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## Brazil Macro | July 2021

FX rate & Balance of Payments

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# INDEX

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## SUMMARY

- The international environment remains relatively constructive for the Brazilian currency, notwithstanding the more hawkish tone conveyed by the FOMC in its last meeting, which suggests a stronger USD over the medium run.
- Additionally, market perception of domestic fiscal risks has improved of late and the Brazilian Central Bank (BCB) has signaled that there is a chance of a faster monetary policy normalization. Unfortunately, macro reforms should continue to follow a protracted process and fiscal uncertainties should not be dimmed by the polarized presidential race the country is likely to witness in 2022.
- As a result, we are revising our year-end 2021 FX forecast to USD/BRL5.05 from USD/BRL5.25, but we are keeping our year-end 2022 FX forecast at USD/BRL5.55.
- The relatively weak BRL, the robust external demand and high commodity prices continue to support the trade and current account balances. However, we believe the improved outlook for Brazilian GDP should lead to larger remittances of profits and dividends, along with outlays for services.
- Hence, we now expect the current account balance to register deficits of US\$7.8 billion and US\$12.4 billion in 2021 and 2022 versus our previous estimates calling for surpluses of US\$4.9 billion and US\$2.5 billion.

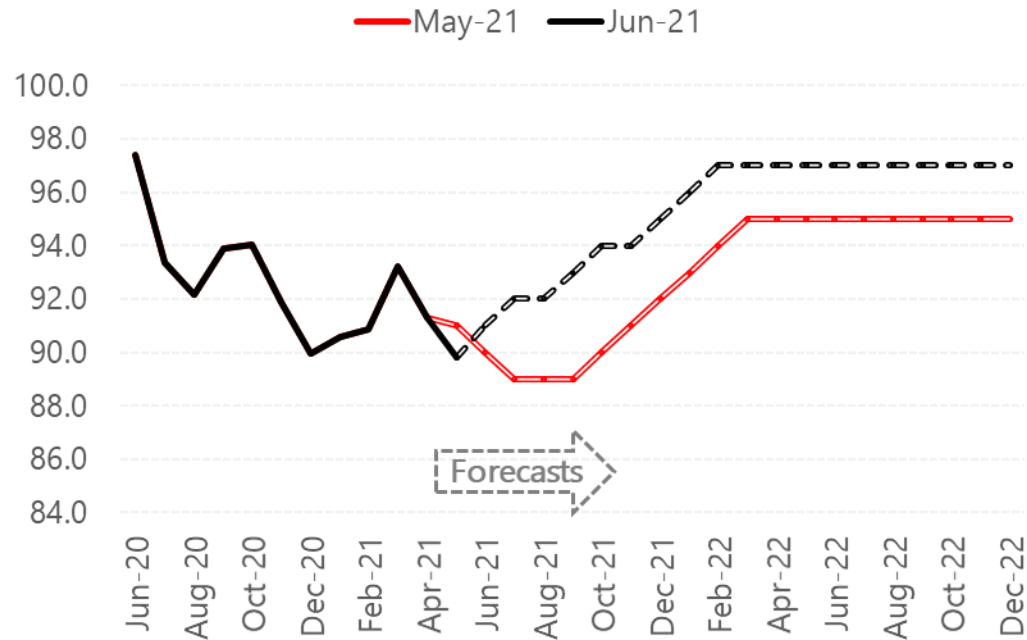
FX rate

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## A (STILL) RELATIVELY CONSTRUCTIVE GLOBAL (LIQUIDITY) ENVIRONMENT

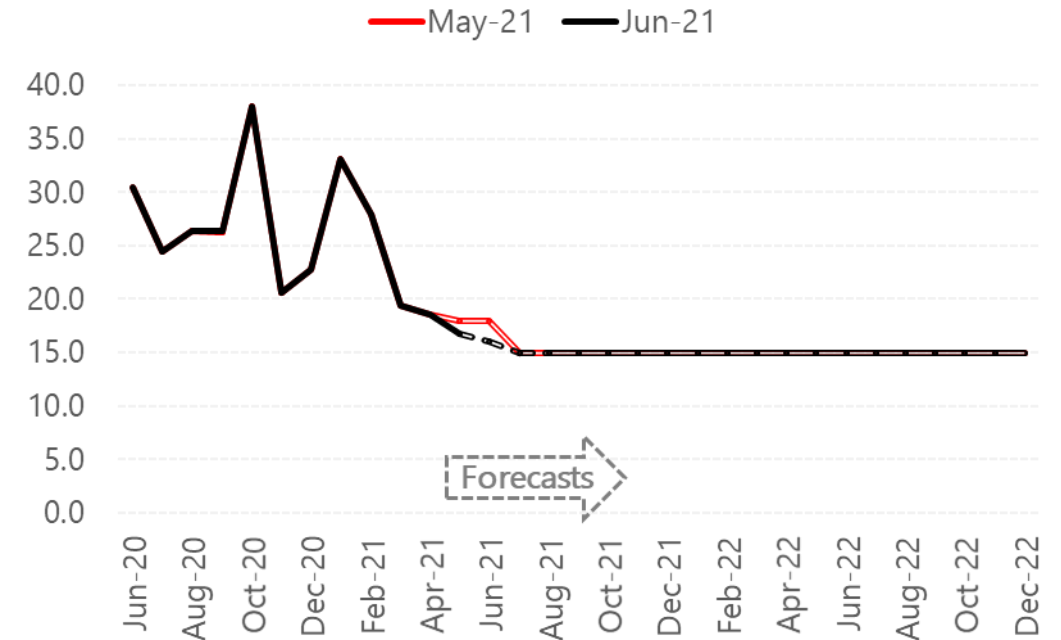
- Although we expect some reversal of the DXY Index late in 2021 on the back of prospects for the beginning of a monetary tapering in the US, we don't believe the move should leave the level of risk aversion among market participants to increase.

**DXY Index (1973=100)**



Sources: Bloomberg, Santander.

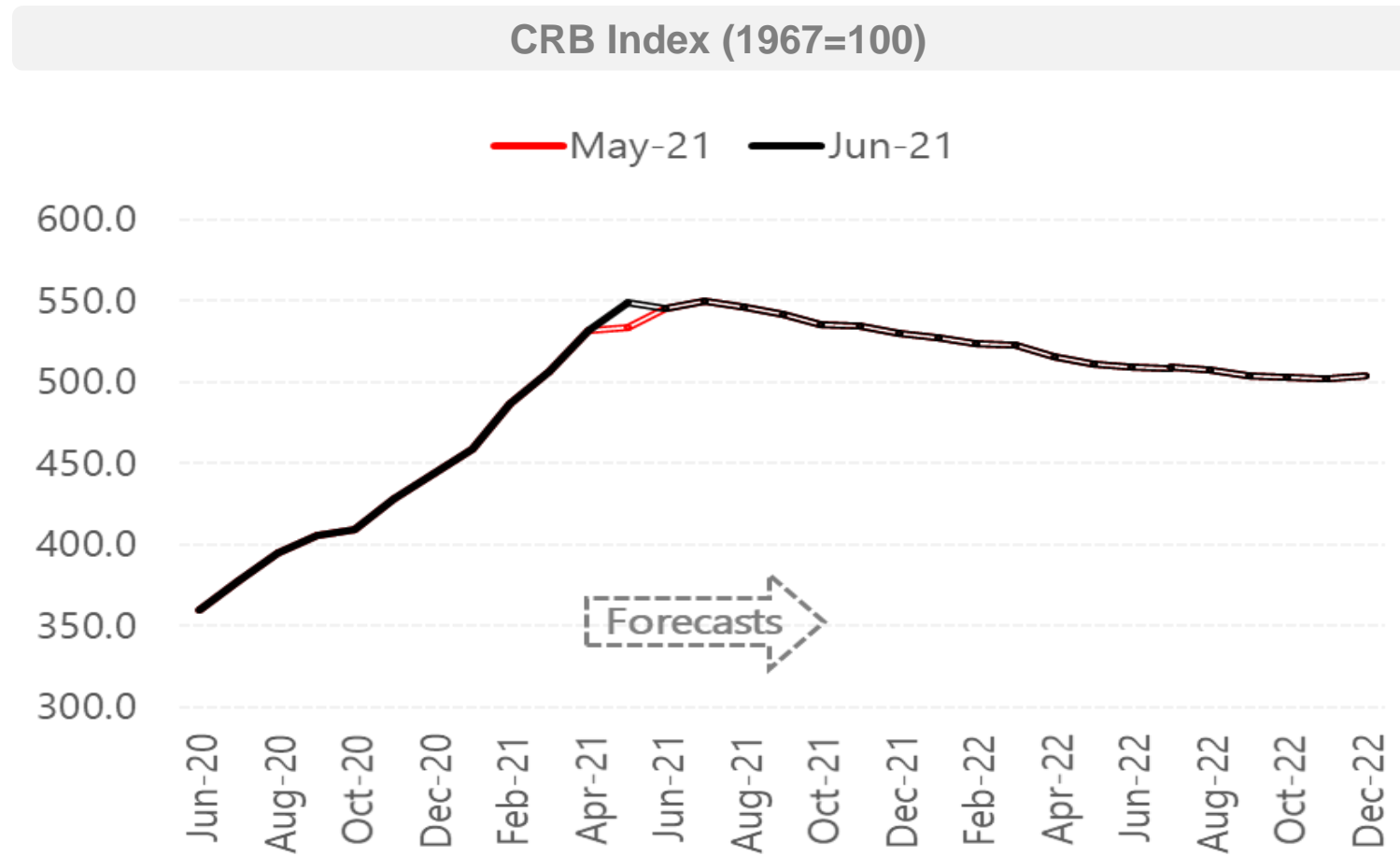
**VIX Index (% pa)**



Sources: Bloomberg and Santander forecasts.

## NO REVERSAL AT FIRST SIGHT

- Still bounteous liquidity conditions, extension of stocks replenishment and the maintenance of economic recovery around the globe should support commodity prices at high levels. However, we expect the US monetary tapering to ignite some correction next year.

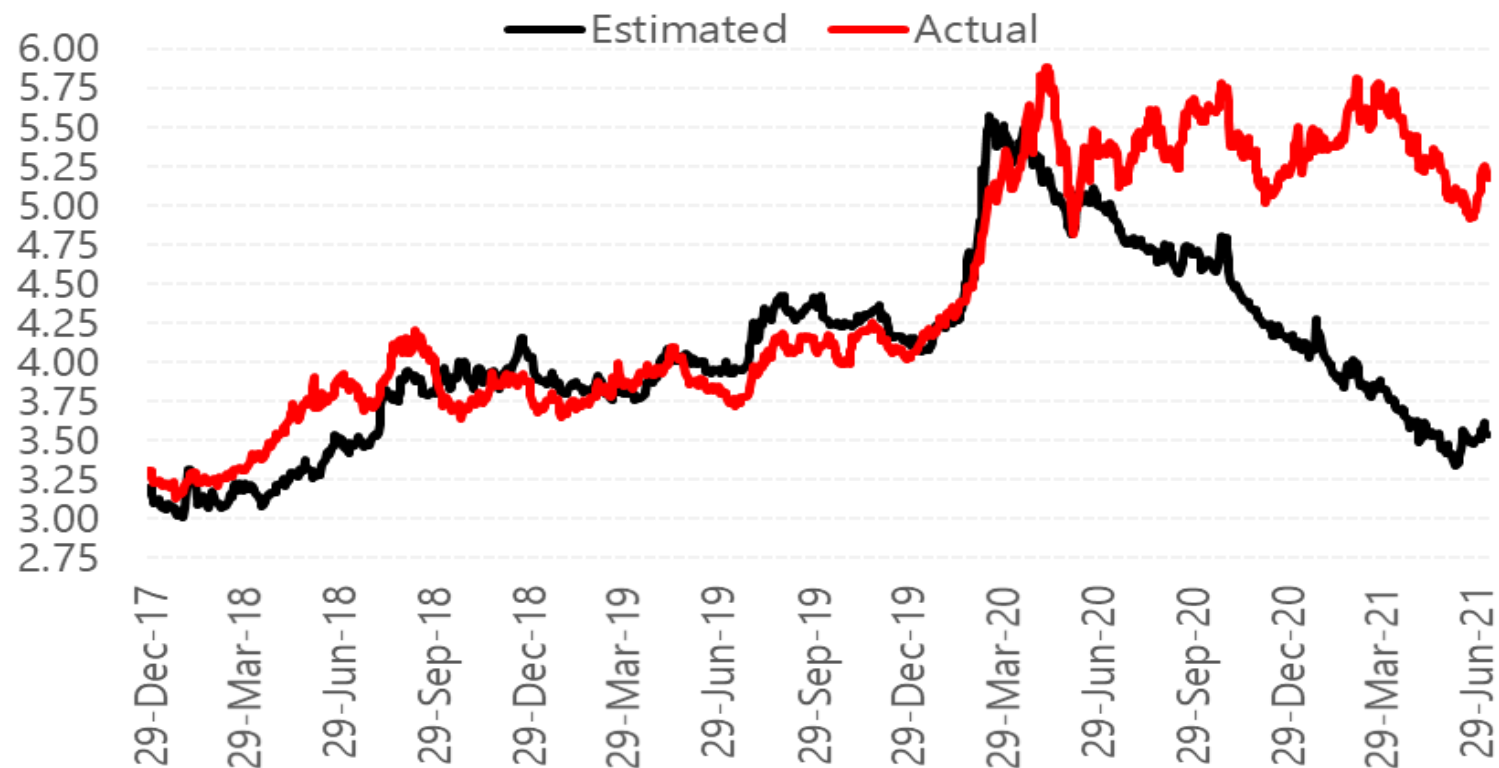


Sources: Bloomberg, Santander.

## A SIGNIFICANT (ALBEIT MARGINALLY SMALLER) RISK PREMIUM...

- The misalignment between the BRL and its main 'fundamentals' has narrowed lately on the heels of an improvement of markets sentiment regarding fiscal dynamics in the short run. However, doubts regarding their medium-term outlook keeps the BRL far from its 'fair' levels.

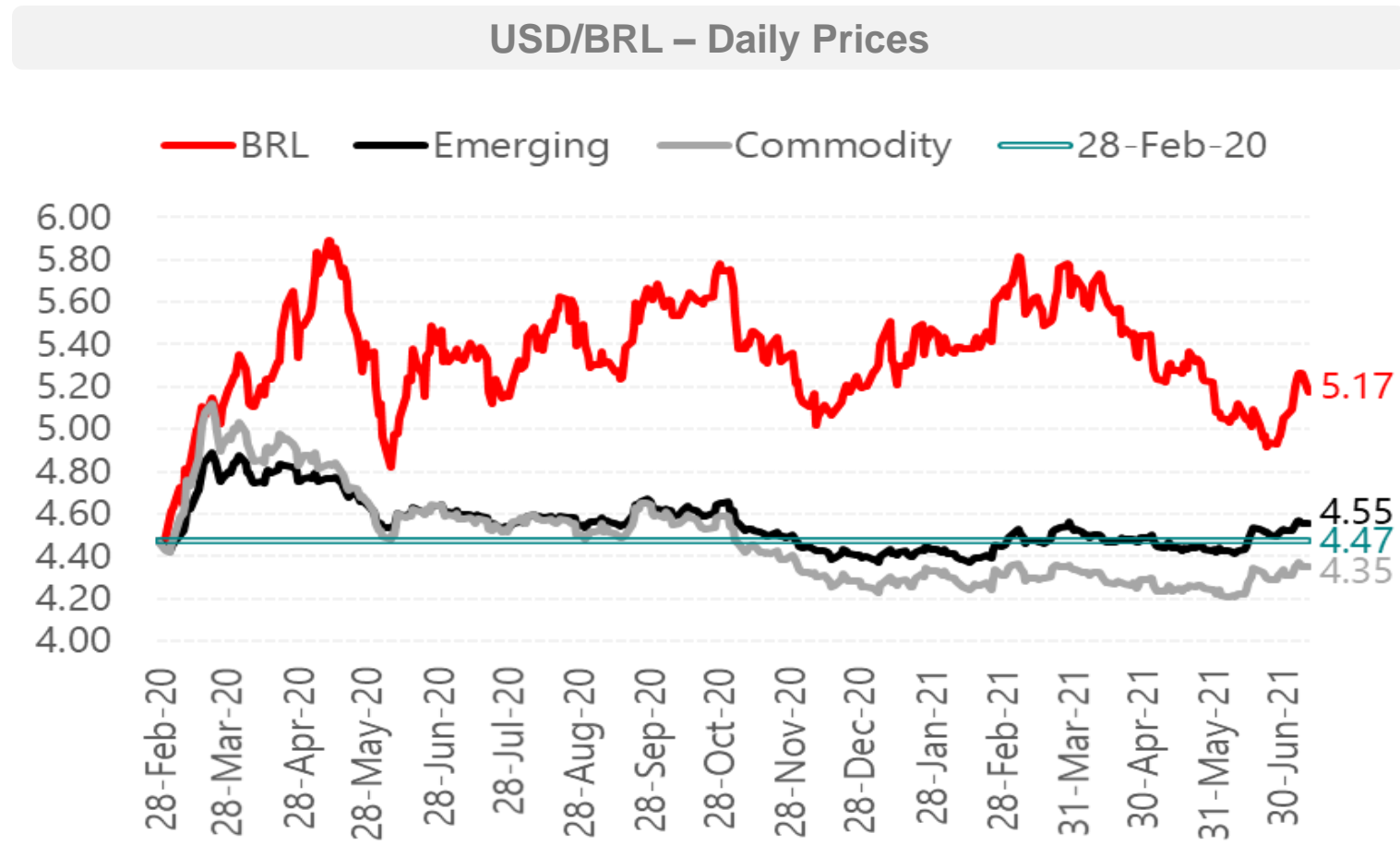
USD/BRL – External factors versus Domestic (fiscal?) influences



Sources: Bloomberg, Santander .

## ... NOT SEEN IN MANY OTHER CURRENCIES

- The USD/BRL pair would be trading at pre-pandemic levels if it had followed the average change of emerging currencies (or stronger, according to currencies influenced by commodity prices).

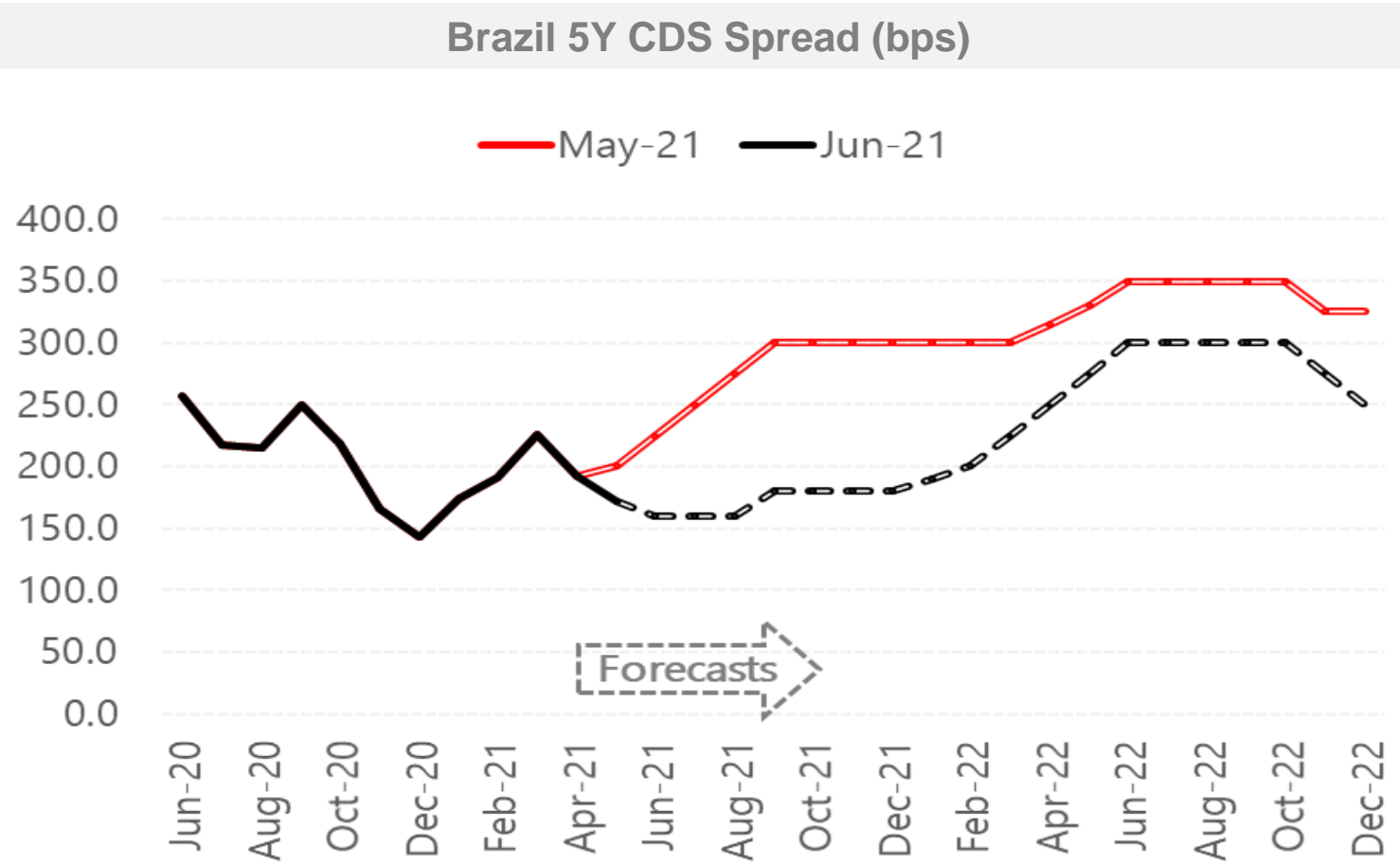


Sources: Bloomberg, Santander .



## A SHORT TERM RESPITE, WITH (EXPECTED) CONCERNS ON THE MEDIUM RUN

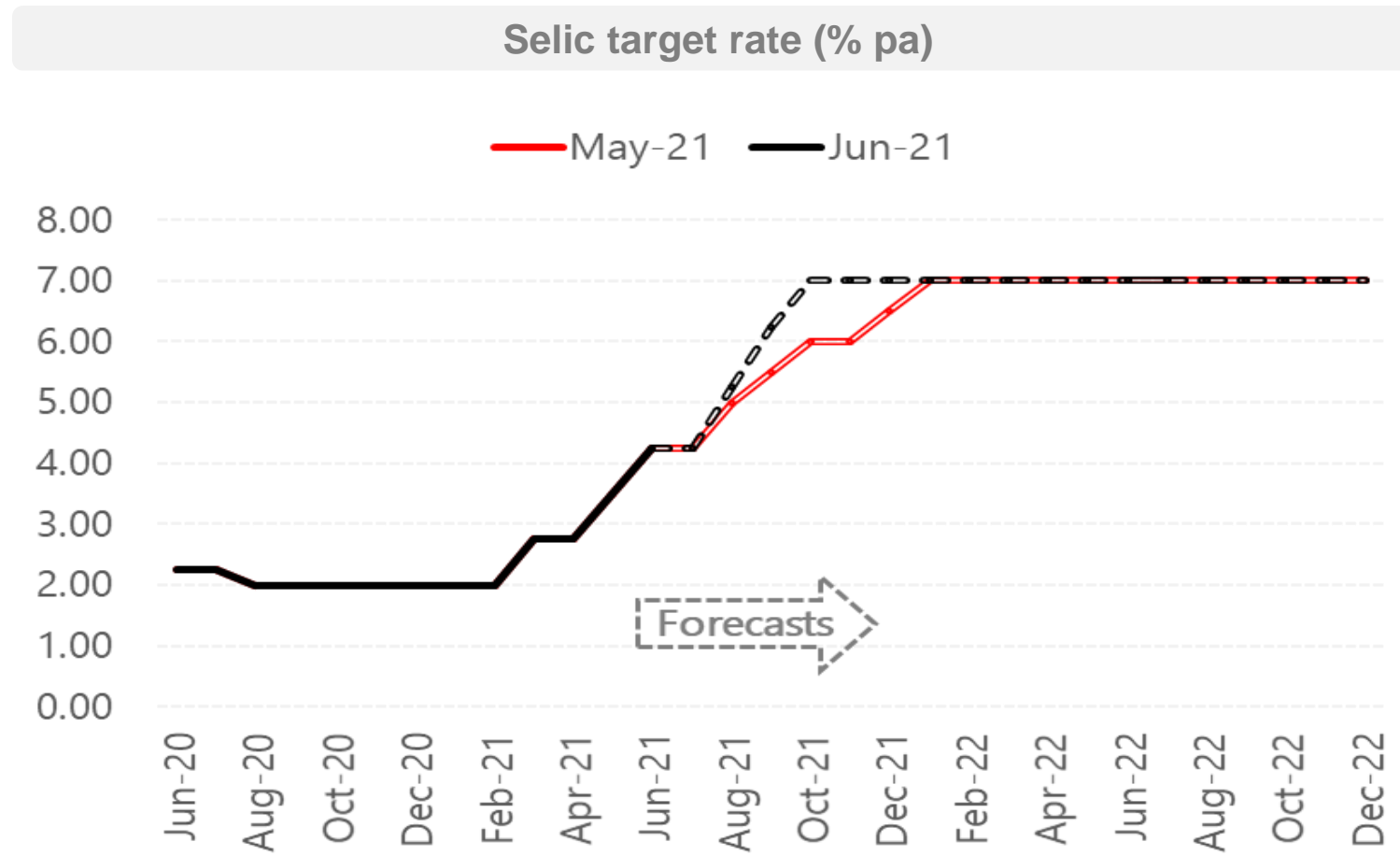
- The circumstantial improvement brought by higher inflation and economic growth rates to fiscal dynamics has improved the Brazilian CDS spreads. Nonetheless, as we have not seen any structural change in the public expenditures dynamics, we believe this is likely to be a short-lived process. Then, the polarized presidential race we expect to witness in 2022 should lead to a new wave of uneasiness.



Sources: Bloomberg, Santander.

## WHATEVER IT TAKES

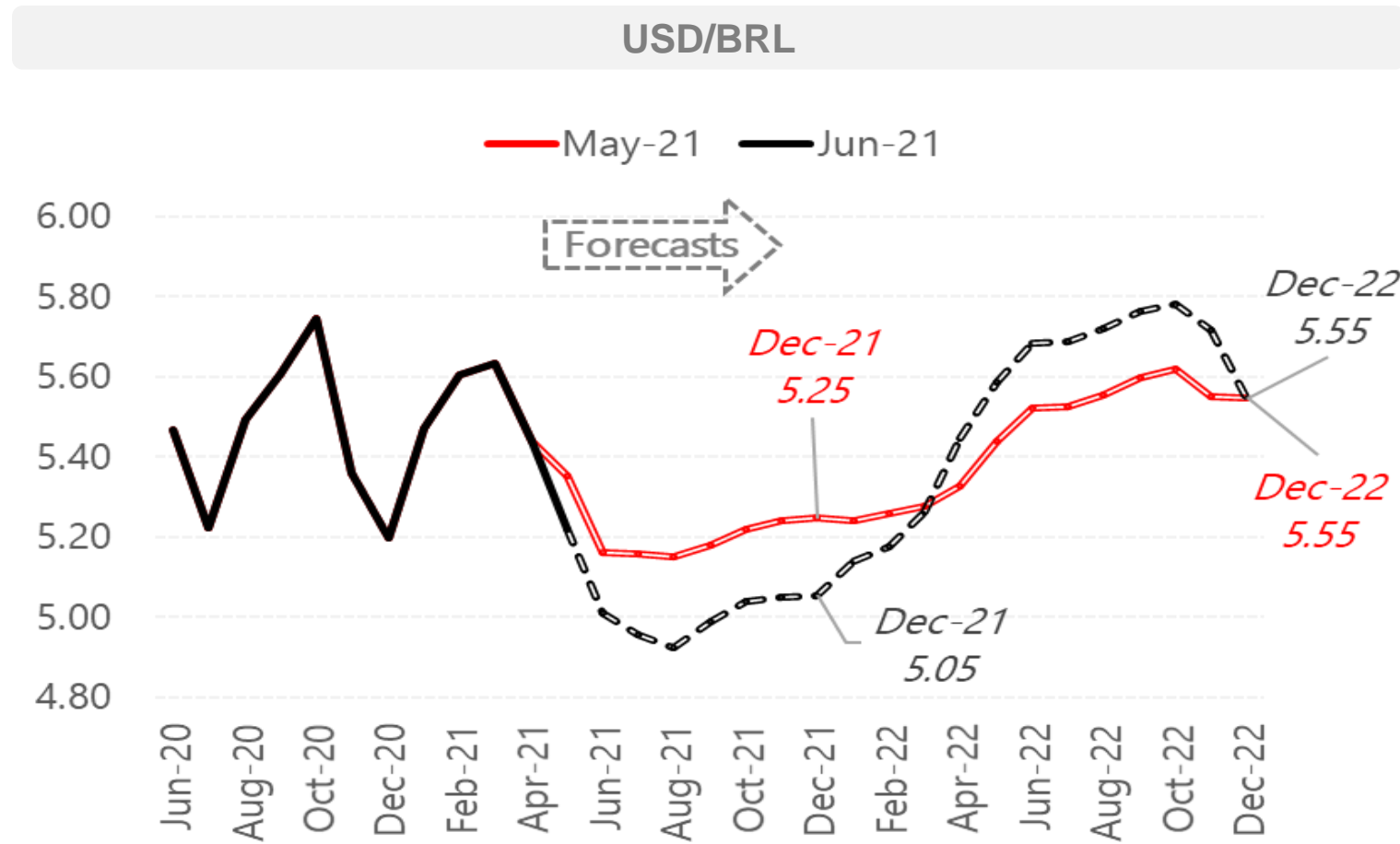
- Negative inflation surprises in the short term, less sanguine inflation expectations and a still fragile fiscal outlook in the medium run should lead the Brazilian Central Bank to anticipate the full normalization of the monetary policy status.



Sources: Bloomberg, Santander.

## A (STILL) LIMITED ROOM FOR STRENGTHENING

- The constructive international environment, the tighter monetary grip and the circumstantial improvement regarding fiscal outlook in the short term should favor the BRL in the coming months. However, the skepticism with the fiscal outlook in the medium run and the polarized presidential race in 2022 should limit the room for a substantial and perennial strengthening of the Brazilian currency.



Sources: Bloomberg, Santander.

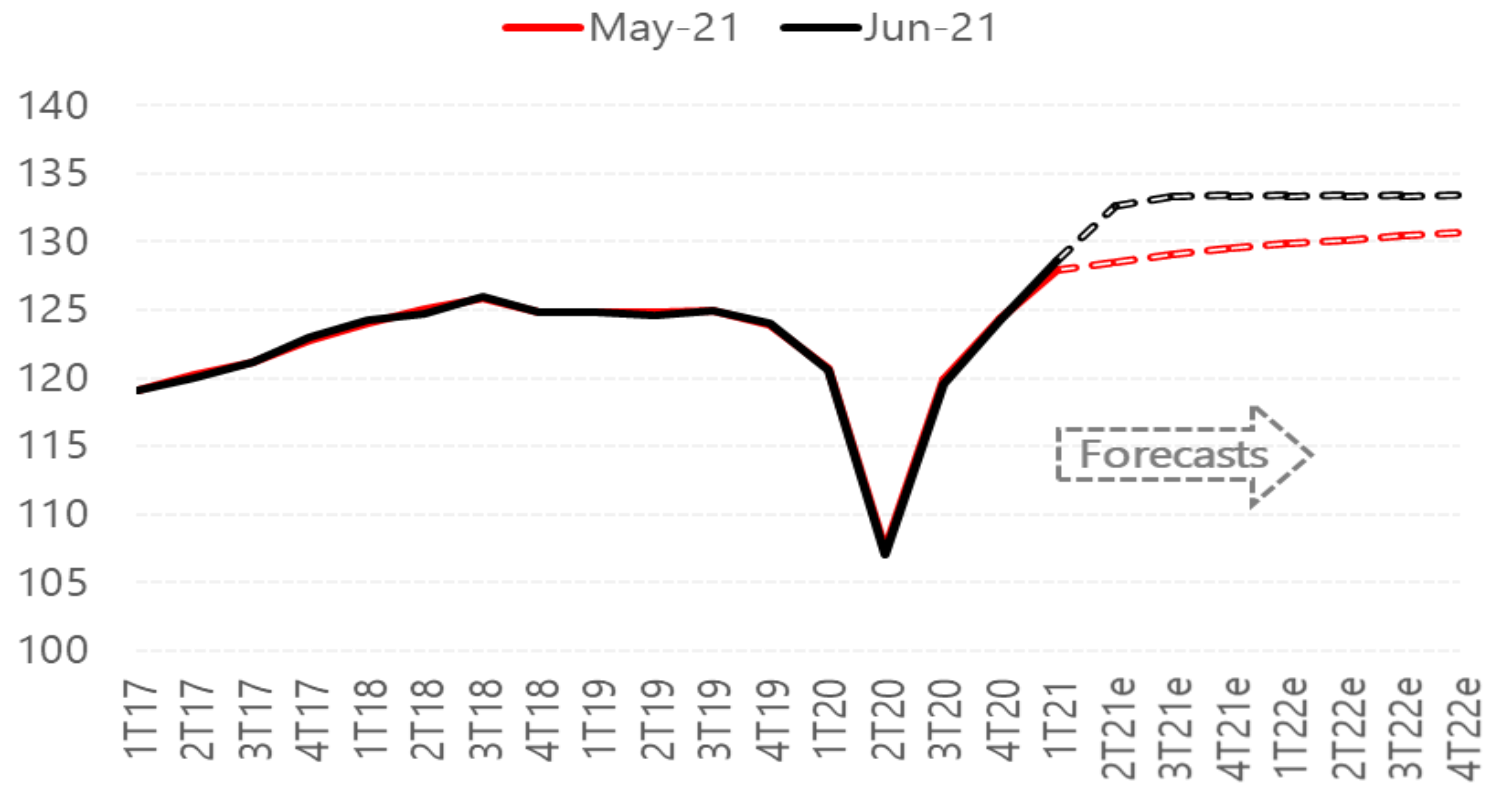
Balance of  
Payments

03

## A VIGOROUS RECOVERY, BUT WITH ACCOMODATION SIGNS LOOMING

- The initial drop observed in international trade flows in 1H20 nearly matched the one observed in the 2008 crisis, but the fast recovery seen in large countries led them to have already overcome their pre-pandemic levels. Recent data suggest a more gradual expansion onwards.

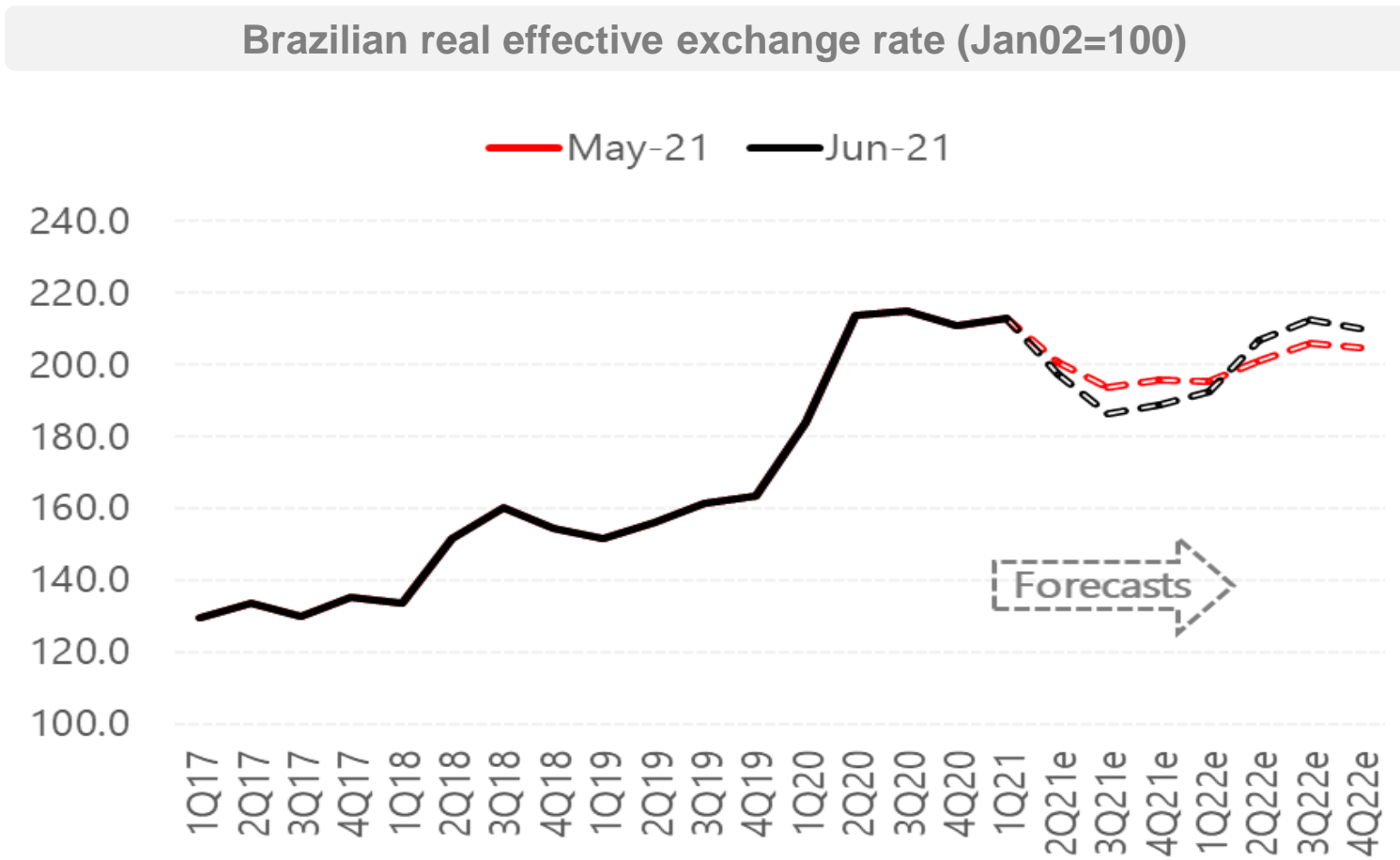
CPB Index – International trade flow (2010=100, s.a.)



Sources: Bloomberg, Santander.

## WEAKER FOR LONGER

- Though higher than previously thought, we do not expect inflation and the base interest rate to lead the BRL to strengthen substantially in real terms, which means the currency should remain at relatively weak levels for historical standards.

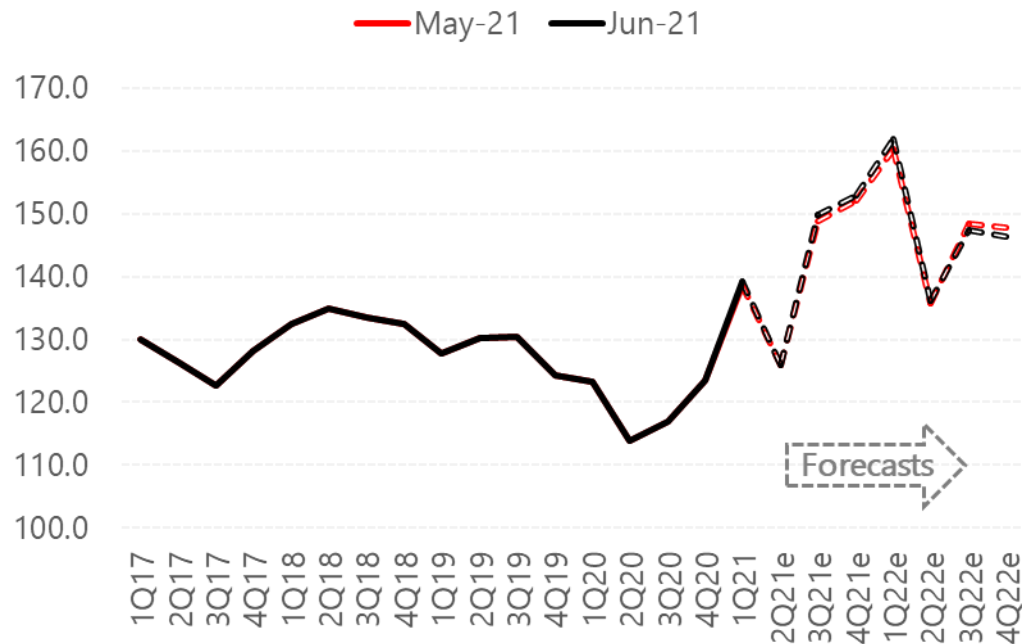


Sources: Bloomberg, Santander.

## FURTHER IMPROVEMENTS IN TERMS OF TRADE

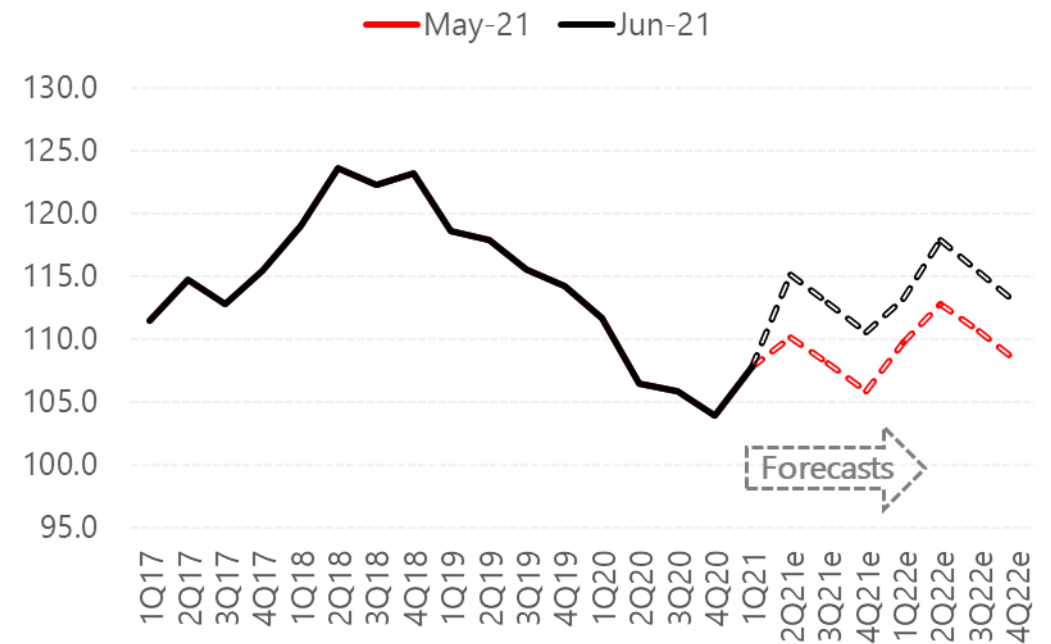
- Given our expectation of an extension in the bull market for commodities (beneficial for export prices) and the existence of idleness in the industrial sector (detrimental to import prices), we judge the Brazilian terms of trade should continue to improve.

Export price index (2006=100)



Sources: FUNCEX, Santander.

Import price index (2006=100)

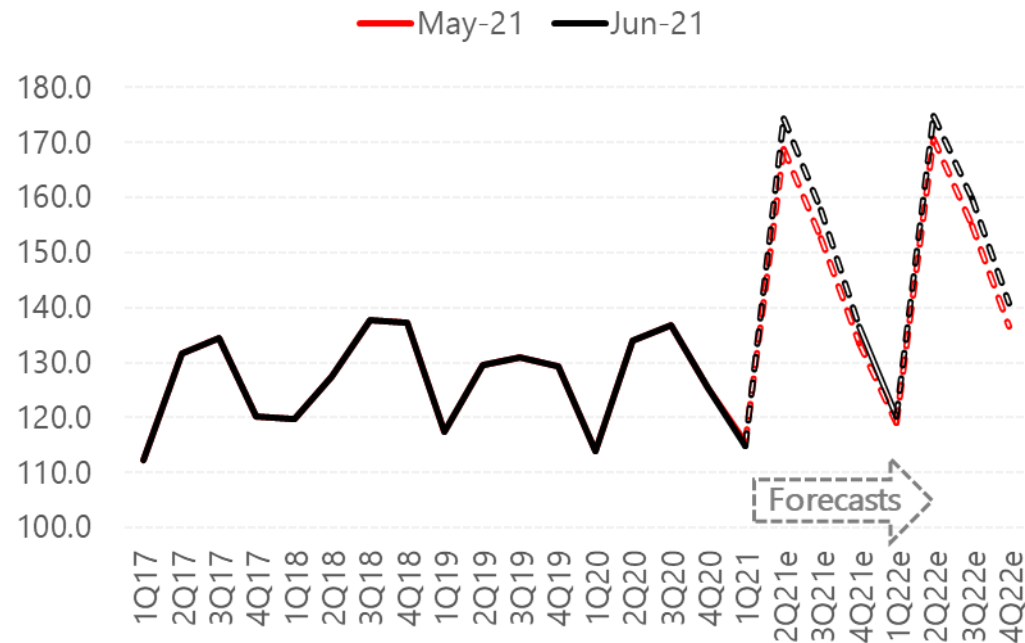


Sources: FUNCEX, Santander.

# THE RABBIT AND THE TURTLE

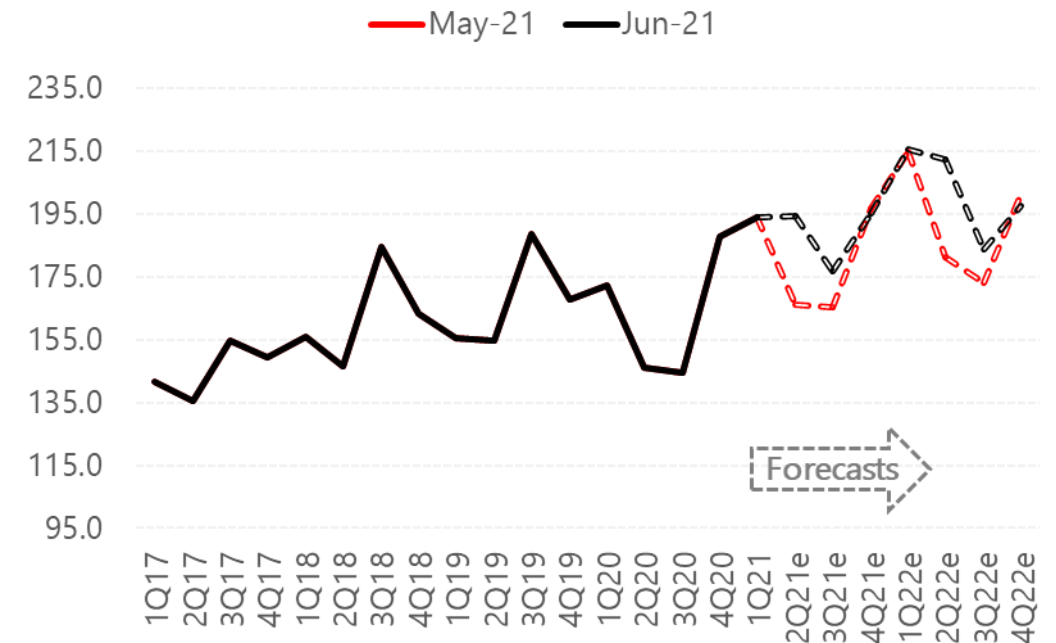
- While the lagged effects of the BRL weakening and the strong demand for commodities are likely to favor exports this year, we expect little additional improvement in 2022. On the import side, the gradual economic recovery should translate into a steady expansion in 2021 and 2022.

Export volume index (2006=100)



Sources: FUNCEX, Santander.

Import volume index (2006=100)

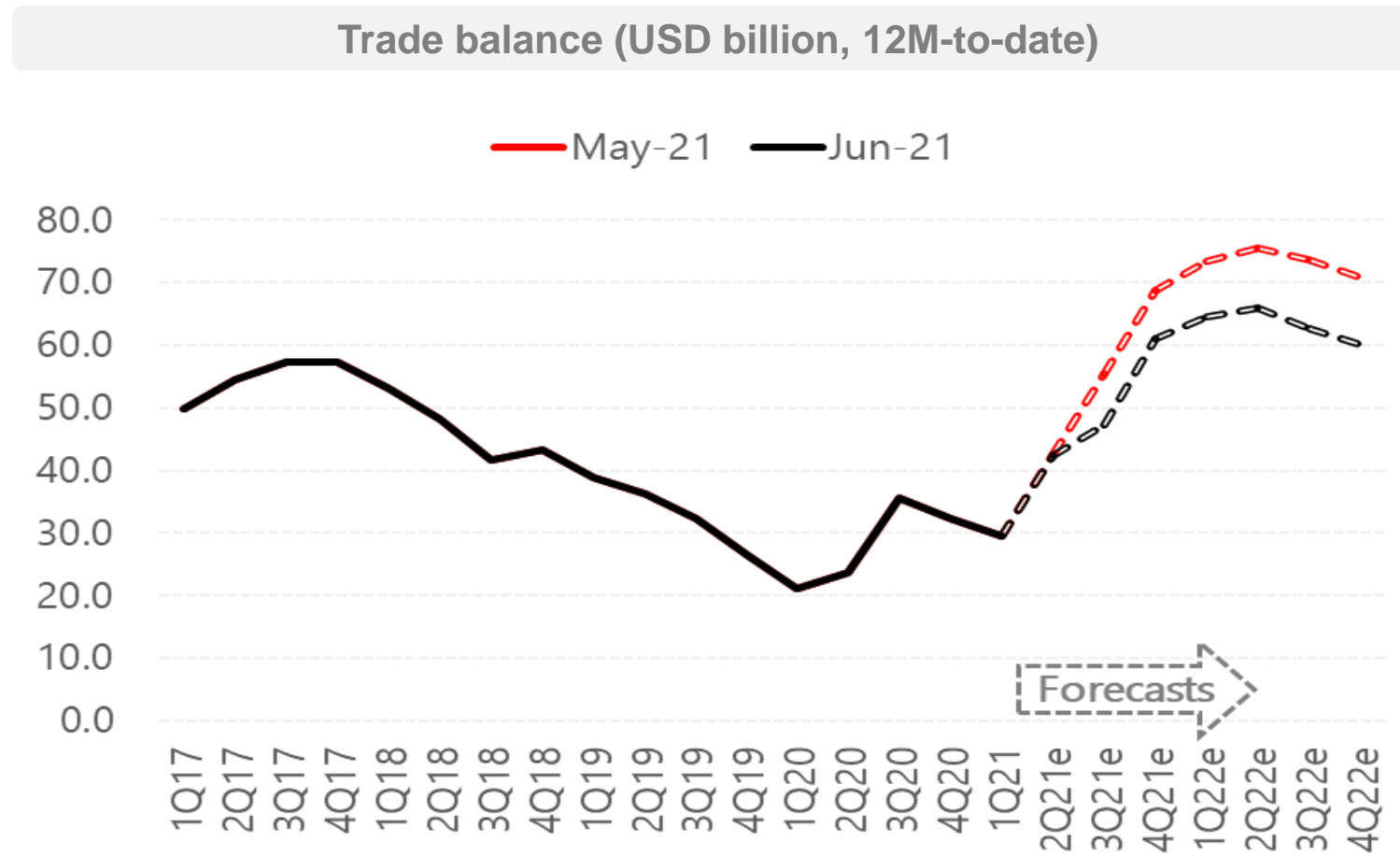


Sources: FUNCEX, Santander.



## CHANGING TO A NEW LEVEL

- The combination of a weak currency in real terms, favorable commodity prices, growing trade flows and increasing demand for soft and metal commodities should help the trade balance to register sizeable surpluses in the near future. However, the stronger-than-expected economic recovery in Brazil led us to revise down our forecasts marginally.

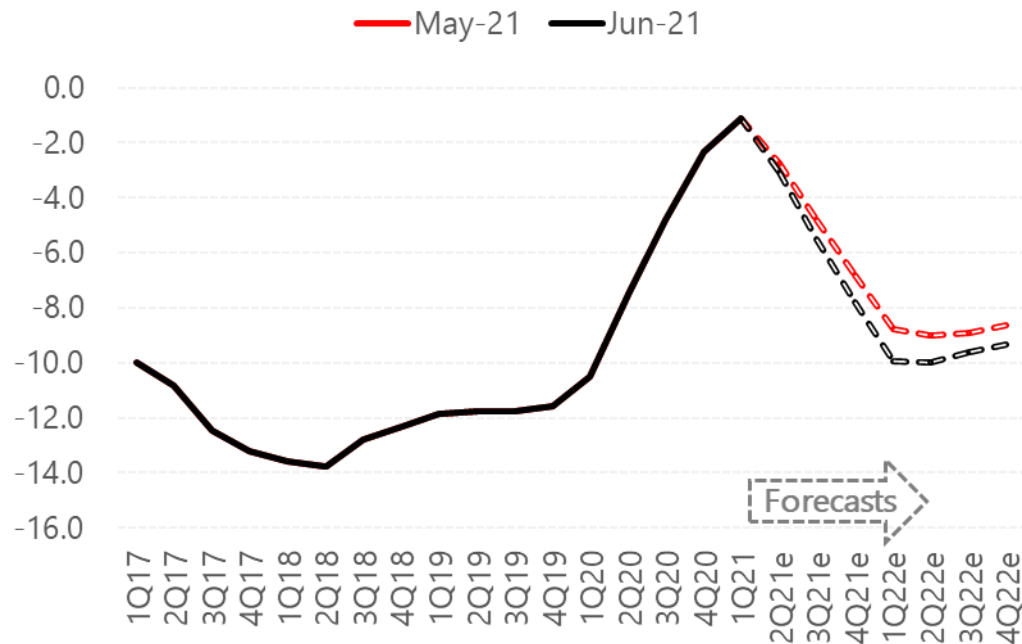


Sources: Brazilian Central Bank, Santander.

## FASTER PACE, HIGHER SPENDING, BUT STILL FAR FROM “NORMAL”

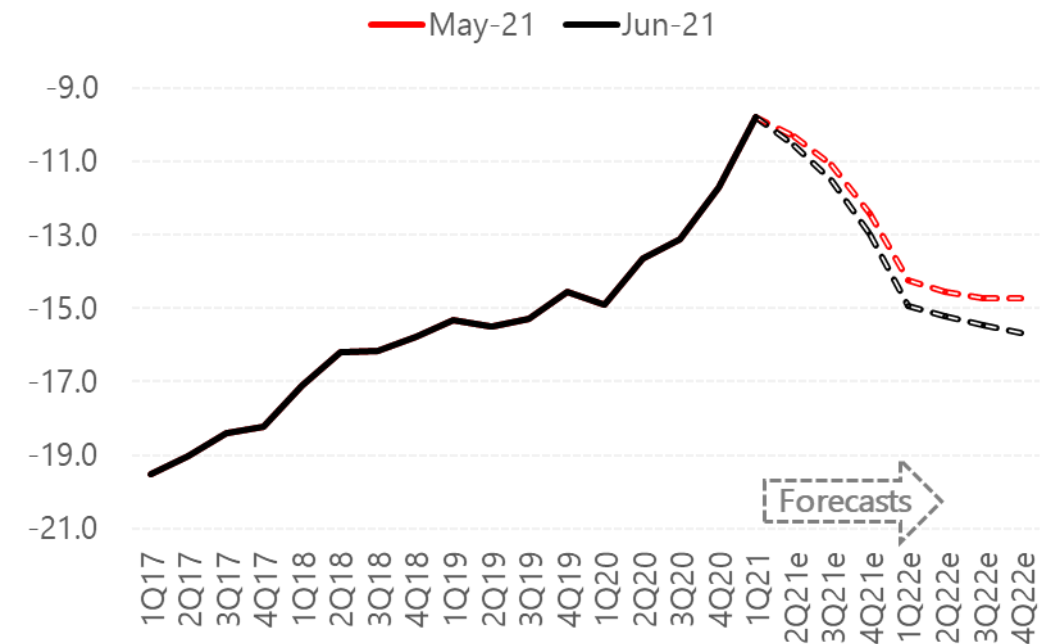
- Distension of mobility restrictions derived from the progress in the immunization against the Covid-19 and the increase in investments on the oil sector should lead to larger tourism outlays and equipment rental payments, although at a gradual pace.

Tourism net balance (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

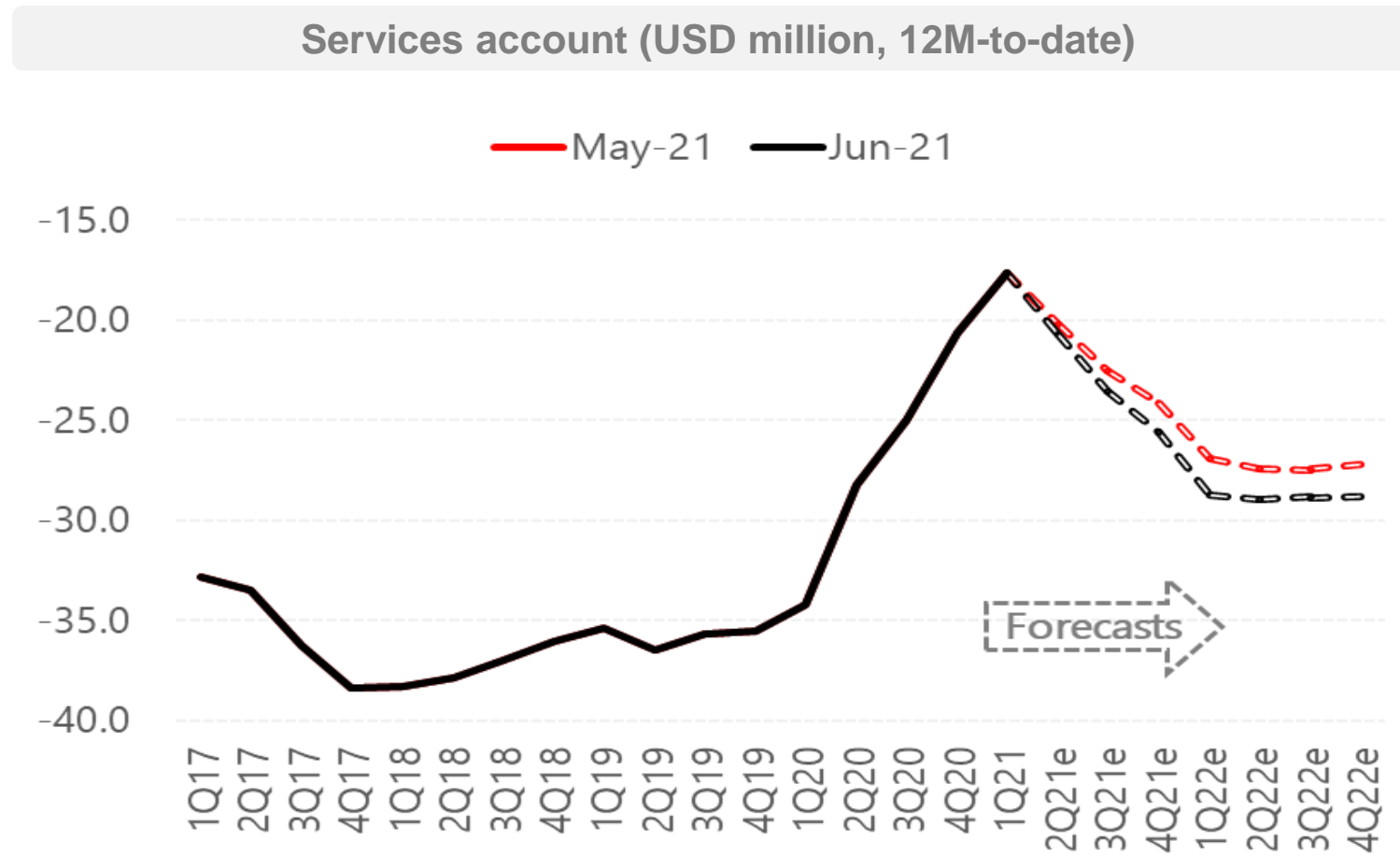
Equip. Rental (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

## A SLOW RETURN

- Services account should gradually become more negative as the economy gets back to normal.

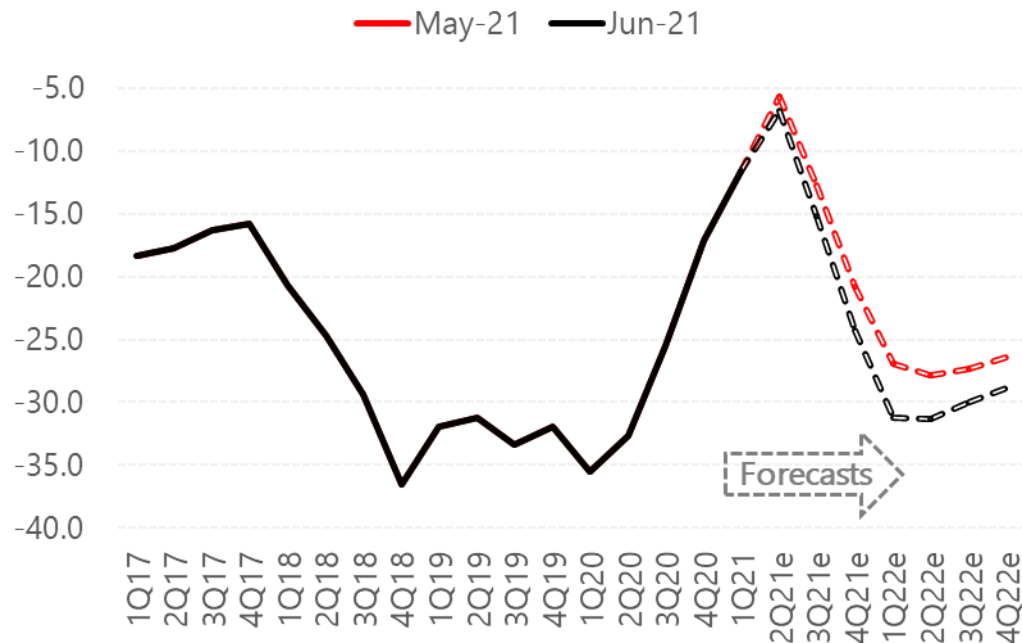


Sources: Brazilian Central Bank, Santander.

## PARTNERS RATHER THAN CREDITORS

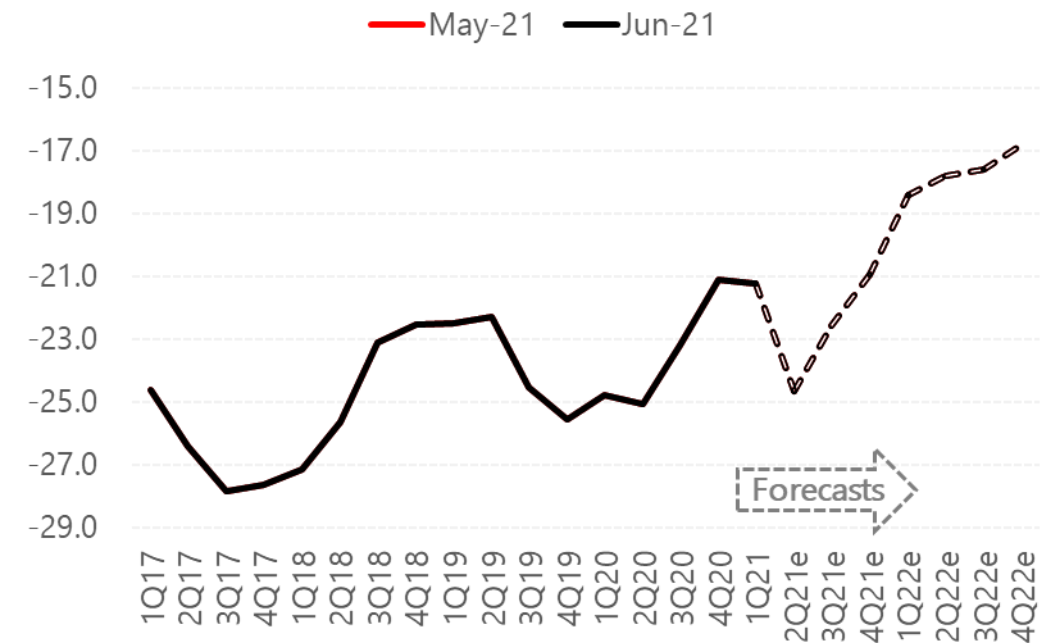
- The (expected) larger remittances of profits and dividends should be offset by the decline in the volume of external debt service, as the Brazilian corporate sector has improved its capital structure.

Profits & Dividends (USD million, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

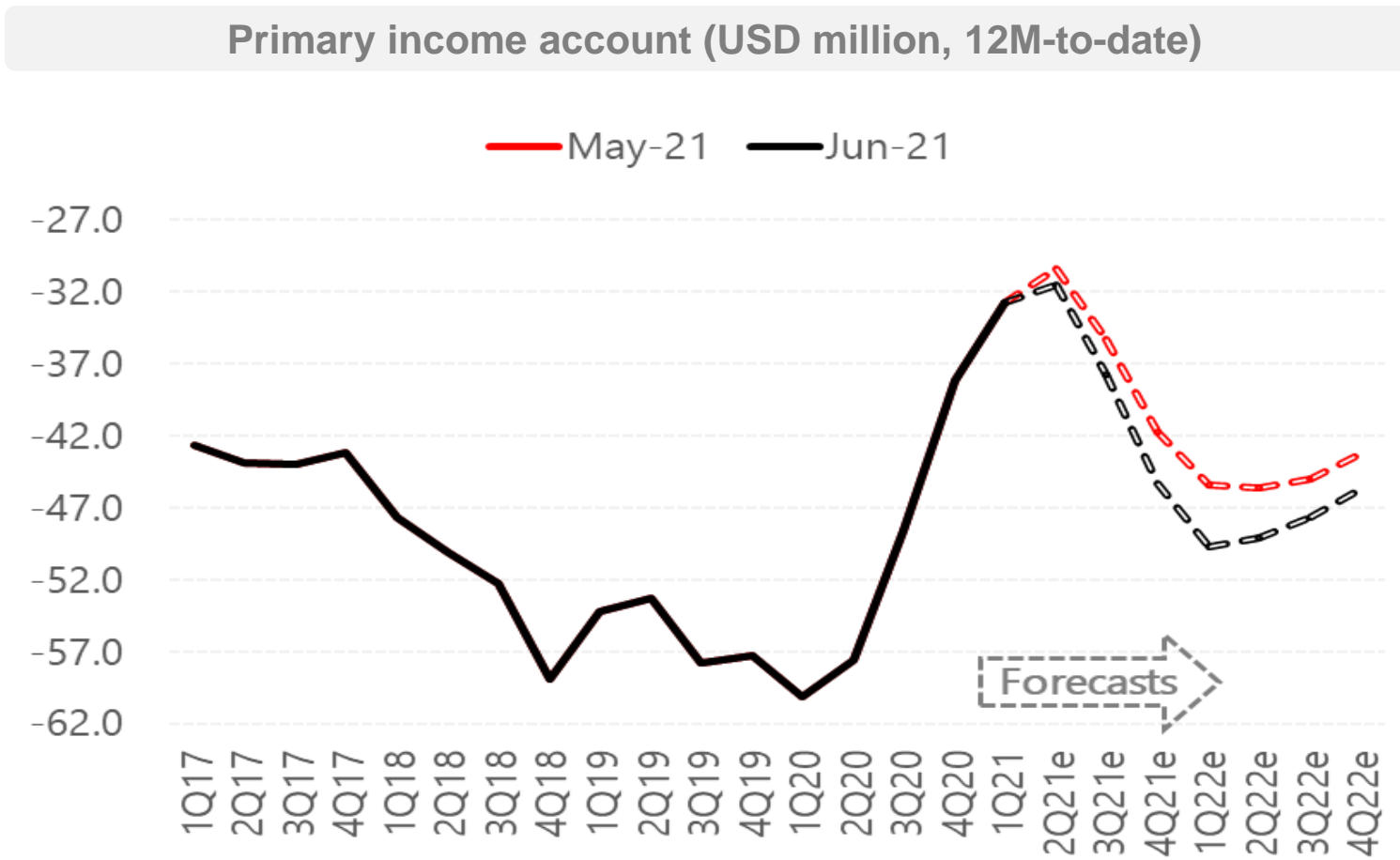
Interest payments (USD million, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

## PRO-CYCLICAL DYNAMICS, BUT WITH LIMITATIONS

- The gradual economic recovery should lead to a soft deterioration in the primary income account, which is likely to stabilize at much more comfortable levels than in the recent past.

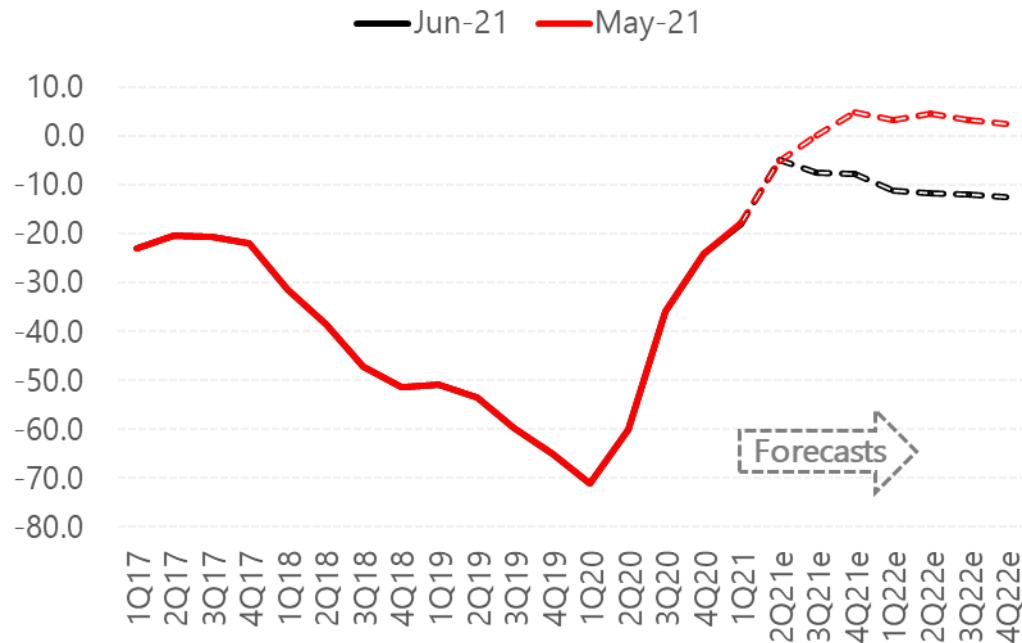


Sources: Brazilian Central Bank, Santander.

# HEADING TOWARDS SMALL DEFICITS RATHER THAN (UNUSUAL) SURPLUSES

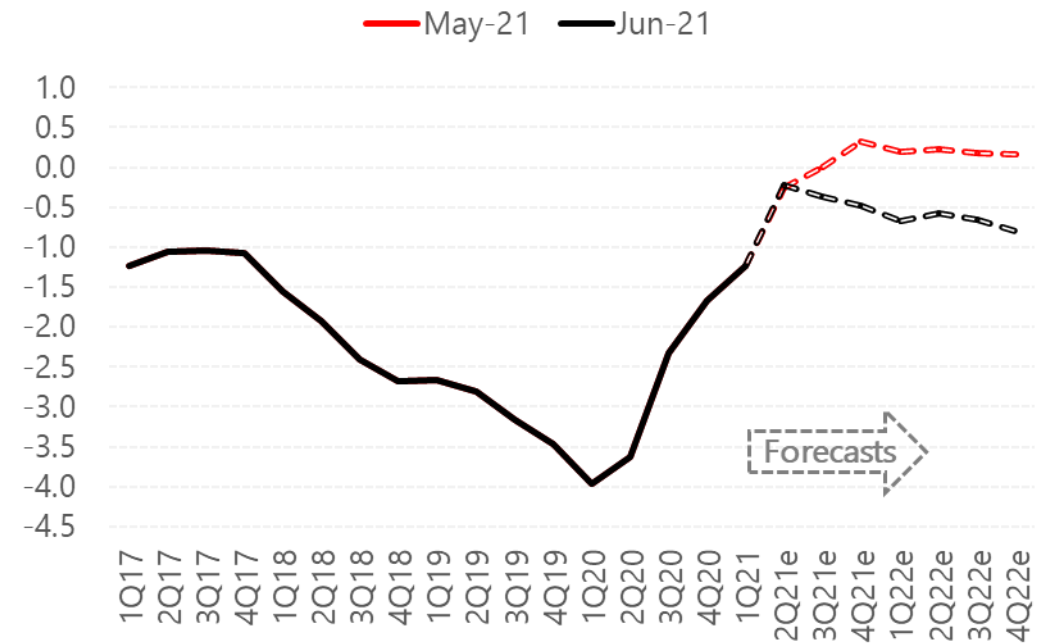
- We expect the adjustment in the current account balance to continue, but the faster economic recovery should prevent the country from registering surpluses as we previously expected. Nonetheless, current account deficits should hover around comfortable levels.

**Curr. Account Balance (USD million, 12M-to-date)**



Sources: Brazilian Central Bank, Santander.

**Current Account Balance (% of GDP)**

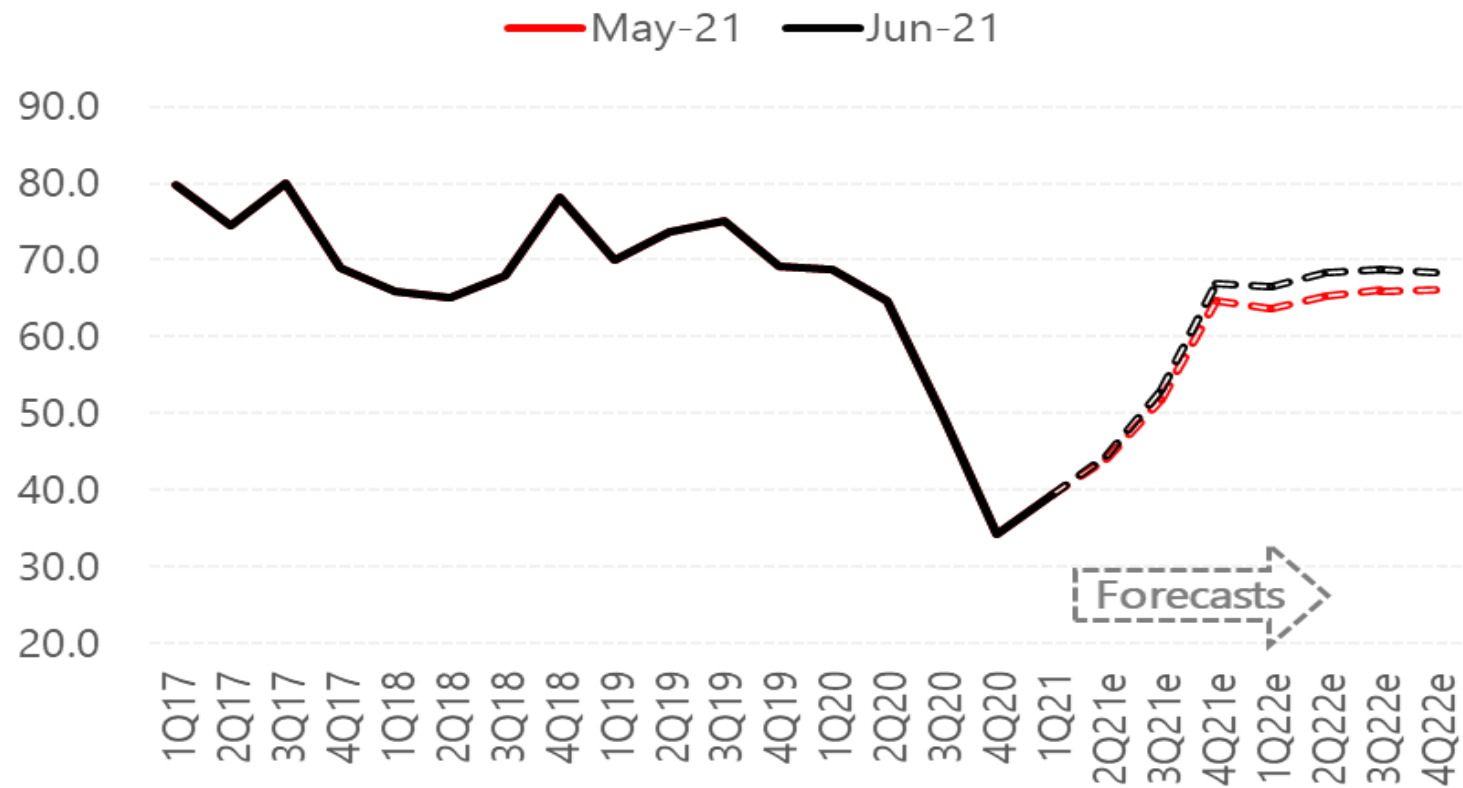


Sources: Brazilian Central Bank, Santander.

## STEP BY STEP

- The maintenance of the current fiscal framework, a more resilient economy than previously imagined and prospects for a faster immunization in 2H21 should increase investors' confidence. Hence, direct investments in the country should expand as well.

Direct investment in the country (USD million, 12M-to-date)

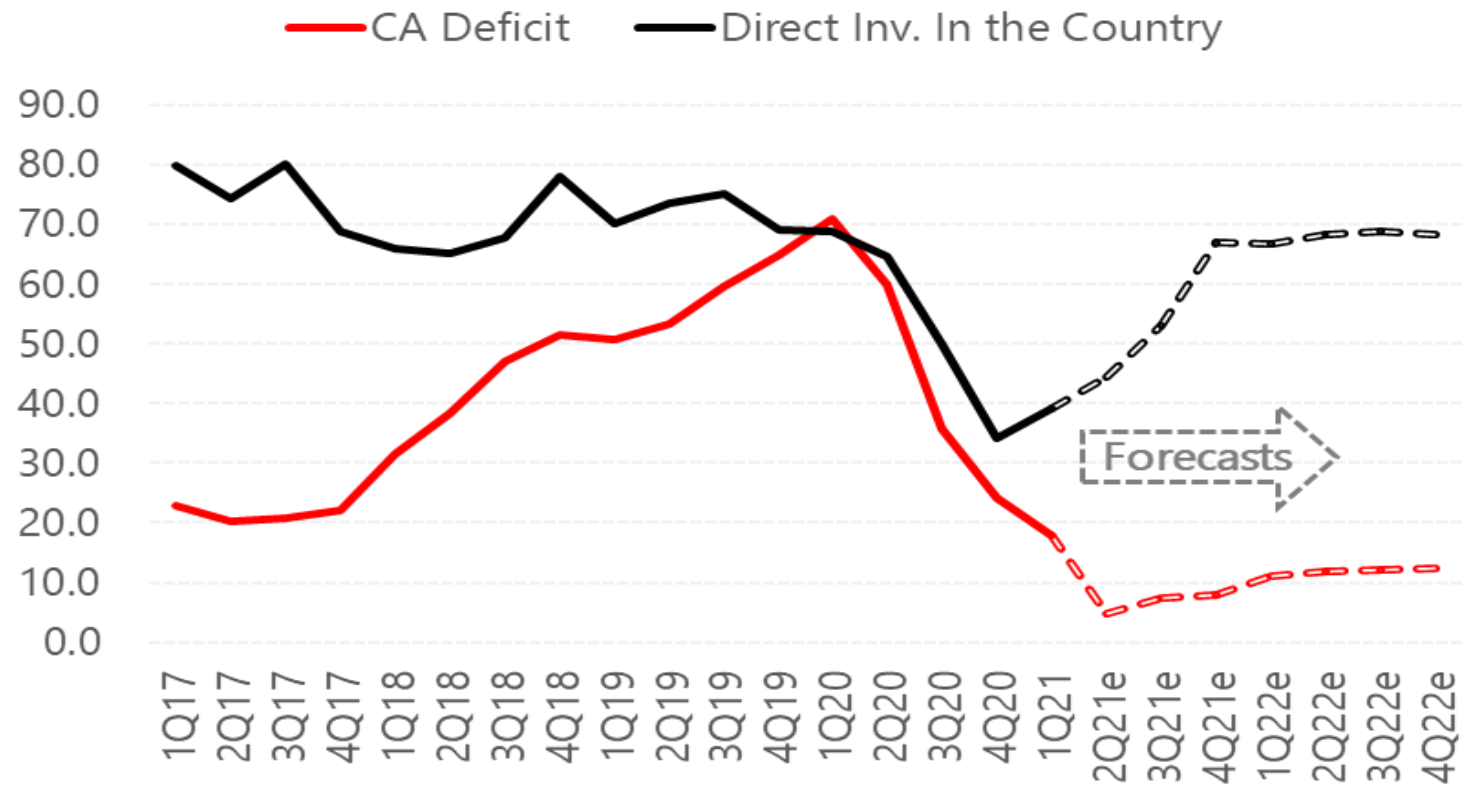


Sources: Brazilian Central Bank, Santander.

## A (QUITE) COMFORTABLE SITUATION

- On the back of small current account deficits and the return of direct investments in the country, the Brazilian external financing needs should keep external sector data off market participants' radar for more than a while.

Dynamics of External Financing Needs (USD million, 12M-to-date)



Sources: Brazilian Central Bank ,Santander.



# SOLID FUNDAMENTAL

- Based upon these indications, we maintain our view that the pressure on the FX rate has to do with elements other than external sector fundamentals.

Brazilian External Financing Needs				
USD billion	2019	2020	2021e	2022e
<b>Current account balance</b>	<b>-65.0</b>	<b>-24.1</b>	<b>-7.8</b>	<b>-12.4</b>
Trade balance	26.5	32.4	61.1	60.0
Exports	225.8	210.7	272.7	284.8
Imports	199.3	178.3	211.6	224.8
Services	-35.5	-20.6	-25.6	-28.8
Tourism	-11.6	-2.3	-7.8	-9.3
Eq. Rental	-14.6	-11.7	-13.0	-15.7
Others	-9.3	-6.6	-4.9	-3.8
Income	-57.3	-38.2	-45.2	-45.7
Profits & Dividends	-31.9	-17.2	-24.3	-28.9
Interest payments	-25.5	-21.1	-20.9	-16.8
Transfers	1.2	2.4	2.0	2.0
Direct investment onshore	69.2	34.2	66.9	68.4
External funding (-ve=shortage / +ve=excess)	4.1	10.1	59.1	56.0

Sources: Brazilian Central Bank, Santander.

Macroeconomic  
forecasts

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# FORECASTS

Macroeconomic variables		Previous		Current
GDP (%)	2021E	3.6	↑	5.1
	2022E	1.5	↑	2.0
	2023E	1.8	↓	1.5
IPCA (%)	2021E	5.9	↑	6.7
	2022E	3.9	↑	4.0
	2023E	3.3	→	3.3
Selic Rate (% end of period)	2021E	6.50	↑	7.00
	2022E	7.00	→	7.00
	2023E	7.00	→	7.00
FX Rate - USDBRL (end of period)	2021E	5.25	↓	5.05
	2022E	5.55	→	5.55
	2023E	5.20	→	5.20
Current Account Balance (% of GDP)	2021E	0.3	↓	-0.5
	2022E	0.2	↓	-0.8
	2023E	-0.5	↓	-1.0
Primary Fiscal Balance (% of GDP)	2021E	-3.0	↑	-1.9
	2022E	-2.1	↑	-1.7
	2023E	-1.6	↑	-1.3
Gross Public Debt (% of GDP)	2021E	85.0	↓	82.2
	2022E	87.6	↓	84.3
	2023E	90.0	↓	87.2

Sources: Brazilian Central Bank, IBGE, Santander.

## PARAMETERS

Selected Indicators				
Indicator	2020	2021e	2022e	
<b>USDBRL</b>	<b>5.20</b>	<b>5.05</b>	<b>5.60</b>	
DXY (1973=100)	89.9	95.0	97.0	
VIX (% pa)	22.8	15.0	15.0	
CRB Index (1967=100)	443.8	530.0	503.4	
Brazil 5Y CDS spread (bps)	142.9	180.0	250.0	
Interest rate differential (% pa)	1.75	6.25	6.75	
CPB Index (2010=100, sa)	124.3	129.5	130.7	
Brazilian REER (Jan02=100)	210.9	189.0	210.0	

Sources: Bloomberg, Santander.

Contacts

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## Simple Personal Fair



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