MACRO BRAZIL

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DATA ANALYSIS – BALANCE OF PAYMENTS

ENDOGENOUS ADJUSTMENTS

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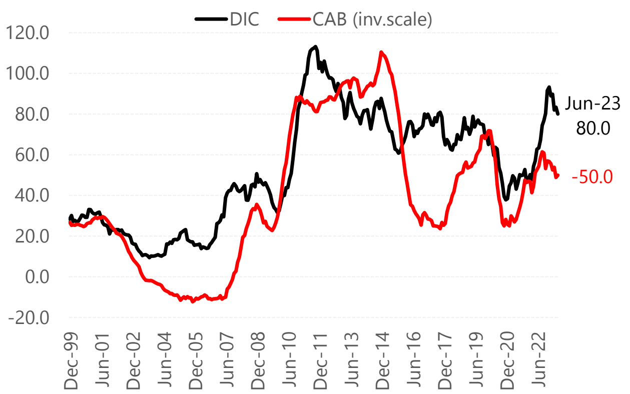
- **Today, the Brazilian Central Bank (BCB) released June balance-of-payments (BoP) data which revealed a monthly current account deficit of USD0.8 billion, a figure worse than our estimate of a USD1.0 billion surplus—which was the market median projection—and below the outcome registered a year ago as well (+USD0.3 billion). As a result, the 12-month current account deficit climbed to USD50.0 billion from USD48.9 billion in May's release, but it remained below the USD57.0 billion deficit seen at the end of 2022. That is, the current account balance continued to improve this year, a backdrop that was reinforced by its 3MMA-saar gauge that reached -USD38.9 billion from -USD62.4 billion in the end of last year.**
- **Larger imports outlays than what we calculated based upon figures displayed by the Foreign Trade Secretariat in tandem with larger interest payments and remittances of profits and dividends were responsible for the downward miss, with the deficit in services account falling short of our expectation. In our view, the latter reinforces the perception that the economy is losing steam and should contribute for the current account deficit to remain at manageable levels. As for the former influences, we think the strengthening of the currency played an important role in the anticipation of payments of obligations and in the diversification of Brazilian investments abroad (cryptocurrencies were the reason for the discrepancy in imports outlays).**
- **Regarding the components of the financial account, the volume of direct investments in the country reached USD1.8 billion last month, a reading far lower than what we anticipated (USD6.0 billion) based upon preliminary figures provided by the BCB. The figure was also worse than a year ago (USD5.2 billion), which led the 12-month rolling volume to recede to USD80.0 billion last month vs. USD83.4 billion in the previous reading. In other words, despite the negative surprise, the country continued to comfortably meet its external financing needs. The reason for the setback referred to the amortization of intercompany loans, which reinforces our view that the stronger BRL fostered the anticipation of payments.**
- **In contrast with smaller-than expected direct investment inflows, we witnessed foreigners buying a sizeable amount of assets in the domestic market (USD4.4 billion) in June, thus more than reversing the USD4.0 billion sales seen in May. Purchases were focused on the bond market (USD4.4 billion), but we also saw some acquisitions in the equity market (USD0.4 billion), which offset the withdrawals of resources in the funds markets (USD0.3 billion). The backdrop reinforces the importance of the interest rate differential to portfolio flows, in our view.**
- **All in all, we think that the June BoP data should not impact the general constructive view about the external position of the Brazilian economy, as the current account deficit is running at manageable levels and that the financial account has a favorable outlook. However, they also showed that endogenous mechanisms of adjustments in the BoP should prevent much stronger levels of the BRL ahead.**

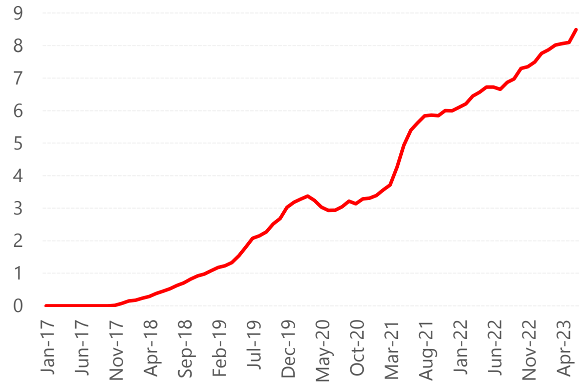
The release of the figures for Brazilian balance-of-payments data for June showed the current account balance registered at USD0.8 billion deficit rather than the USD1.0 billion surplus we expected to see. Besides falling short of our expectation, the reading was worse than the one seen a year ago (+USD0.2 billion), which led the current account gap to increase to USD50.0 billion in 12-month terms (or -2.5% of GDP). Part of the downward miss referred to larger remittances of profits and dividends than we had calculated based upon their seasonal pattern and preliminary figures provided by the BCB in the middle of last month. Larger interest payments than those indicated by the BCB's schedule also contributed to the negative surprise. Last but not the least, the wider-than-usual discrepancy between imports outlays data provided by the Foreign Secretariat and those displayed in the BCB's estimates also contributed to our miss. The BCB's trade balance factors in items other than just shipped merchandises as cryptocurrencies and deals via online trading platforms–which accounted for the bulk of the wider discrepancy.

Figure 1. Current Account vs. Direct Investment (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 2. Brazilian purchase of cryptocurrencies (USD billion, 12m)

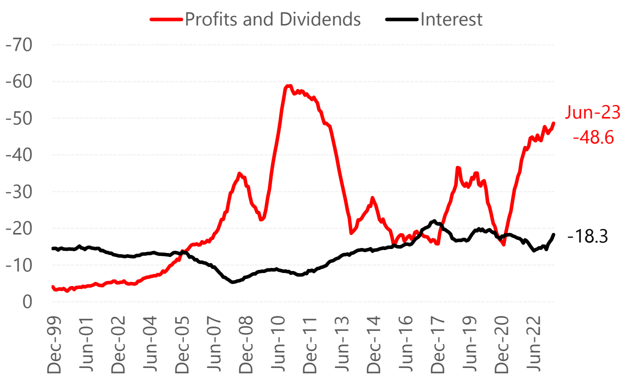


Sources: Brazilian Central Bank, Santander.

In contrast with those lowlights, we saw the deficit in services account falling short of our estimate, thus reinforcing our view that the economy is losing steam and should contribute to keep the services deficit subdued. In turn, we believe that the worse outcomes than expected displayed by imports and the primary income components could have reflected the strengthening of the BRL last month, with companies and individuals taking advantage of the stronger BRL to anticipate payments of obligations or to diversify their investments abroad (cryptocurrencies). Therefore, in our view, they should work as endogenous mechanisms of adjustment of the current account balance limiting the room for the BRL to strengthen much further.

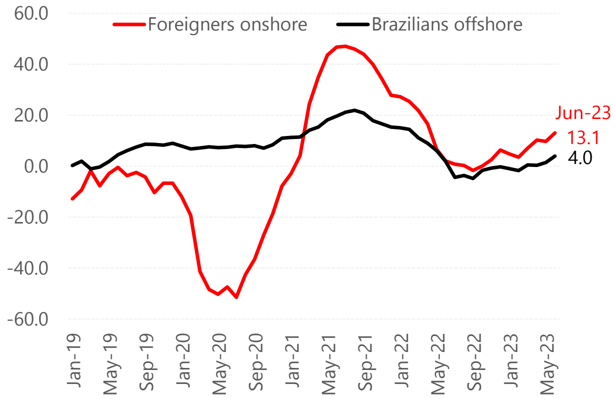
We believe the same mechanism of adjustment justified the larger amortizations of intercompany loas seen last month, which led the volume of direct investments in the country to tally USD1.9 billion in the period – far below our estimate of USD6.0 billion and market median estimate of USD6.3 billion. It is true that the rolling 12-month gage remained in the USD80 billion level, thus being more than enough to finance the current account gap and not altering the constructive view that markets have about the external position of the Brazilian economy. However, it also hints at the limitation for the BRL to get much stronger.

Figure 3. Primary income account – Selected Items (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 4. Portfolio Investments – Selected Items (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

In turn, the volume of foreign portfolio investments in the domestic market was positive in June (USD4.4 billion) and offset the negative print seen in the previous reading (-USD4.0 billion), with deals in the bond market responding for the bulk of the purchases (USD4.4 billion) and the equity market and funds withdrawals offset each other (+USD0.4 billion and USD0.3 billion, respectively). In our opinion, these dynamics hint at the importance of the interest rate differential to lure foreign investors to Brazil. Given that central banks of advanced economies have not yet concluded their tightening cycles while the BCB is about to launch an easing cycle soon, the lure to invest in the bond market could dwindle, in our opinion. In addition, Brazilian investors have also sought to diversify their portfolio lately and it was no different last month when they sent USD0.8 billion abroad. It is true that both volumes have shown an ascendant path lately, with their 12-month rolling gages reaching USD13.1 billion and USD4.0 billion, respectively. However, while the volume of Brazilian investors abroad should increase stemming from the lower interest rate differential and the domestic economic slowdown, we believe there is a chance for the volume of foreign investors in the domestic country to follow the opposite way.

All in all, in our view, data indicates the Brazilian economy continues to be in a comfortable situation regarding its external source of funding, which we expect will keep the Brazilian balance of payments off the radar of market concerns. Nonetheless, as the endogenous mechanisms of adjustments have already started to show up, we remain confident on our forecast of a USD52.9 billion deficit for the current account balance this year.

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