Santander
Macroeconomic Research

BRAZIL MACRO

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DATA ANALYSIS – EXTERNAL SECTOR

ON THE EDGE

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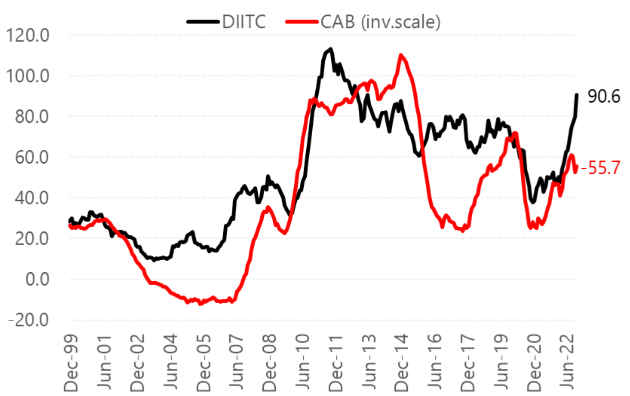
- **The Brazilian Central Bank (BCB) released December balance-of-payment (BoP) data, which revealed a monthly current account deficit of USD10.9 billion, a figure worse than the market median estimate and our projection (USD6.4 billion and USD6.6 billion deficits, respectively). As a result, we calculate the 3MMA-saar gauge worsened to -USD63.0 billion from -USD57.3 billion in November. The outcome was also worse than the one registered a year ago (-USD7.7 billion), which led the 12-month current account deficit to reach USD55.7 billion as compared with -USD52.5 billion in the previous release.**
- **Remittances of profits and dividends in December 2022 topped our estimate and came in much higher than suggested by preliminary figures provided by the BCB last month. They accounted for nearly 50% of the downward miss between our estimate for the monthly current account deficit and the real outcome. A larger deficit in the services account, a smaller trade surplus, and bulkier interest payments accounted for the remainder of the slip.**
- **Although the annual current account deficit of USD55.7 billion (-2.9% of GDP) was higher than what we expected (-USD51.2 billion and -2.7% of GDP, respectively), we also saw the volume of direct investments in the country reaching USD90.6 billion last year (4.8% of GDP and the largest reading since the USD92.6 billion observed in December 2012), which surpassed our expectation of a USD87.8 billion inflow for the last year. That is, the country continued to comfortably meet its external financing needs.**
- **On top of direct investment inflows, we also witnessed foreigners purchasing a sizeable amount of assets in the domestic market (USD4.1 billion) for the third consecutive month, which also reinforces our perception that the Brazilian external position is out of the markets' list of concerns. Nonetheless, it was also the third consecutive month in which Brazilian investors sent money abroad, which illustrates the contrasting views regarding the prospects for the new administration.**
- **All in all, we think that the December BoP data reinforces our assessment that the current account deficit runs at manageable levels and the financial account bears favorable prospects. Hence, we think the constructive view of the Brazilian external position is likely to continue offering partial insulation against international jitters.**
- **Although the backdrop we outlined before implies a small probability of a massive devaluation of BRL, we think it is important to bear in mind that the current account deficit should become an additional hurdle for the strengthening as it has reached the level of 3% of GDP. In past occasions, current account gaps above that threshold were followed by strong adjustments that combined BRL weakening and economic contraction.**

The release of the figures for Brazilian balance-of-payments data for December showed a much larger current account deficit than our (and market's) estimate, as the actual outcome stood at -USD10.7 billion and we were anticipating a USD6.6 billion gap (market median estimate was -USD6.4 billion). As a result, the current account gap ended 2022 at USD55.7 billion in 12-month terms (or -2.9% of GDP). The bulk of the difference between our estimate and the actual reading had to do with larger remittances of profits and dividends than we had calculated based upon preliminary figures provided by the BCB in the middle of last month. According to these data, the remittance of profits and dividends had amassed USD2.3 billion in the first half of December 2022. We thought that the largest part of those operations had already concluded given the proximity of Greetings Season, but there was an acceleration in the second half of last month and the remittances reached USD6.7 billion. In our view, the intensification in the last few days of December 2022 derived from fears of potential changes in tax rules regarding these operations, which means remittances are likely to lose steam this year, in our view–and even more intensely due to the economic slowdown we expect to materialize soon on the heels of lagged effects of prior interest rate hikes.

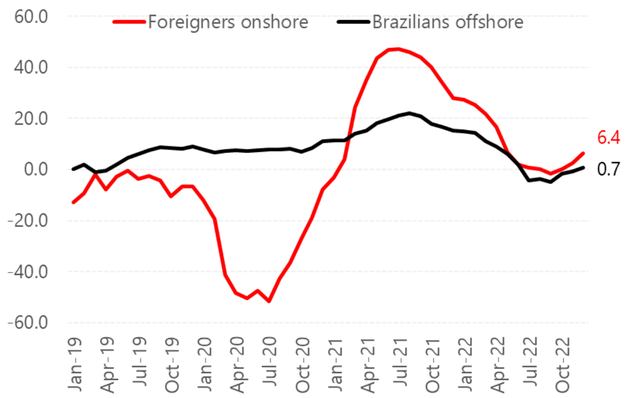
Besides the sizeable remittances, we also witnessed a larger deficit in the services account stemming from deals related to construction and architecture assistance–something that is quite rare to happen in this specific line of the services account. Finally, the trade surplus registered last month was smaller than we anticipated as imports from global marketplaces (low-ticket purchases that are packed and settled by local financial entities) added USD1.6 billion to data provided by the Foreign Trade Secretariat. The economic slowdown we mentioned before is likely to weigh on the rhythm of domestic income growth and curb imports ahead, in our opinion. Moreover, given our expectations for commodity prices to remain at historically favorable levels and the external demand for Brazilian products to be robust, we expect sizeable trade surpluses in the coming years, which should contribute positively for the performance of the current account balance. That is, we continue to see favorable prospects for the Brazilian current account balance.

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



Sources: Brazilian Central Bank, Santander.

Figure 2. Portfolio investments – selected items (USD billion, 12m)



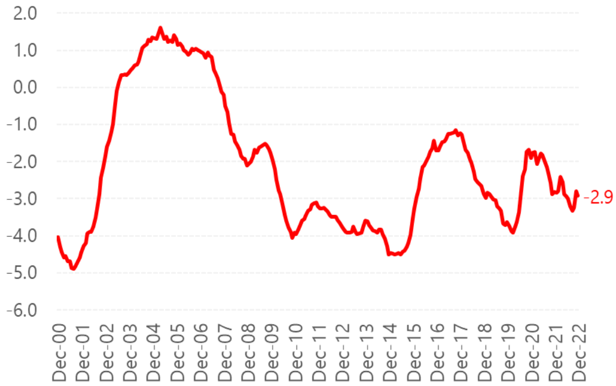
Sources: Brazilian Central Bank, Santander.

On top of the qualifications made to the larger-than-expected current account deficit in December 2022, we think it is also important to notice that direct investments in the country have continued to flow fairly freely. Given the USD5.6 billion recorded last month, the amount amassed in 12-month terms reached USD90.6 billion (4.8% of GDP), which is the highest level observed since 2012. We also highlight that the volume of foreign portfolio investments in the domestic market was positive in December (the third month in a row), with net inflows on fixed income, funds, and the equity market. As a result, we saw the country registering the second consecutive year of net inflows in its domestic financial market (USD6.4 billion in 2022).

In our view, this is a sign of foreigners' eagerness to take advantage of depressed prices of Brazilian financial assets, which have been hit by uncertainties regarding the future of economic policy from 2023 onward. In turn, we saw the pause in the repatriation of money to the country, marking a three-month streak as well, as Brazilian portfolio investments abroad tallied USD0.8 billion in the period, which also led the 12-month volume to move up. We think the foreign inflows indicate there is appetite for Brazilian financial assets at the current levels, but the Brazilian outflows signal there are concerns to be solved in the domestic front in order to lure investors in a more sustainable fashion. However, in our view, data indicates 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.

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 and should prevent the BRL from witnessing massive episodes of weakness in the short term, we believe the current account deficit should be a hurdle for the strengthening of the currency. The reason is that it has reached 3.0% of GDP level, above which the country ran into severe adjustments that combined BRL weakening and economic deceleration. Any coincidence with our current macroeconomic scenario is not by accident, in our view.

Figure 3. Current Account Balance (% of GDP, 12m)



Sources: Brazilian Central Bank, Santander.

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