BRAZIL MACRO February 23, 2022

DATA ANALYSIS – EXTERNAL SECTOR

FORGET FIRST IMPRESSIONS

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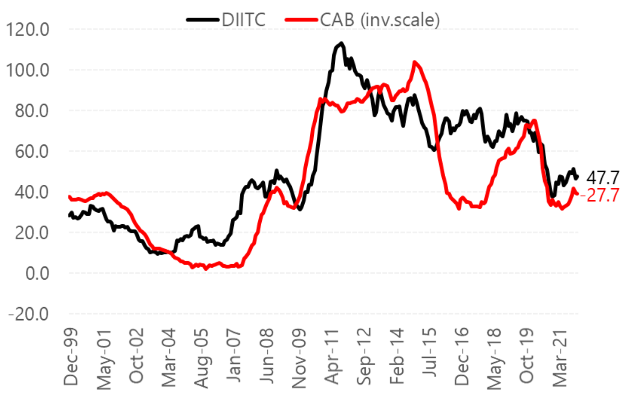
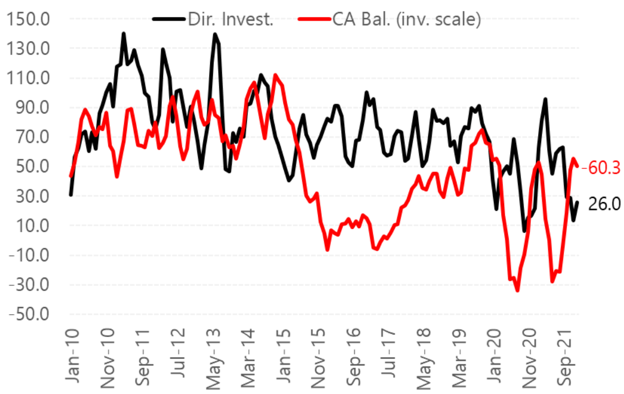
- **The Brazilian balance-of-payments data for January 2022 revealed that the current account balance registered a US$8.1 billion deficit, which surpassed both our estimate (-US$7.0 billion) and the market's median estimation (-US$7.8 billion). On a 12-month basis, the current account deficit receded to US$27.7 billion from US$27.9 billion in December 2021, thus reinforcing our perception that there is room for improvement ahead.**
- **Additionally, the data indicated that the volume of direct investments in the country (DIITC) totaled US$4.7 billion last month, which was also higher than our forecast (US$3.5 billion) and led to net inflows of US$47.7 billion on a 12-month basis from US$46.4 billion in the previous reading. That is, the country continues to find a steady financing source for its current account deficit.**
- **In addition to funds provided by DIITC, the Brazilian economy has also lured portfolio investments recently. In January 2022, foreigners acquired US$5.4 billion of Brazilian financial assets in the domestic market, which translated into net inflows of US$26.7 billion on a 12-month basis.**
- **All in all, figures released this morning do not alter the constructive view—which we share—about the soundness of the Brazilian external position.**

Figure 1 – Current account balance vs. Direct investment in the country (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 2 – Current account balance vs. Direct investment in the country (USD billion, 3MMA saar)

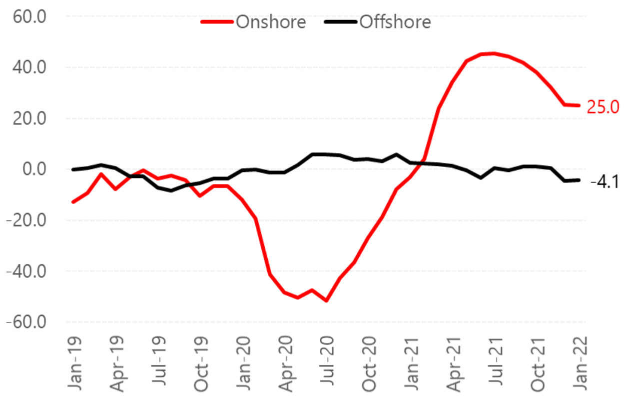


Sources: Brazilian Central Bank, Santander.

The January 2022 current account deficit of US$8.1 billion exceeded our estimate (-US$7.0 billion) and market median estimation (-US$7.8 billion), basically on the heels of stronger remittances of profits and dividends, which boosted the primary income deficit (-US$5.4 billion vs. estimate of -US$4.3 billion). Regarding the other components of the current account balance, the larger-than-expected trade deficit (-US$1.5 billion vs. estimate of -US$1.0 billion) was offset by a smaller-than-anticipated imbalance in the services account (-US$1.5 billion vs. estimate of -US$2.0 billion). Despite the setback, January 2022 data led the current account deficit on a 12-month basis to remain nearly stable as compared to the previous reading (-US$27.7 billion from -US$27.9 billion in December 2021), which is a quite praiseworthy performance, as the country registered a trade deficit last month. As we expect trade figures to improve in the coming months, we believe there is room for the current account deficit to shrink ahead, which should continue to keep the theme out of the markets' list of concerns.

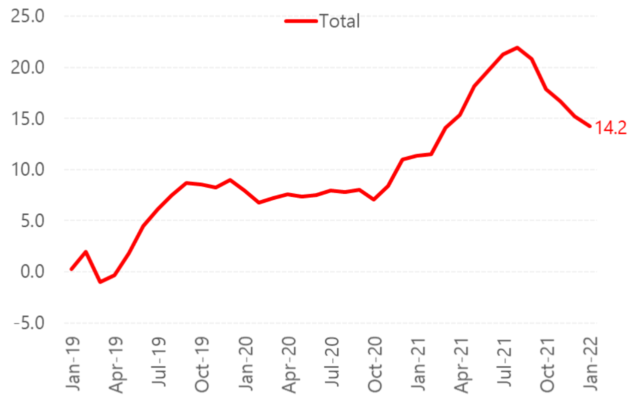
Moreover, taking a look at the discrepancy wrought by the remittances of profits and dividends, we note that the bulk of this discrepancy related to reinvested earnings, which are mirrored in the financial account in the line of direct investments in the country (DIITC) and helps to explain the positive surprise observed in January 2022. While we had expected the volume of direct investments in the country to total US$3.5 billion, the actual reading indicated net inflows of US$4.7 billion in the period. Hence, on a 12-month basis, DIITC reached US$47.7 billion in January 2022 from US$46.4 billion in December 2021 and reinforced the perception that it continues to be a steady source of funds to finance the Brazilian current account deficit by a large margin.

Figure 3 – Net Foreign Portfolio Investments (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 4 – Brazilian Portfolio Investments Offshore (USD billion, 12m)

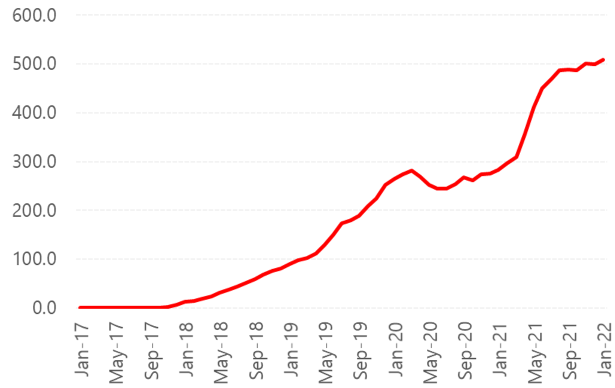


Sources: Brazilian Central Bank, Santander.

In addition to DIITC, portfolio investments have also provided funds to the Brazilian economy. Last month, foreigners acquired US$5.4 billion of Brazilian financial assets in the domestic market, with the bulk of the operations being related to fixed-income bonds (US$3.5 billion), but with a fairly decent amount of money (US$1.8 billion) flowing into the equity market as well. These data underpin the current perception that part of the strengthening of the BRL has to do with a global asset reallocation wave in tandem with the higher level of interest rate in Brazil.

By the same token, similar factors have led Brazilian citizens to refrain from investing abroad, which led to a four-month streak without net acquisitions of foreign assets by Brazilian citizens. The sole exception to that trend was cryptocurrencies, which Brazilian citizens continue to buy at a reasonable pace (~US$0.5 billion a month, according to the average of the last 12 months – 12MMA). Nonetheless, even in this case, there has been a loss of momentum lately, which we believe indicates the lure of higher interest rate levels in the domestic market could thwart further expansion of these purchases.

Figure 5 – Brazilian Purchases of Crypto-Assets (USD million, 12MMA)



Sources: Brazilian Central Bank, Santander.

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