Brazil Macro: External Sector

Balance of Payments: November 2020

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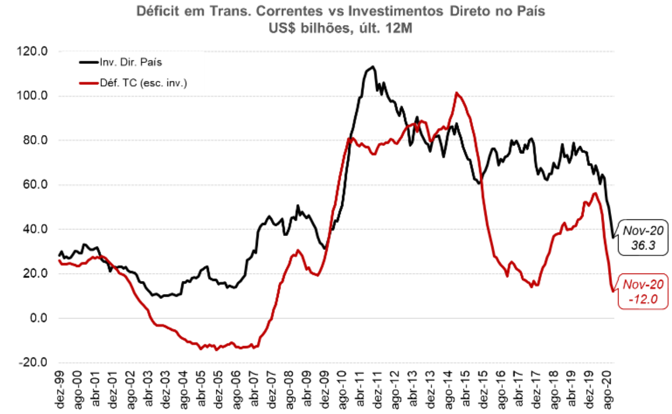
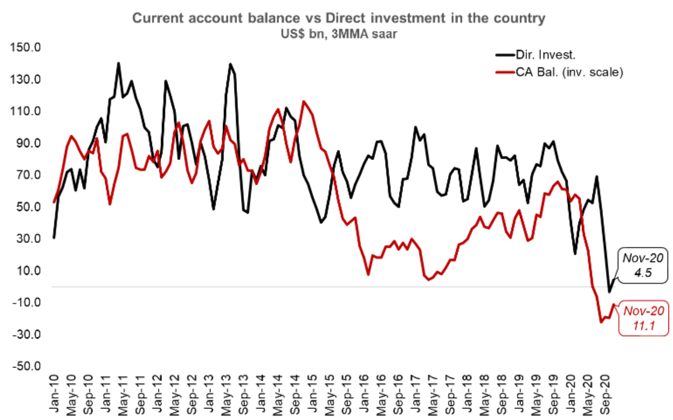
The release of Brazilian balance of payments data for November 2020 revealed that the current balance (CAB) came in a tad higher than our estimate (USD0.2 billion versus US0.1 billion, respectively), while the net inflow of direct investments in the country (IDP, in the Portuguese acronym) exceeded our estimates by a larger margin (USD1.5 billion versus USD1.0 billion). In 12-month-to-date terms, the data reinforced our view that the situation continues to be "comfortable" with respect to Brazilian external financing needs, as the IDP continued to exceed the deficit in the CAB. Nonetheless, we call our readers' attention to the fact that this "comfortable" situation has come on the heels of a swift improvement in the CAB in tandem with a declining trend in the volume of IDP.



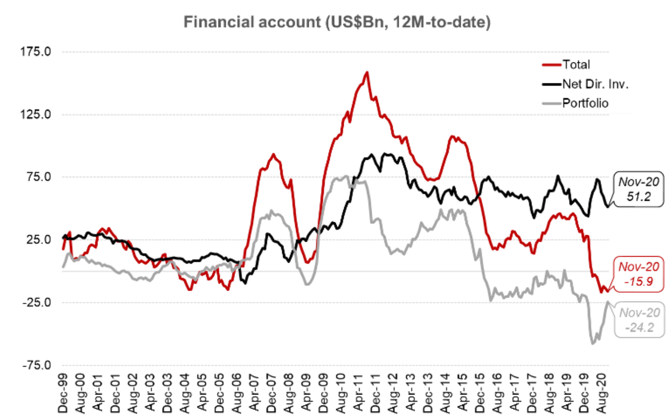
Source: Brazilian Central Bank, Santander.



Source: Brazilian Central Bank, Santander.

Incidentally, the three-month moving-averages of seasonally adjusted figures for both indicators suggest to us that the CAB is running at a pace compatible with an annualized surplus near USD11.1 billion, while the IDP annualized gauge is in line with a net inflow of USD4.5 billion. In our view, the low level of IDP indicated by this gauge is nowhere near favorable to an emerging economy, and it reinforces the need to implement changes in Brazil's economic structure in order to lure investors back to the country. As we expect the economic recovery trend to remain gradual in the coming years and anticipate the resumption of debate about a reformist agenda in Congress, we think Brazil is likely to witness some reversal in this recent trend farther down the road.

On the bright side, although the IDP has failed to gain momentum lately, foreign flows related to portfolio deals indicated sizeable volume last month. According to the Brazilian Central Bank (BCB), foreigners acquired USD6.8 billion of Brazilian financial assets in November 2020, with equities accounting for the bulk of that (USD6.1 billion). That is the sixth month in a row with a net inflow, and preliminary data for December 2020 from the BCB indicate that we are likely to see a seventh monthly positive result (until December 15, foreigners had purchased USD3.2 billion, according to the BCB). Hence, after the steep decline since early this year, the financial account seems to have leveled off lately and looks poised to show some improvement in the margin, in our view. In a nutshell, we believe this should help keep the Brazilian balance of payments off market participants' radar for now.



Source: Brazilian Central Bank, Santander.

In addition to the usual pieces of information related to the balance of payments, market participants were particularly keen to learn the amount of money that Brazilian banks repatriated in November 2020 from their offshore branches, in order to assess their need to purchase USD derivatives at the end of this year—the so-called “over hedge” theme.

Based on data released by the BCB, the Brazilian corporate sector repatriated USD1.7 billion last month, which is far less than the USD15 billion that is widely expected to be repatriated by the end of this year. We think the figure helps explain why the BCB has been tendering USD swaps in a larger volume than is needed to roll over its previous FX exposure. At the current pace (16K contracts per day), if the Brazilian monetary authority extends its supply of USD derivatives until December 29 (the BCB usually does not intervene in the last business day of any given month), there will be an increase in the BCB’s FX exposure of roughly USD10 billion. Therefore, the remaining USD5.0 billion that would match the expected volume of repatriation will need to be provided by market participants, which may prevent the USD/BRL pair from breaching the 5.00 threshold in the short term.

However, given the sound performance of Brazil’s balance of payments, and the favorable outlook for BoP, we believe the Brazilian economy is likely to witness the strengthening of its currency over the medium term (under the key assumption that the government will abide by the spending cap rule in the coming years).

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