BRAZIL MACRO

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DATA ANALYSIS – EXTERNAL SECTOR

AT EASE

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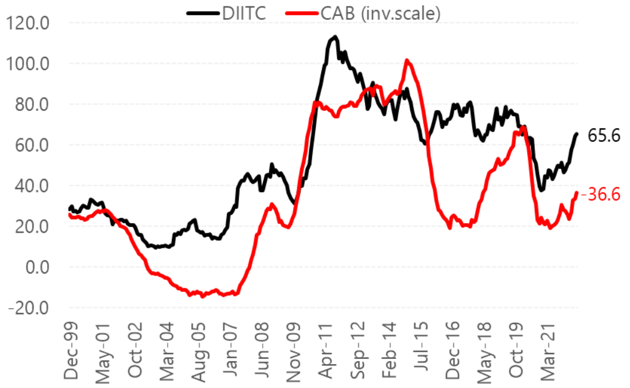
- **Today the Brazilian Central Bank (BCB) released June and July balance-of-payment (BoP) data, which revealed a current account surplus of US$1.3 billion for the former month and a current account deficit of US$4.1 billion for the latter. Both figures came in better than our estimates of a US$0.4 billion deficit for June and a US$4.8 billion deficit for July, with July's BoP implying a smaller current account deficit in 12-month terms than we were expecting: US$36.6 billion vs. US$38.9 billion.**
- **Positive surprises in both results stemmed from smaller remittances of profits and dividends than we anticipated, as trade balance surpluses and services income deficits in the period were in line with our expectations. As a result, the 3MMA-saar gauge for the current account deficit improved to US$36.6 billion in July from US$48.9 billion in May, which reinforces our expectation of a US$39.1 billion deficit for FY2022.**
- **In addition to these favorable dynamics in the current account balance (CAB), we also continued to see sizeable investment flows into the country. The volume of direct investments in the country (DIITC) was US$12.9 billion in the two months, which led to a US$65.6 billion amount in 12-month terms (the highest level since March 2020). Therefore, Brazil continues to be in a comfortable situation as far as external financing is concerned.**
- **Despite the soothing backdrop described above, we highlight that foreign portfolio investments in the domestic market registered mixed results in June and July, with inflows in the fixed income segment being accompanied by outflows in the equity market. At the same time, we saw Brazilian portfolio investments abroad being unwound, which indicates a greater appetite to keep money in the country, in our opinion.**
- **All in all, given the manageable level of the current account deficit and the favorable prospects regarding the financial account, we think the constructive view of the Brazilian external position is likely to continue offering partial insulation against international jitters.**

The release of the (delayed) figures for Brazilian balance-of-payments data for June and July showed a deterioration in the current account deficit in 12-month terms, to US$36.6 billion. The bulk of the worsening in the current account deficit is associated with larger remittances of profits and dividends stemming from stronger-than-expected economic activity in 1H22 on the heels of fiscal incentives and the normalization of activities that were previously hit by the COVID-19 pandemic. However, we saw the actual monthly figures (+US$1.3 billion and -US$4.1 billion, respectively) revealing better performance than our estimates (-US$0.4 billion for June and -US$4.8 billion for July). These positive surprises stemmed from smaller remittances of profits and dividends in the period than we anticipated, which reinforces our assessment that these payments are likely to lose steam as the lagged effects of prior interest rate hikes start to take a toll on economic activity in the coming months. That is, we continue to see remittances as an endogenous mechanism of adjustment that currently characterizes the current account balance.

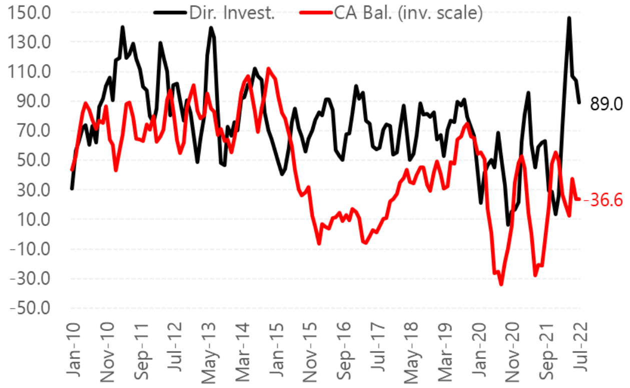
Another indication of a slower deterioration in the current account deficit ahead came from the behavior of the 3MMA-saar gauge. Although the current account deficit reached 2.1% of GDP in July — a threshold that usually triggers concerns among investors — the 3MMA-saar gauge improved significantly to a US$36.6 billion deficit (the same level seen in 12-month terms) from US$48.9 billion (2.8% of GDP) in May 2022.

Figure 1. Current Account Balance vs. Direct Investment in the Country (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

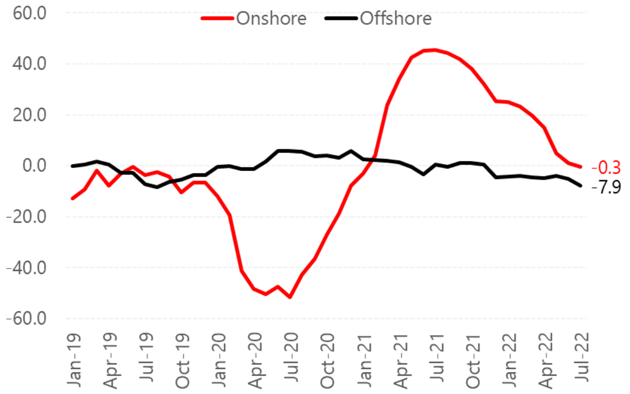
Figure 2. Current Account Balance vs. Direct Investment in the Country (USD billion, 3MMA-saar)



Sources: Brazilian Central Bank, Santander.

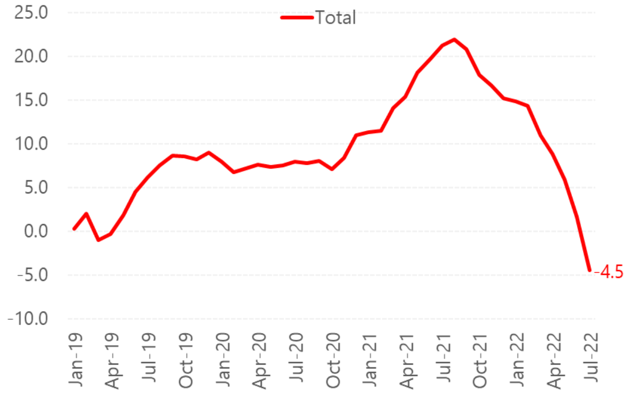
Therefore, we believe the temporary deterioration in the current account balance does not imply a negative trend for the future, especially when we consider that direct investments in the country have continued to flow fairly freely. Given the US$12.9 billion recorded during June and July, the amount amassed in 12-month terms reached US$65.6 billion, which is the highest level observed since March 2020. If we look at the 3MMA-saar gauge, the picture is comfortable as well, as it points to a somewhat higher level than the one shown by the current account deficit on the same terms. In sum, the Brazilian economy continues to be in a comfortable situation regarding its external source of funding, which we expect to keep the Brazilian balance of payments off the radar of market concerns.

Figure 3. Net Foreign Portfolio Investments (USD billion, 12-month)



Sources: Brazilian Central Bank, Santander.

Figure 4. Brazilian Portfolio Investments Abroad (USD billion, 12-month)



Sources: Brazilian Central Bank, Santander.

Although the funding of the current account deficit is an undemanding task, in our view, and the backdrop for the Brazilian balance of payments does not cause significant worries, we highlight that the volume of foreign portfolio investments in the domestic market registered a mixed outlook in June and July, with net inflows in the former and small net outflows in the latter. As a result, we continued to a see a declining trend in 12-month terms. In our view, this is a sign of foreigners' caution regarding the price dynamics of Brazilian financial assets in the coming months, especially amid lingering uncertainties regarding the future of economic policy from 2023 onward. In turn, Brazilian portfolio investments abroad moved into negative territory in 12-month terms, which indicates the repatriation of money to the country, thus partially offsetting foreigners' withdrawals. That bodes well for the maintenance of positive results in the financial account in the near future, but we see a limited capacity for the repatriation process to offset larger (or more protracted) foreign outflows. Therefore, although the constructive view of the Brazilian external position is unlikely to be changed by today's figures, we believe a stronger BRL will require structural improvements in other segments of the Brazilian economy.

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