



Brazil Macro | May 2021

FX rate & Balance of Payments

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SUMMARY

- International environment should continue to be relatively constructive on the heels of favorable commodity prices, bountiful liquidity in advanced economies and the progress in the immunization plans around the globe. However, prospects for the start of the monetary tapering in the US should push the DXY index up late in 2021 and trigger some correction in financial asset prices.
- The reintroduction of an emergency aid program in 2021, the slow progress in the reformist agenda and the polarized political environment should keep market participants skeptical about the trajectory of the Brazilian public indebtedness and limit the room for the BRL to strengthen this year, despite the earlier (and faster) normalization of the monetary policy status. Then, anxiety with the presidential race should add to these concerns and lead the BRL to weaken during 2022.
- Positive prospects for the international trade flow, favorable levels for commodity prices, a weak currency and the gradual economic recovery for the Brazilian economy should continue to lead export proceeds to outpace import outlays and to curb remittances of profits & dividends and tourism outlays. Hence, we expect the current account balance to register surpluses in 2021 and 2022, which is a rather unusual situation for an emerging economy.
- As for the financial account, we expect some recovery in the volume of direct investments in the country, as the immunization program in the country rolls out and allows the economy to head toward a more normal situation. However, remaining financial items may refrain from flowing into the country amid higher uncertainty on the fiscal and political fronts, thus counterbalancing the current account surpluses.

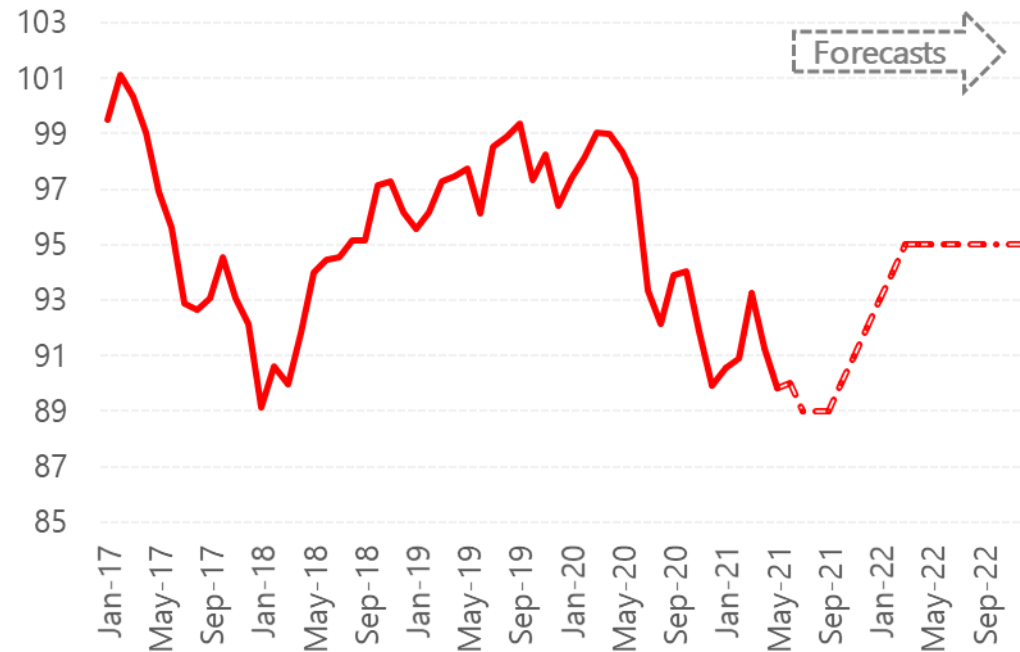
FX rate

02

A RELATIVELY CONSTRUCTIVE GLOBAL (LIQUIDITY) ENVIRONMENT

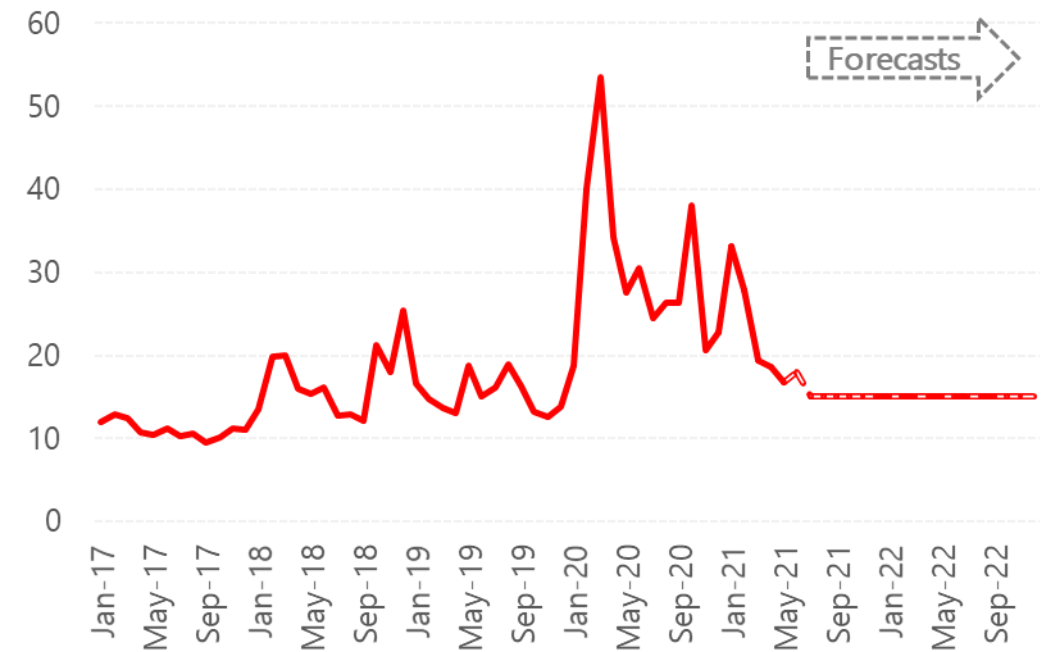
- Although we expect some reversal of the DXY Index late in 2021 on the back of prospects for the beginning of a monetary tapering in the US, we don't believe the move should leave the level of risk aversion among market participants to increase.

DXY Index (1973=100)



Sources: Bloomberg, Santander.

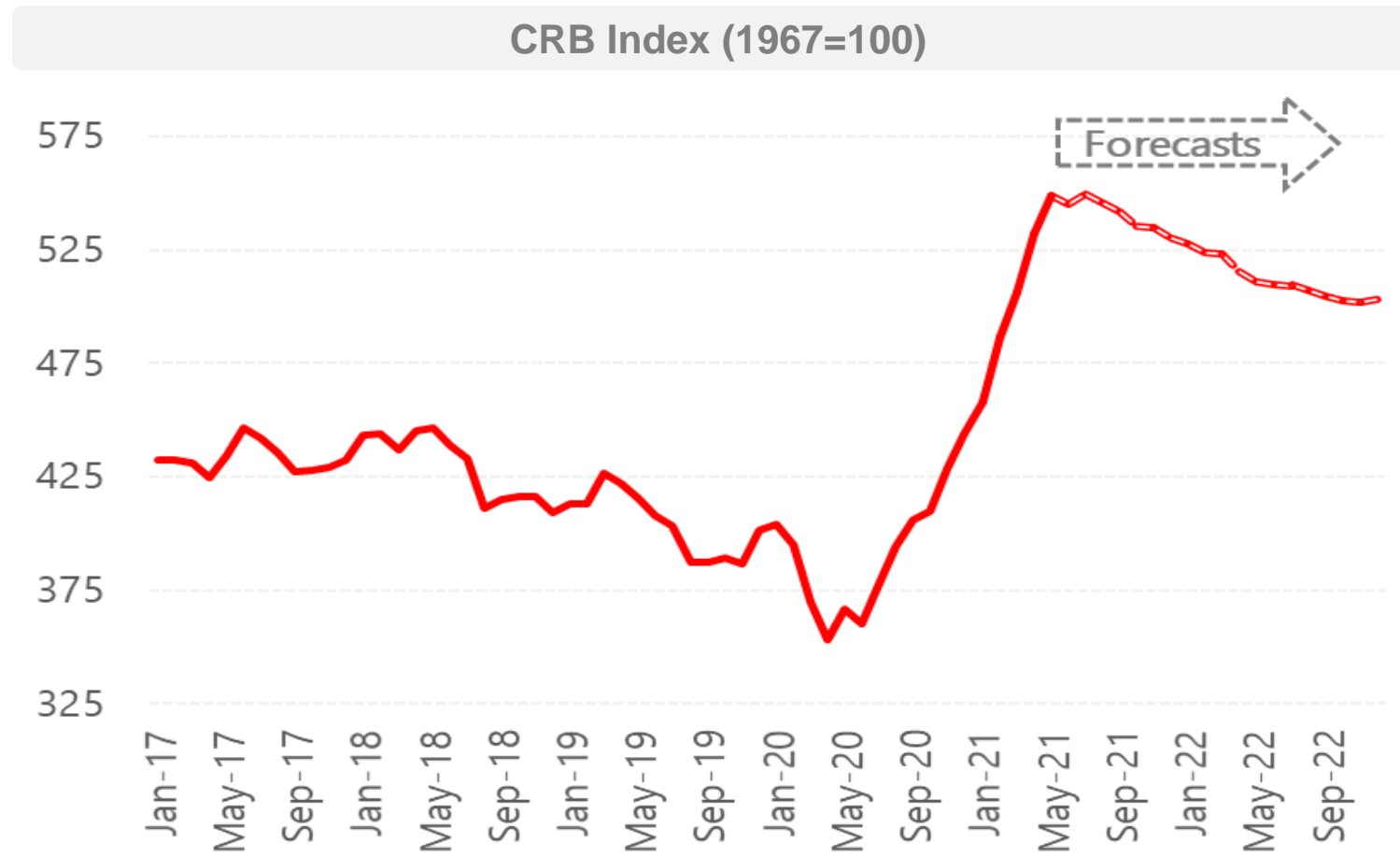
VIX Index (% pa)



Sources: Bloomberg and Santander forecasts.

QUITE FAVORABLE LEVELS

- Bounteous liquidity conditions, the seek for stock replenishment and the resumption of economic growth around the globe should support commodity prices at high levels, but we expect the US monetary tapering to ignite some correction during 2022.

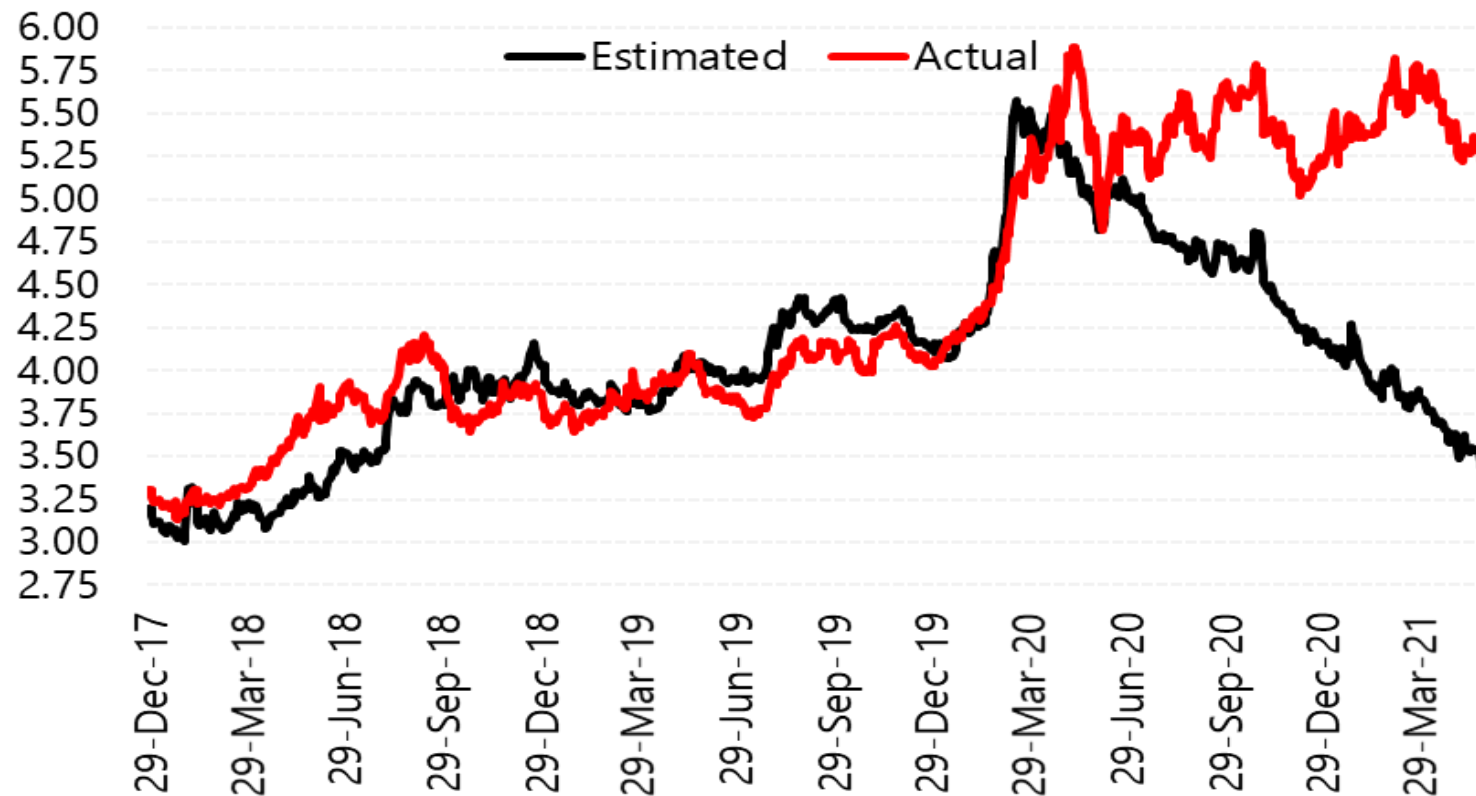


Sources: Bloomberg, Santander.

A SIGNIFICANT RISK PREMIUM...

- Until mid-July 2020, the BRL responded in a relatively close way to the influences of variables previously presented. However, as the skepticism regarding fiscal dynamics has increased lately, the Brazilian currency has decoupled from its main 'fundamentals'.

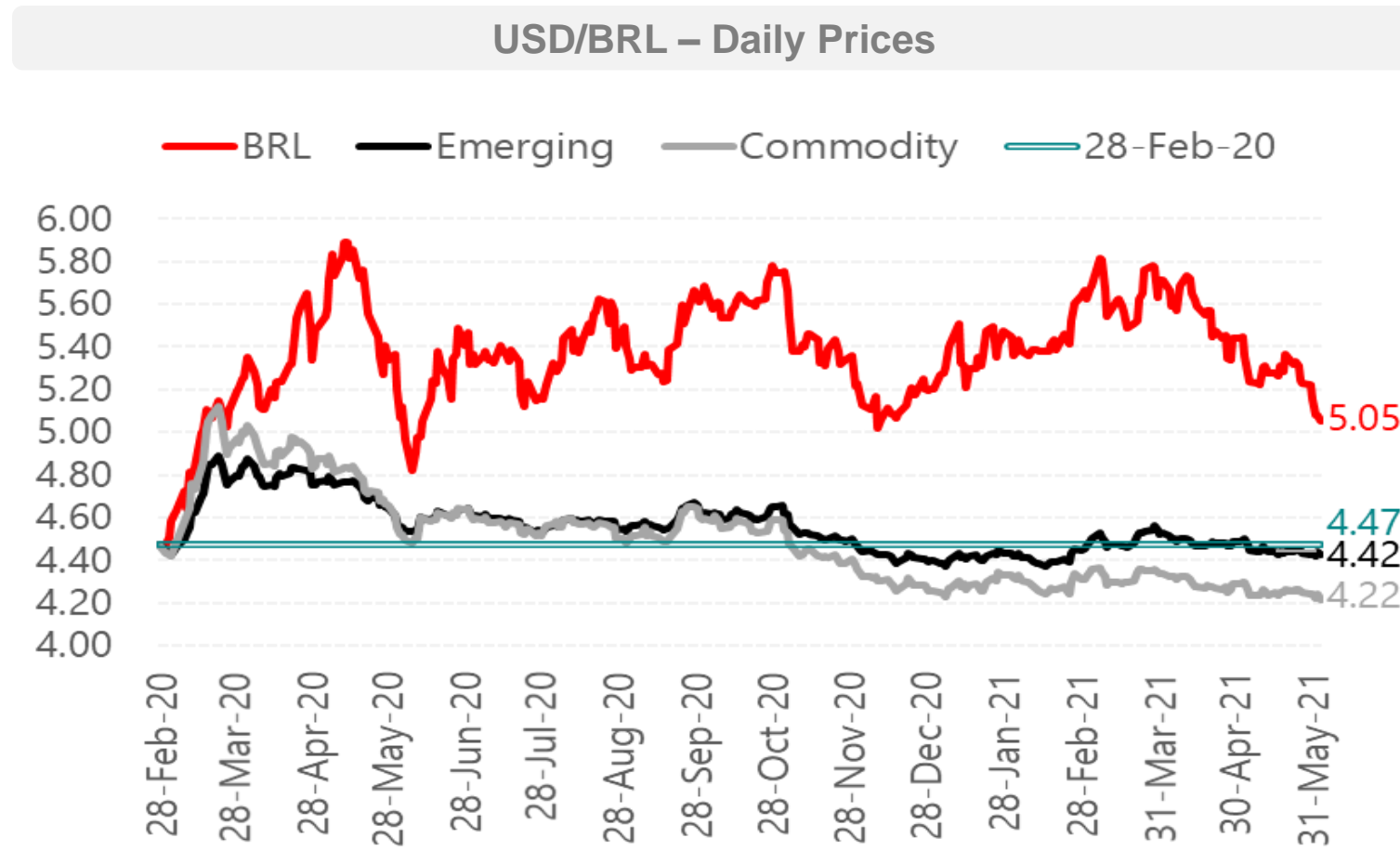
USD/BRL – External factors versus Domestic (fiscal?) influences



Sources: Bloomberg, Santander .

... NOT SEEN IN MANY OTHER CURRENCIES

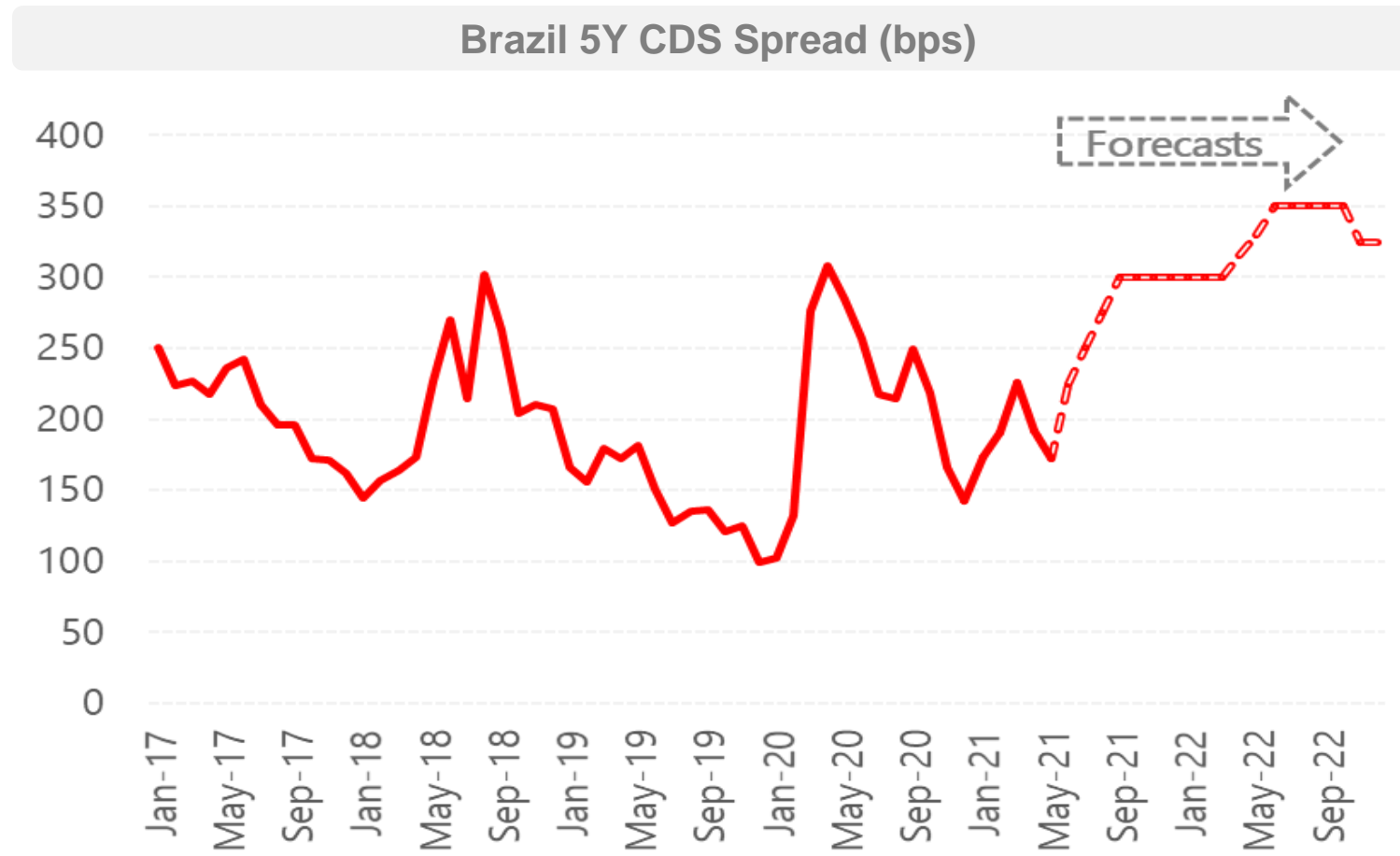
- The USD/BRL pair would be trading at pre-pandemic levels if it had followed the average change of emerging currencies (or stronger, according to currencies influenced by commodity prices).



Sources: Bloomberg, Santander .

HIGHER RISKS...

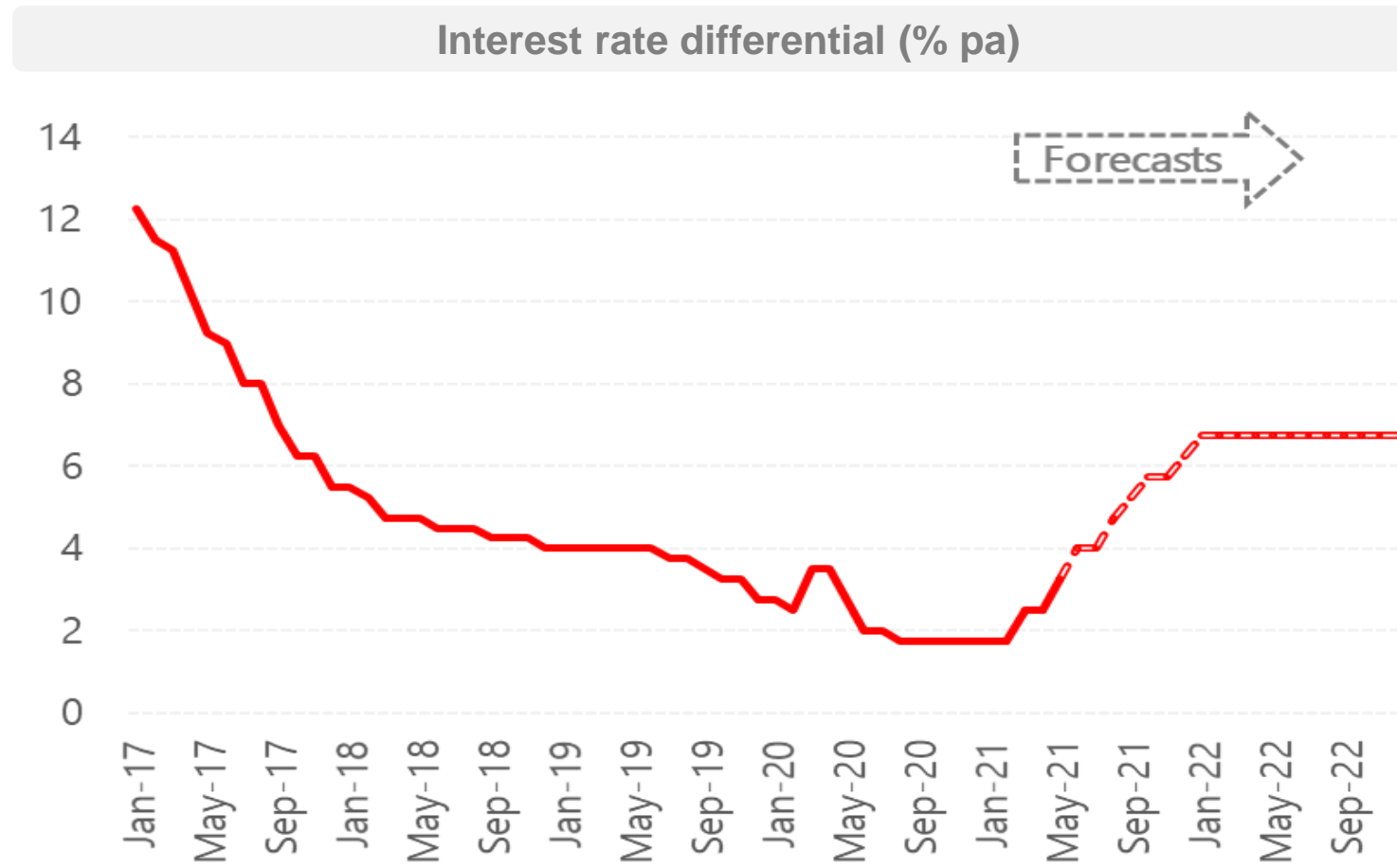
- The reintroduction of an emergency aid in 2021 has weighed on market participants' confidence and the approval of triggers to curb public outlays has just partially offset that influence. Then, the polarized presidential race we expect to witness in 2022 should lead to a new wave of uneasiness.



Sources: Bloomberg, Santander.

... HIGHER YIELDS

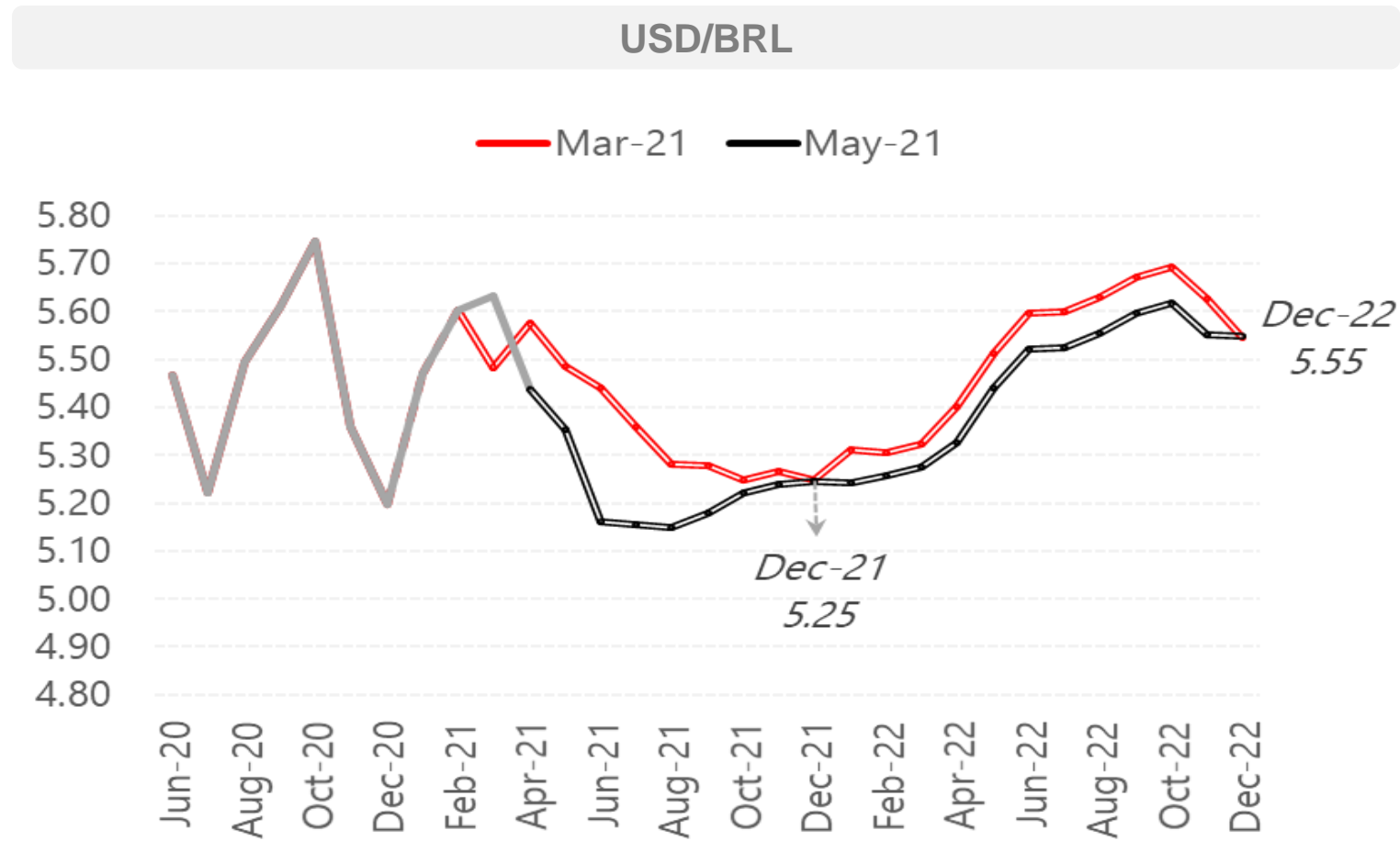
- Negative inflation surprises in the short term, less sanguine inflation expectations and a riskier fiscal outlook should lead the Brazilian Central Bank to anticipate the full normalization of the monetary policy status.



Sources: Bloomberg, Santander.

LIMITED ROOM FOR STRENGTHENING

- The constructive international environment and the tighter monetary grip should partially offset the weakening pressure that higher sovereign risks and larger uncertainty with the fiscal policy conduct are going to exert over the BRL.



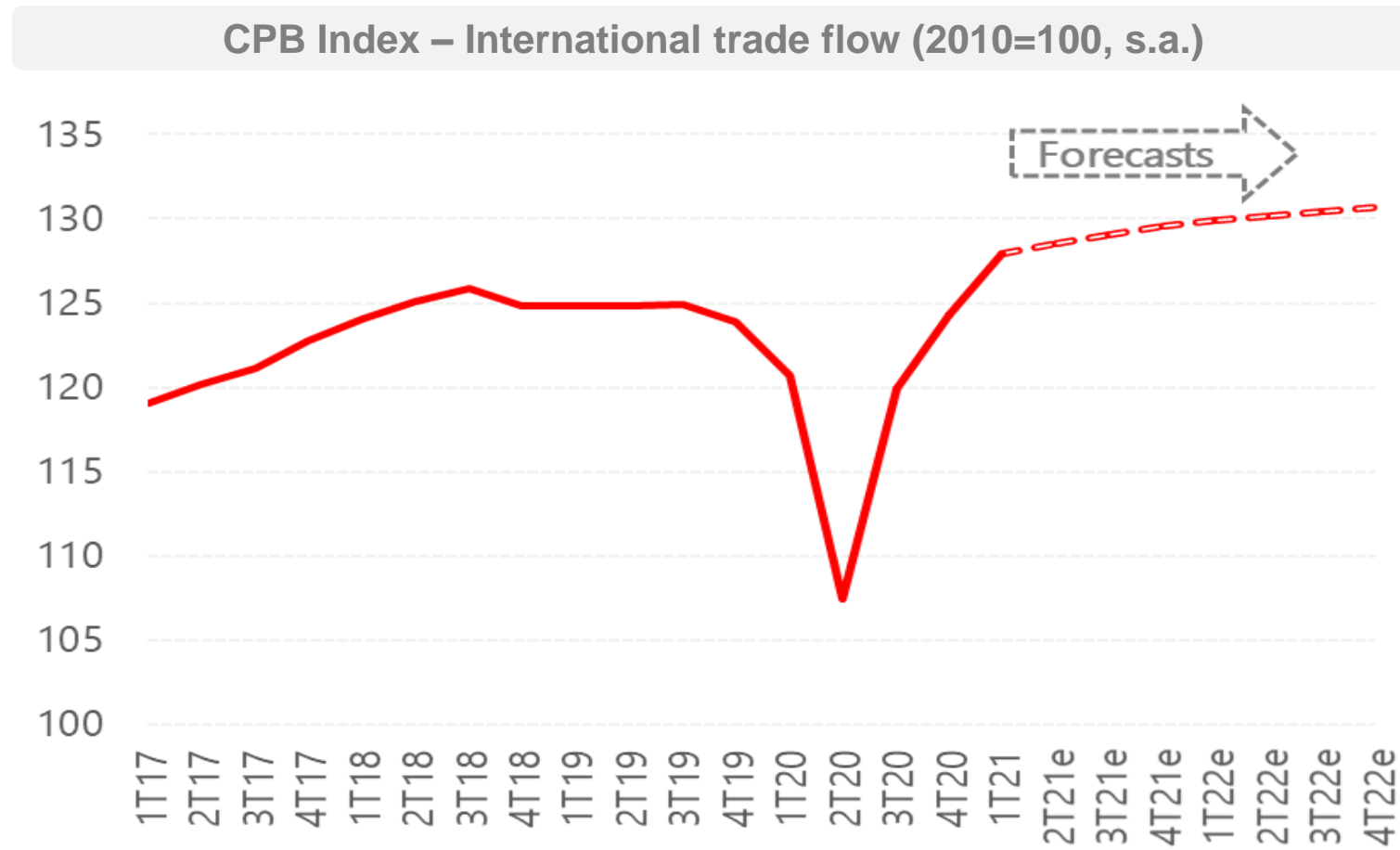
Sources: Bloomberg, Santander.

Balance of
Payments

03

A SIMILAR PLUNGE, BUT A FASTER (INITIAL) RECOVERY

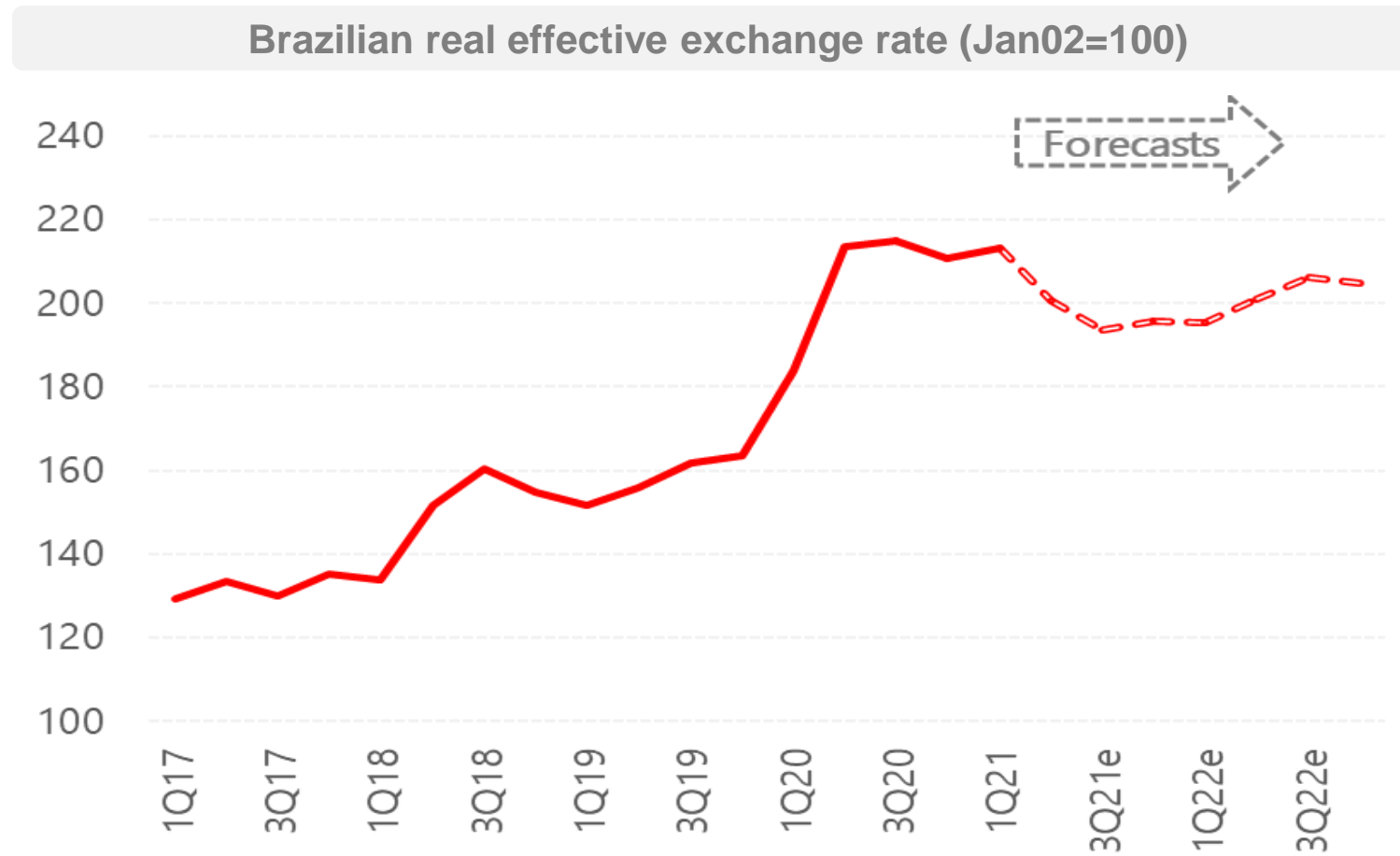
- The initial drop observed in international trade flows in 1H20 nearly matched the one observed in the 2008 crisis, but recent data indicates they have overcome their pre-pandemic levels and they should continue to grow—yet at a more gradual fashion.



Sources: Bloomberg, Santander.

WEAKER FOR LONGER

- Though higher than previously thought, we do not expect inflation to skyrocket, which means the nominal weakening of the BRL should, in fact, remain at relatively weak levels for historical standards.

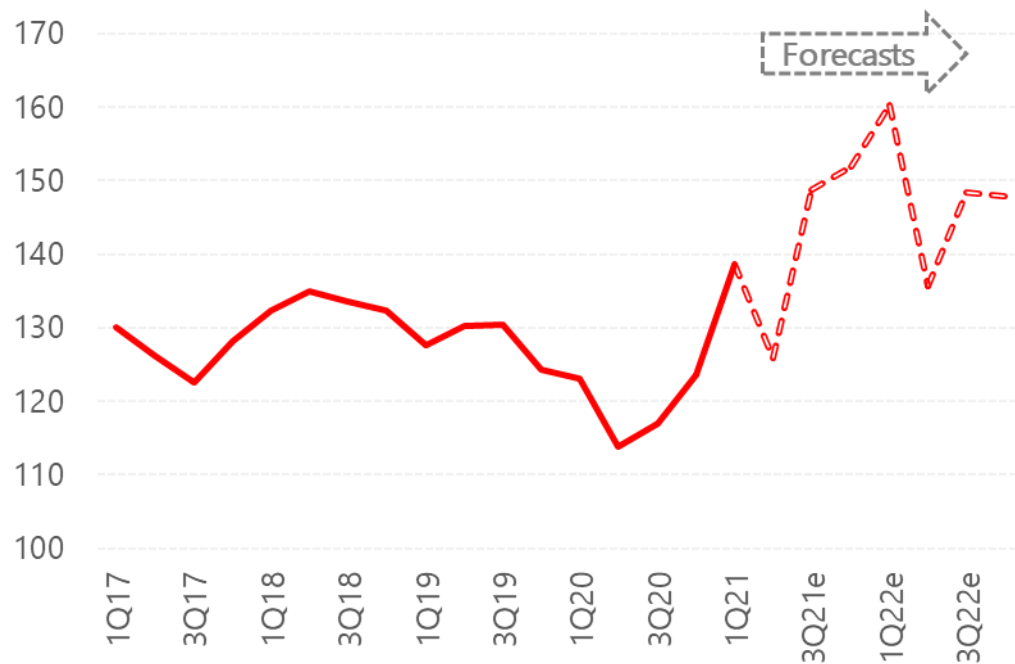


Sources: Bloomberg, Santander.

FURTHER IMPROVEMENTS IN TERMS OF TRADE

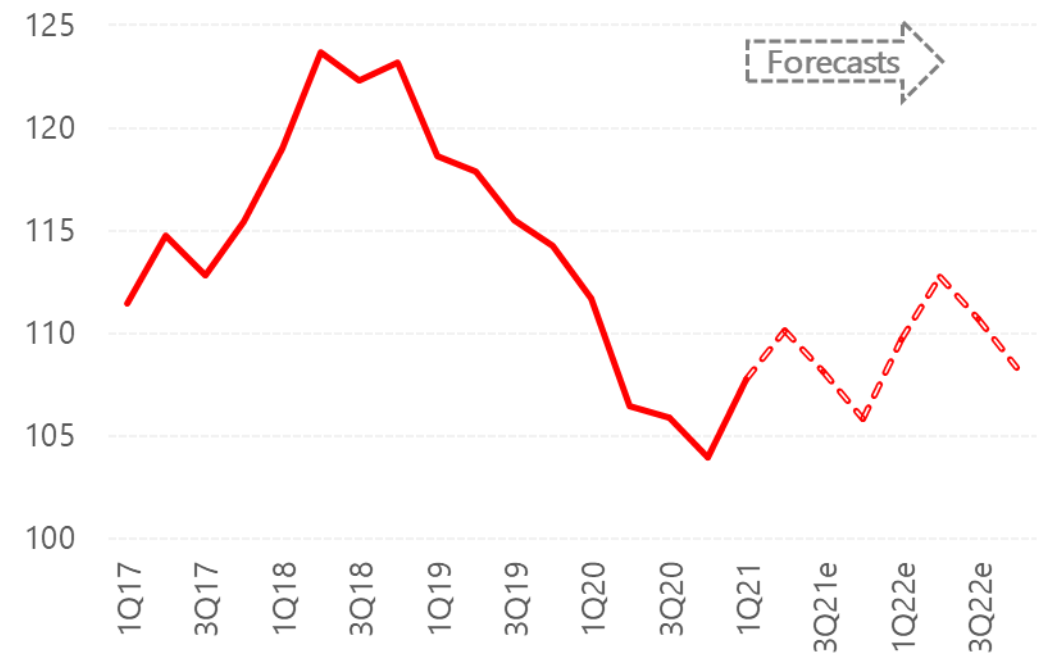
- Given our expectation of an extension in the bull market for commodities (beneficial for export prices) and the existence of idleness in the industrial sector (detrimental to import prices), we judge the Brazilian terms of trade should continue to improve.

Export price index (2006=100)



Sources: FUNCEX, Santander.

Import price index (2006=100)

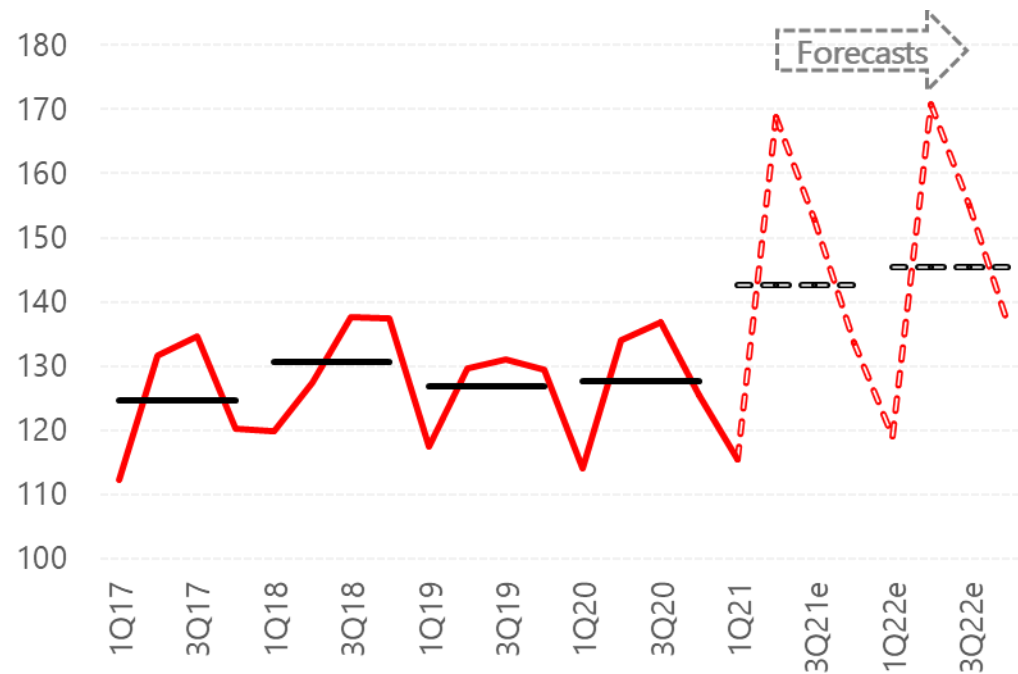


Sources: FUNCEX, Santander.

THE RABBIT AND THE TURTLE

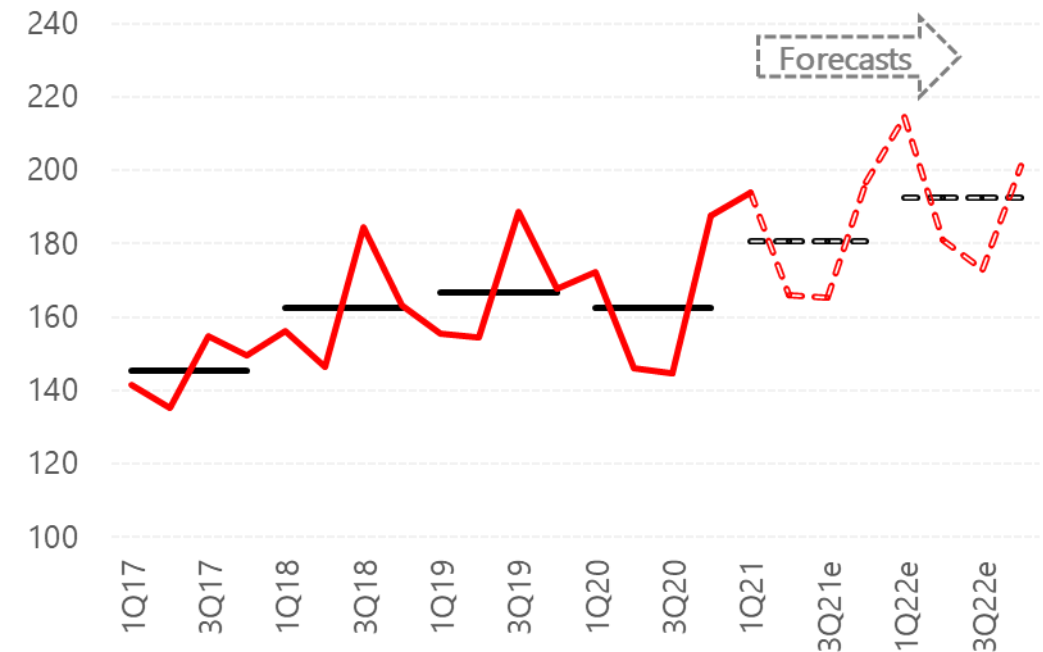
- While the lagged effects of the BRL weakening and the strong demand for commodities are likely to favor exports this year, we expect little additional improvement in 2022. On the import side, the gradual economic recovery should translate into a slow, but steady expansion in 2021 and 2022.

Export volume index (2006=100)



Sources: FUNCEX, Santander .

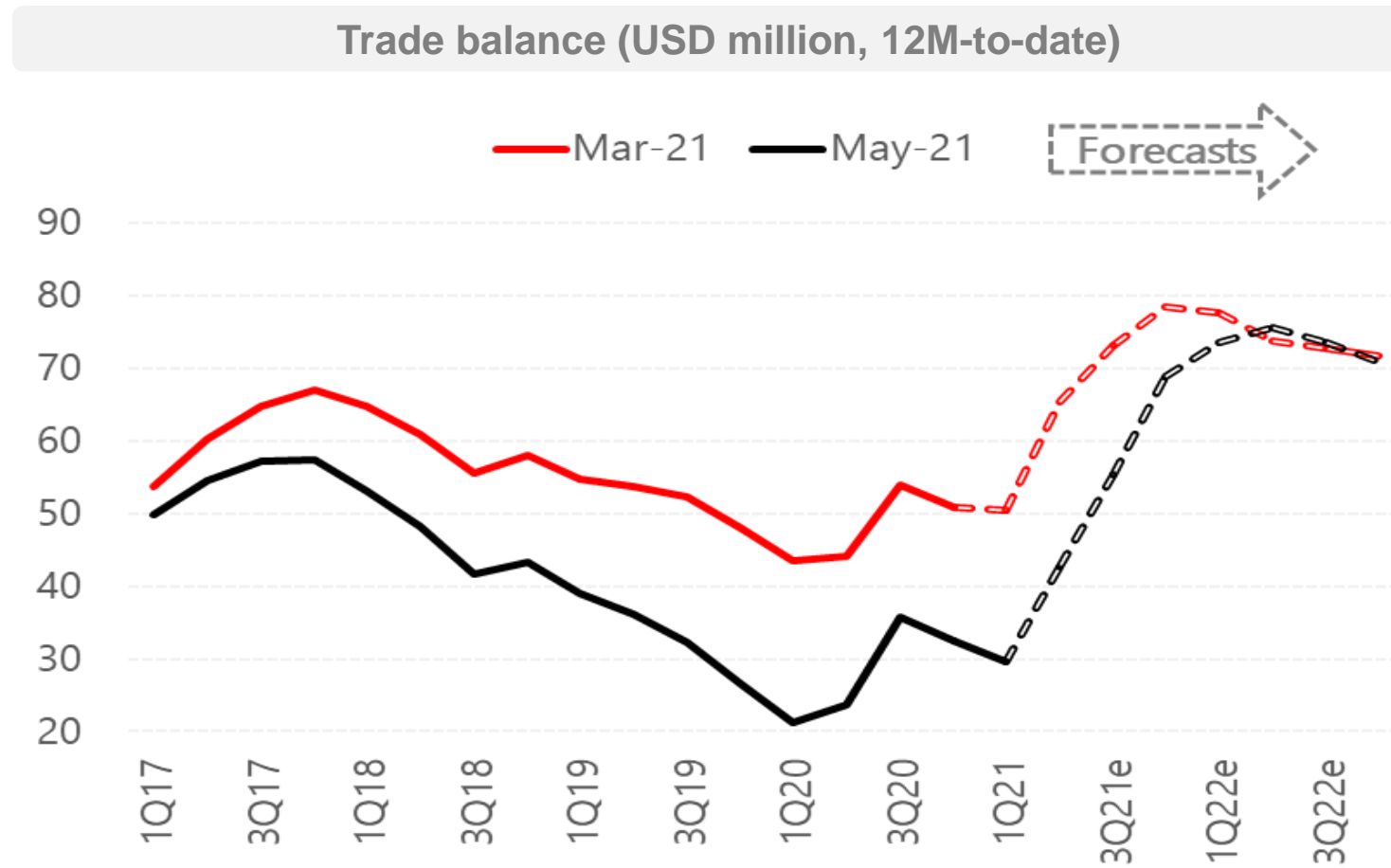
Import volume index (2006=100)



Sources: FUNCEX, Santander.

CHANGING TO A NEW LEVEL

- The combination of a weak currency in real terms, favorable commodity prices, growing trade flows, increasing demand for soft and metal commodities and a gradual economic recovery in Brazil should help the trade balance to register sizeable surpluses in the near future (the downward shift observed in the time series stemmed from a methodological improvement in foreign trade data).

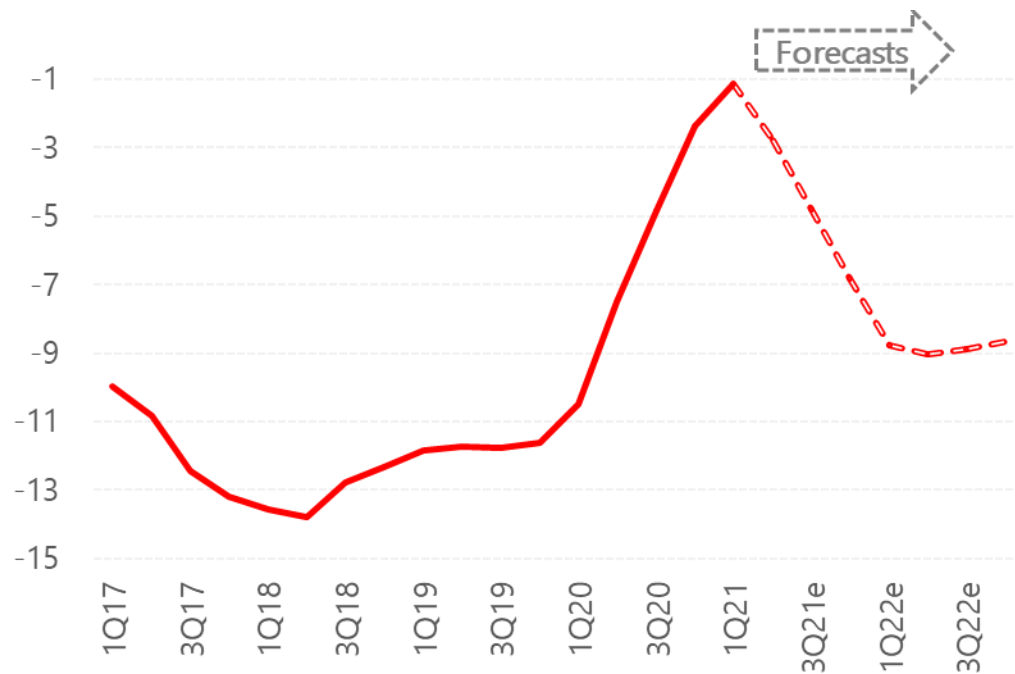


Sources: Brazilian Central Bank, Santander.

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

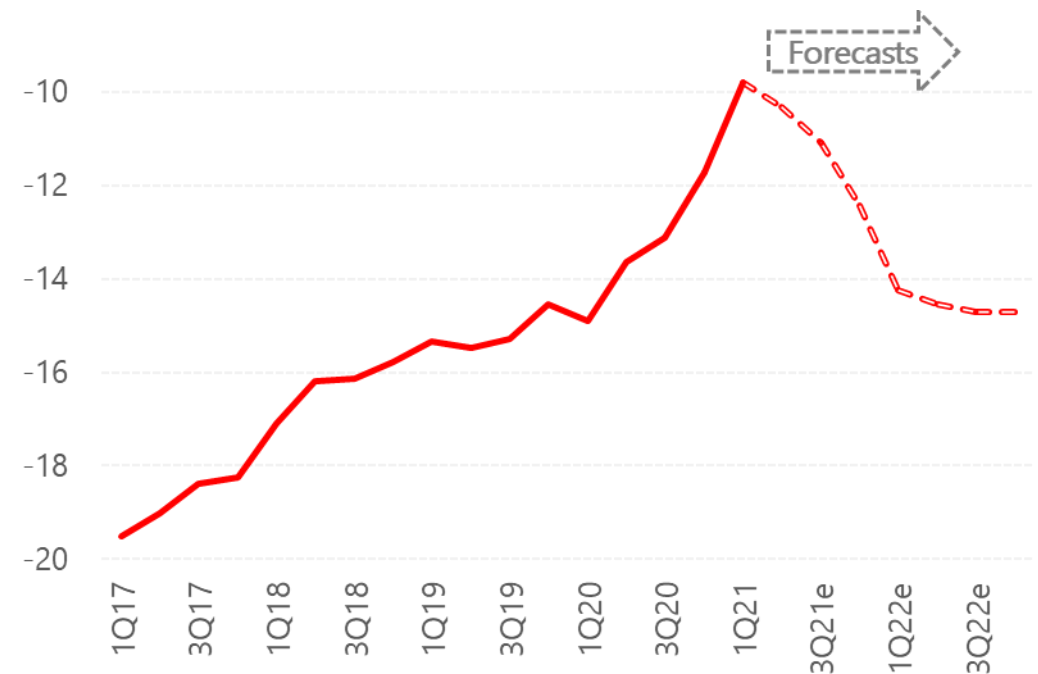
- Distension of mobility restrictions derived from the progress in the immunization against the Covid-19 and the increase in investments on the oil sector should lead to larger tourism outlays and equipment rental payments, although at a gradual pace.

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



Sources: Brazilian Central Bank, Santander.

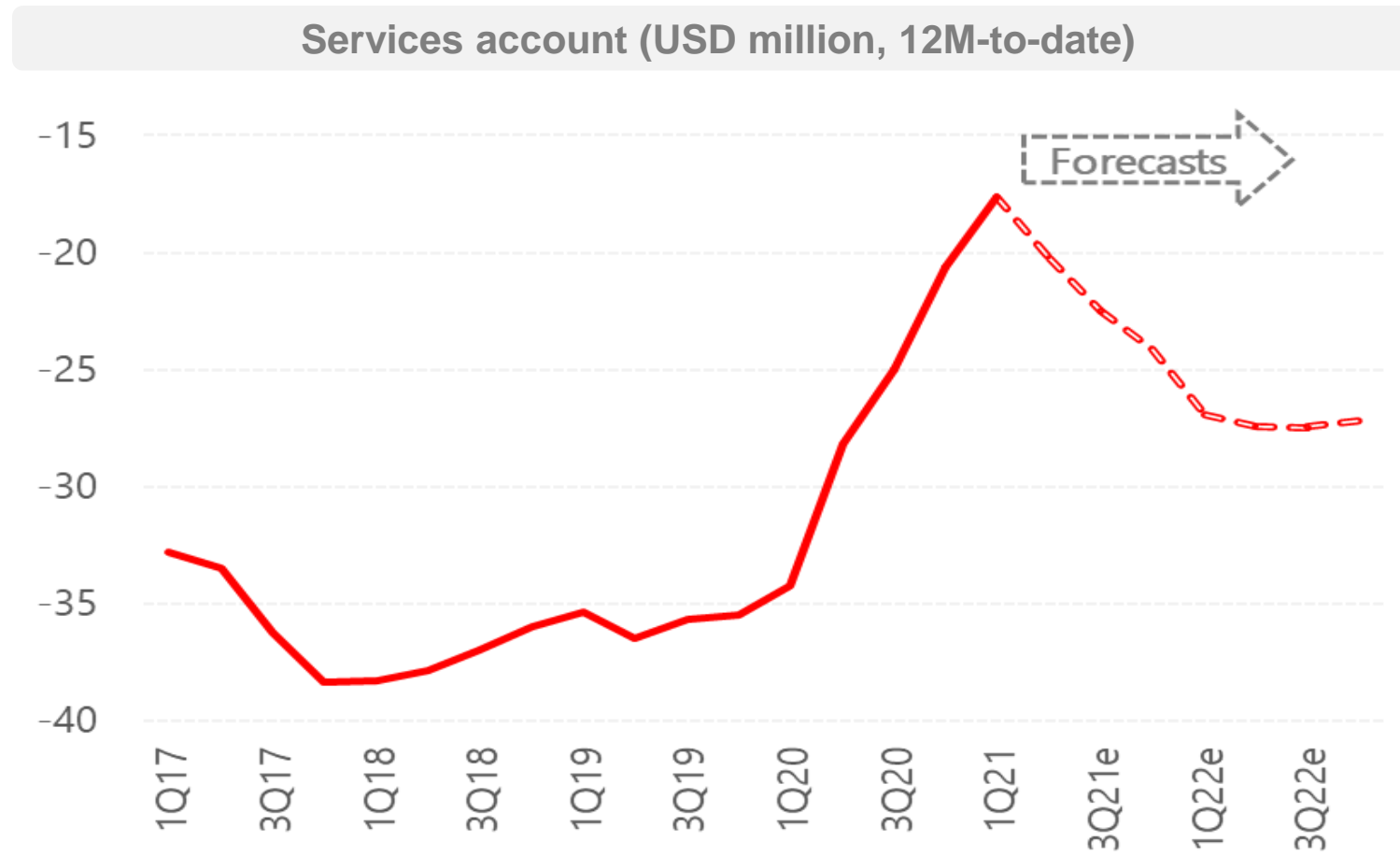
Equip. Rental (USD million, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

A SLOW RETURN

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

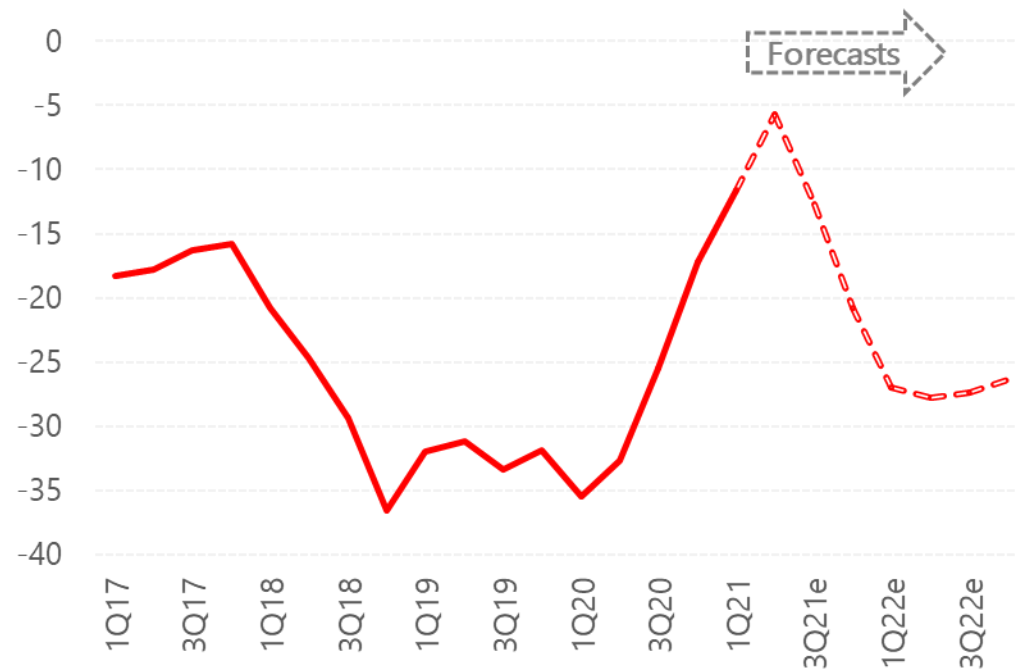


Sources: Brazilian Central Bank, Santander.

PARTNERS RATHER THAN CREDITORS

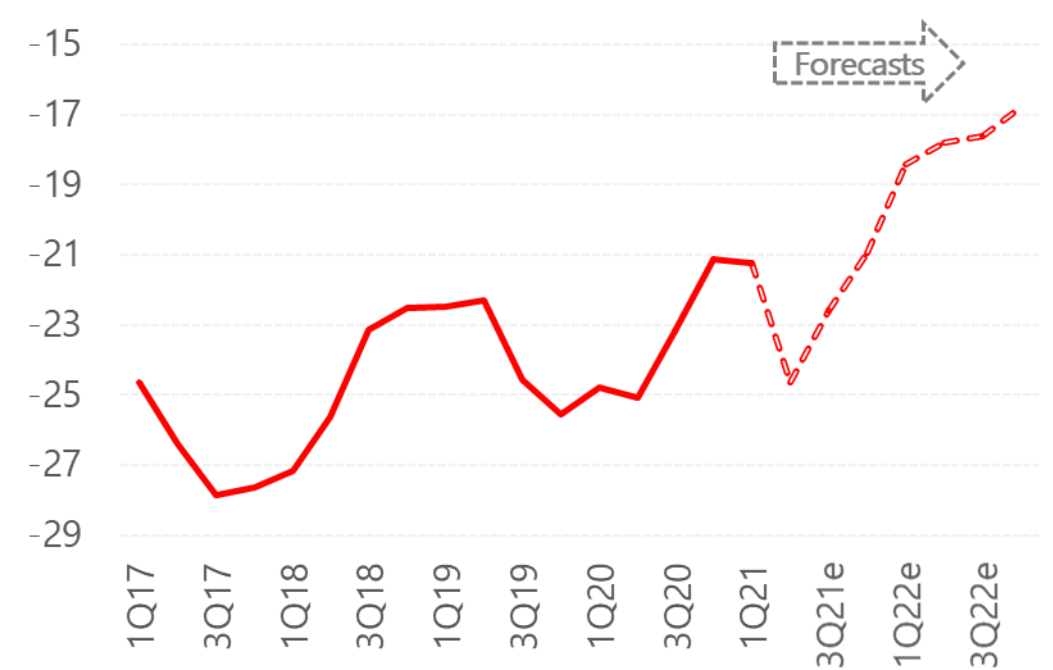
- The (expected) larger remittances of profits and dividends should be offset by the decline in the volume of external debt service, as the Brazilian corporate sector has improved its capital structure.

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



Sources: Brazilian Central Bank, Santander.

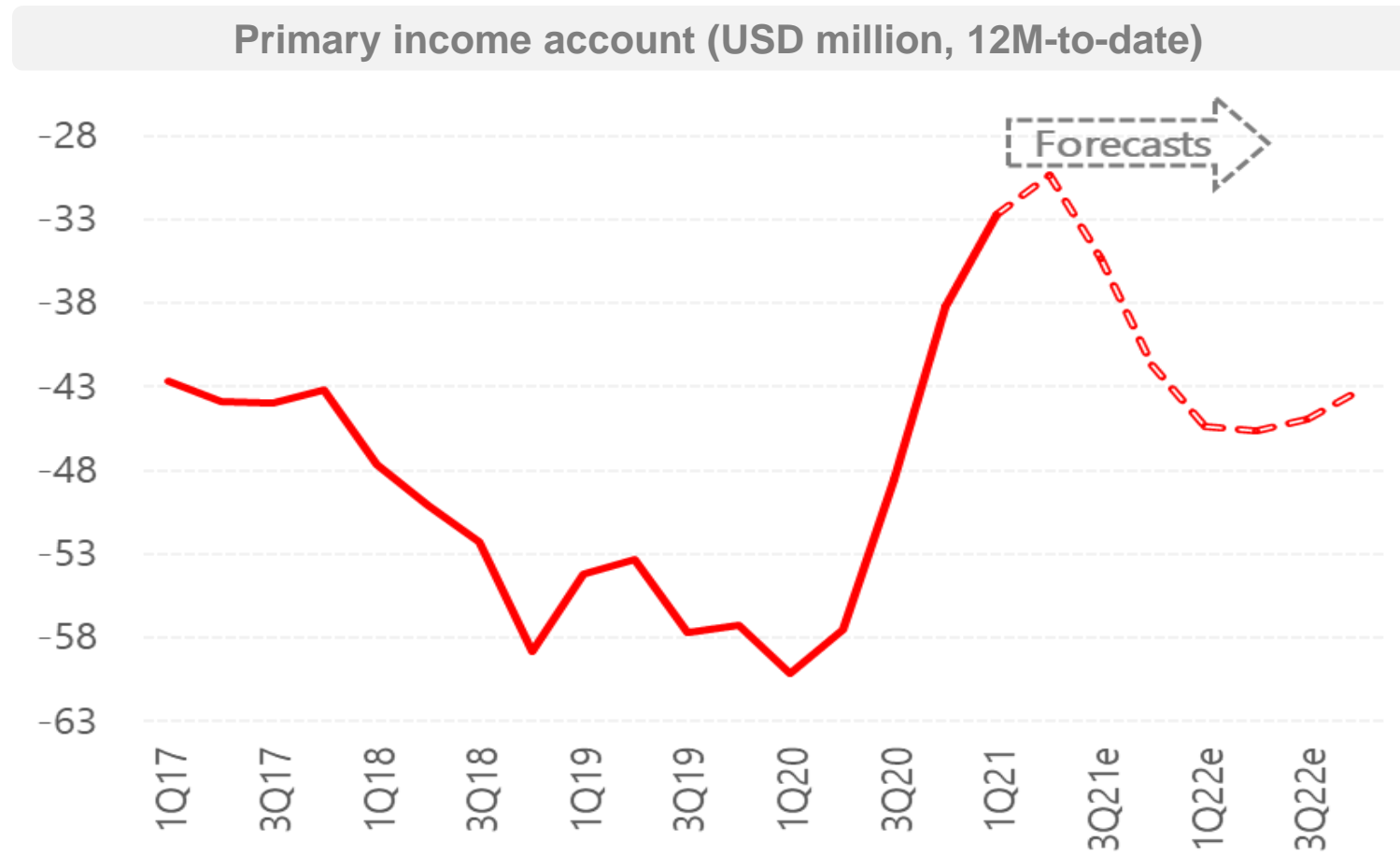
Interest payments (USD million, 12M-to-date)



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.

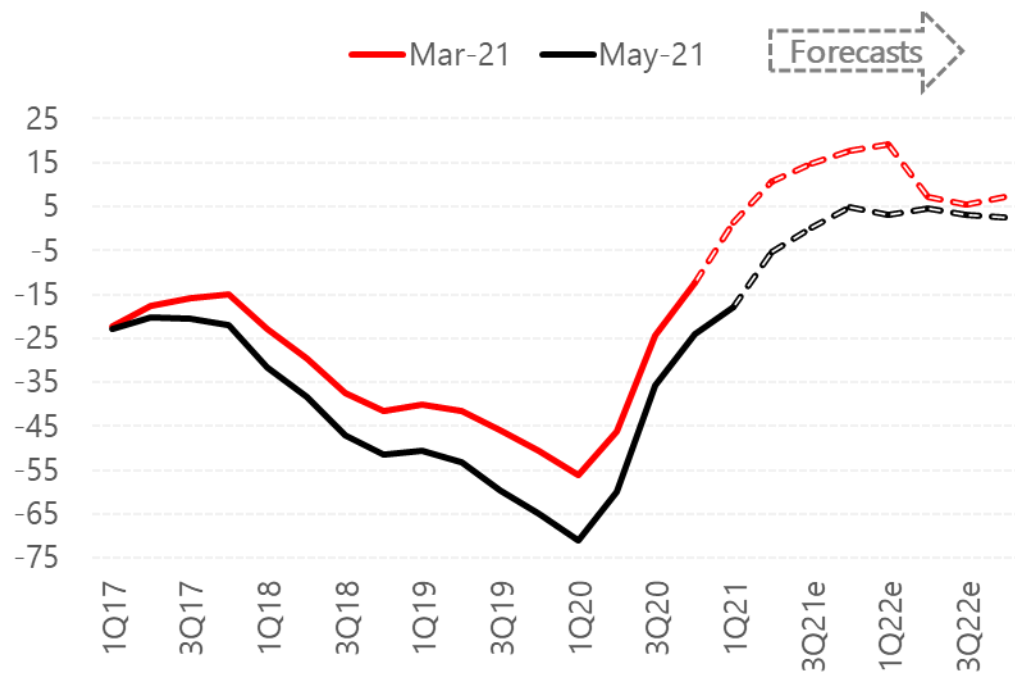


Sources: Brazilian Central Bank, Santander.

HEADING TOWARDS (UNUSUAL) SURPLUSES

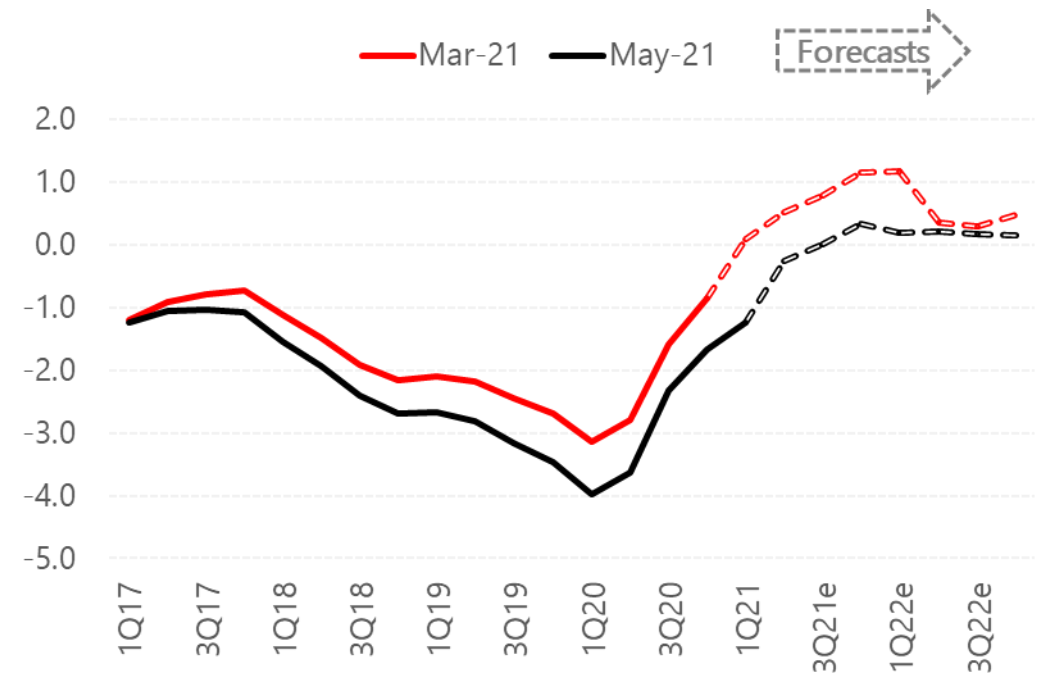
- We expect the adjustment in the current account balance to continue, thus leaving it to register (unusual) surpluses on both this year and the next one. The downward shift in the time series stemmed from the methodological improvement introduced in foreign trade data.

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



Sources: Brazilian Central Bank, Santander.

Current Account Balance (% of GDP)

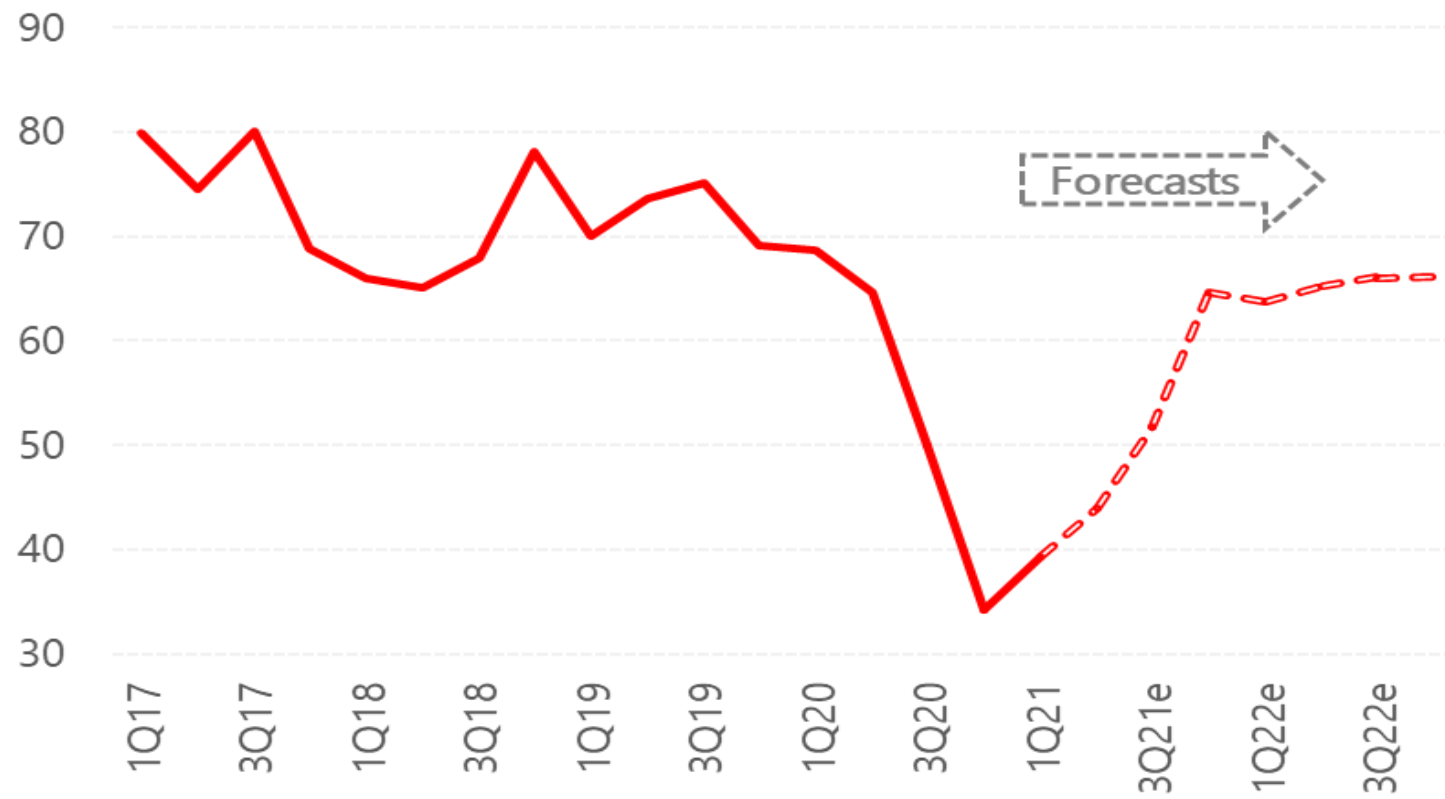


Sources: Brazilian Central Bank, Santander.

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)

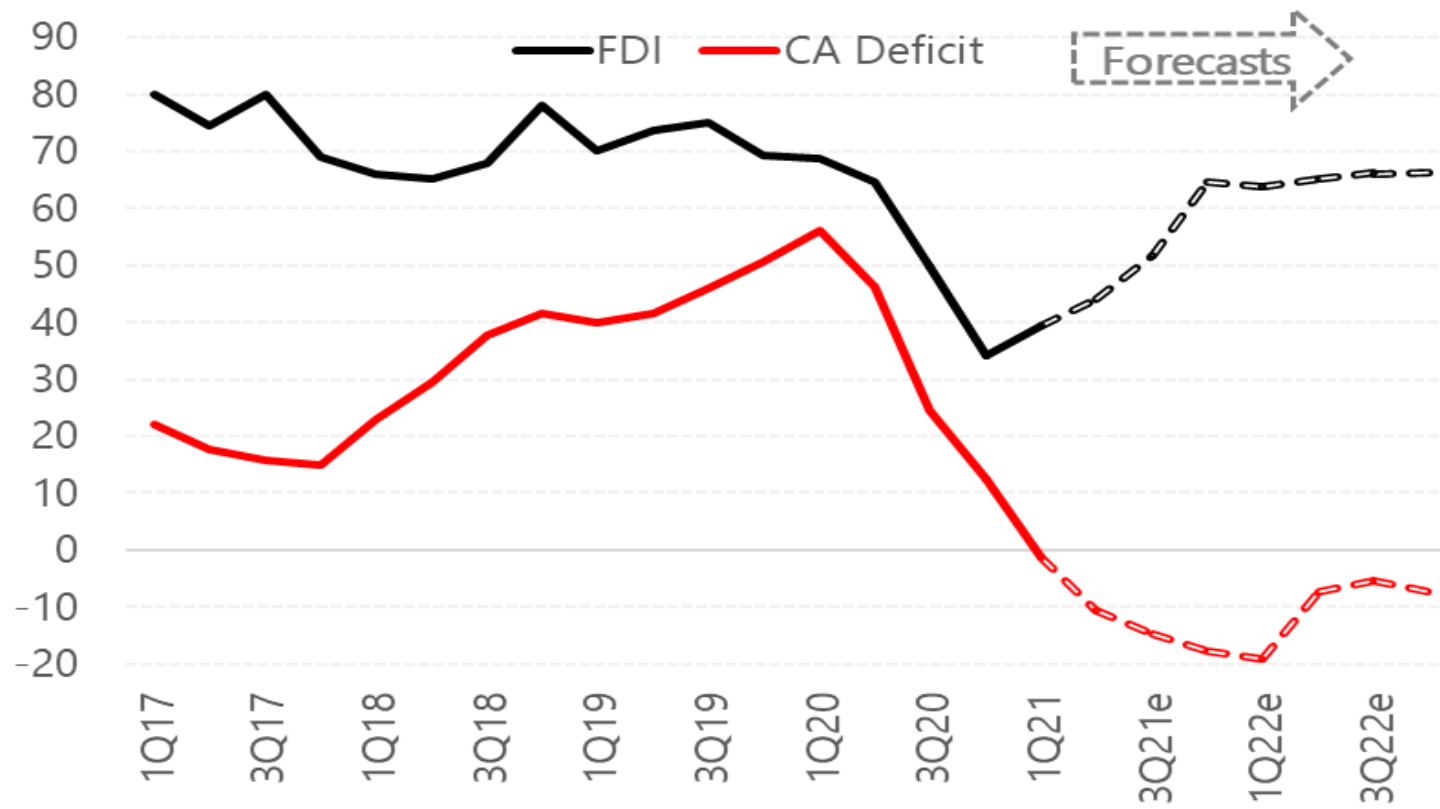


Sources: Brazilian Central Bank, Santander.

A (QUITE) COMFORTABLE SITUATION

- On the back of current account surpluses 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
Current account balance	-65.0	-24.1	4.9	2.5
Trade balance	26.5	32.4	68.8	70.9
Exports	225.8	210.7	265.1	278.0
Imports	199.3	178.3	196.3	207.1
Services	-35.5	-20.6	-24.1	-27.2
Tourism	-11.6	-2.3	-6.8	-8.6
Eq. Rental	-14.6	-11.7	-12.4	-14.7
Others	-9.3	-6.6	-4.9	-3.8
Income	-57.3	-38.2	-41.7	-43.2
Profits & Dividends	-31.9	-17.2	-20.8	-26.4
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	64.7	66.2
External funding (-ve=shortage / +ve=excess)	4.1	10.1	69.7	68.7

Sources: Brazilian Central Bank, Santander.

Macroeconomic
forecasts

04

FORECASTS

Macroeconomic variables		Previous		Current
GDP (%)	2021E	3.0	↑	3.6
	2022E	2.0	↓	1.5
	2023E	1.8	→	1.8
IPCA (%)	2021E	5.0	↑	5.9
	2022E	3.7	↑	3.9
	2023E	3.3	↑	3.3
Selic Rate (% end of period)	2021E	5.50	↑	6.50
	2022E	6.00	↑	7.00
	2023E	7.00	→	7.00
FX Rate - USDBRL (end of period)	2021E	5.25	→	5.25
	2022E	5.55	→	5.55
	2023E	5.20	→	5.20
Current Account Balance (% of GDP)	2021E	1.2	↓	0.3
	2022E	0.5	↓	0.2
	2023E	-0.2	↓	-0.5
Primary Fiscal Balance (% of GDP)	2021E	-3.2	↑	-3.0
	2022E	-2.2	↑	-2.1
	2023E	-1.7	↑	-1.6
Gross Public Debt (% of GDP)	2021E	86.2	↓	85.0
	2022E	88.8	↓	87.6
	2023E	91.2	↓	90.0

Sources: Brazilian Central Bank, IBGE, Santander.

PARAMETERS

Selected Indicators				
Indicator	2020	2021e	2022e	
USDBRL	5.20	5.25	5.55	
DXY (1973=100)	89.9	92.0	95.0	
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	300.0	325.0	
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	195.8	204.8	

Sources: Bloomberg, Santander.

Contacts

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Our culture is based on believing that everything we do should be:

Simple Personal Fair



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