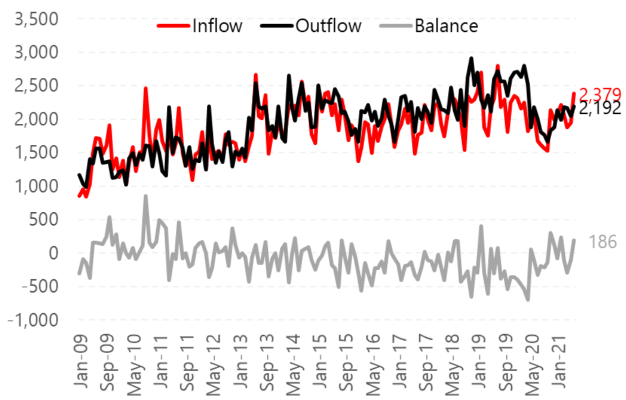
Figure 4: Trade Balance, Shipped vs Financial (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, SECINT, Santander.

Regarding the financial segment, the improvement in the balance since April 2021 has stemmed from an increase in the volume of inflows coupled with a relatively stable volume of outflows. We think this backdrop had to do with the less negative news on the fiscal front, regardless of its temporary nature. These dynamics support our view that uncertainties regarding the outlook for Brazilian government debt continue to be the main driver/hurdle for the trajectory of the BRL.

Figure 5: Spot FX Flows – Financial Segment (USD million, daily avg, s.a.)



Sources: Brazilian Central Bank, Santander.

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