ECONOMICS

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Brazil Macro Compass

Tightening, but Still Comfortable External Financing

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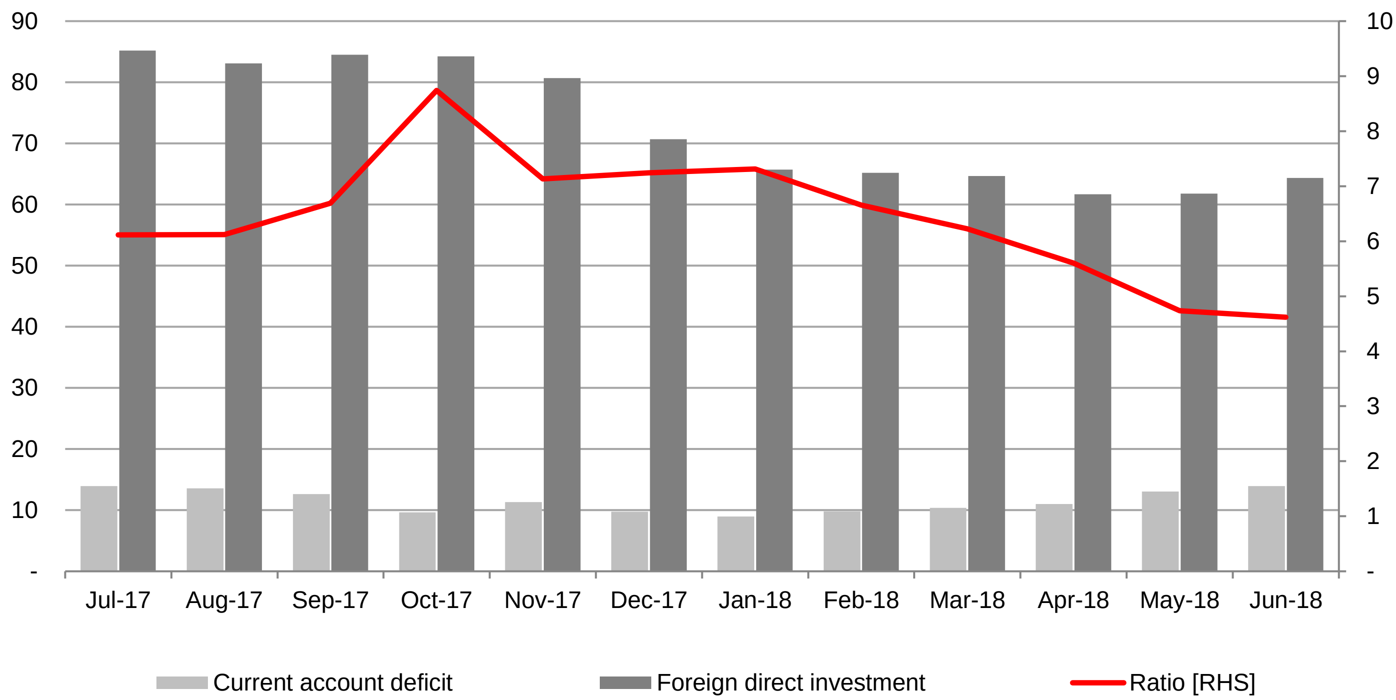
Chart of the Week: Current Account Deficit and FDI

Our *Chart of the Week* plots the most recent data on Brazil's external sector, released this week by the Central Bank. We compare the current account deficit with its most reliable source of funding, foreign direct investments (FDI). Although the first has been quite stable (at USD13.9 billion in the 12 months until last June), FDI has been in a downtrend, to USD64.3 billion in the same period, down 24% from a peak of USD85 billion one year ago. Still, the ratio FDI/current account deficit is more than 4x, indicating that, barring strong portfolio outflows, the country is unlikely to have trouble in finding external funding in the short term, in our view.

Brazil – Current Account Deficit and Foreign Direct Investment, 12-Month Rolling (USD billion)



Sources: Brazil's Central Bank, Santander.

Political Agenda: Congress Is Back

Brazil's Senate and Lower House resume their regular sessions next Wednesday, back from the two-week winter recess. The two houses have a narrow time window to move new laws forward before the campaign for the October general elections officially starts, on August 16.

The period of party conventions comes to a close on August 5, which leaves next week as the last for negotiations before the final definition of candidacies. Most of the presidential pre-candidates still have not picked their running mates, and some definitions should also take place next week.

In-Depth Research: Credit Unlikely to Constrain the Economic Recovery

In *It's Not for a Lack of Credit – Part II: Companies* and *It's Not for a Lack of Credit – Part III: Delinquency, Way Better than it Seems* (July 20, 2018), we continued analyzing the most recent data on credit released by the Central Bank. On the corporate side, we show that the main drag on credit concession has been BNDES' deleverage – the portfolio of outstanding loans of the state bank shrank almost 13% y/y. On the other hand, other borrowers are expanding their portfolios at 6% y/y, and capital markets (both domestic and external) have been partially occupying the gap left by BNDES. We conclude that credit is unlikely to be a constraint to the ongoing economic recovery. An examination of non-performing loans data points to that same diagnosis: delinquency indicators have been falling consistently across sectors, both in public and private banks, leading debtors to increase their ability to borrow.

Upcoming Data: Copom to Stay on Hold

Brazil's Monetary Policy Committee (Copom) meets next Wednesday (August 1). In the six weeks since the last meeting, the balance of risks evolved favorably, making more likely, in our view, that the committee will follow its flight plan and keep the base rate at 6.5%. The most recent inflation release, July's IPCA-15, surprised to the downside (0.64% m/m, 9 bps below market consensus), suggesting a normalization in fuel and food prices while core measures point toward well contained prices. Furthermore, the pass-through of the recent BRL weakening to domestic prices seems to be low, in-line with we expected for an economy in slow recovery, but still with high slack level. Finally, the indicator that we believe to be the most relevant to this year's rate decisions, the 2019 median inflation expectation according to the Focus survey, has been stable at 4.10% for the last five weeks, temporarily discarding the risk of de-anchoring pointed in the latest BCB documents (minutes and inflation report). We expect the statement to reflect those improvements and maintain a data-dependent tone for the next meeting. In our scenario, the first rate hike should come only in 2H19, as we expect current and expected inflation to stay below the target midpoints.

Apart from the monetary policy decision, June industrial production is the most relevant data release next week (on August 2). Following a strong contraction in May (-10.9% m/m) due to the truckers' strike, the volume of production should have rebounded in June, especially in the auto sector. We forecast a 14.2% monthly growth.

Number of the Week

US$30 bn

Brazil's soybean exports may reach USD 30 billion this year, up 17% from 2017 to a new all-time record, according to estimates from the Brazilian Association of the Vegetable Oil Industries. Brazilian farmers are thankful to Donald Trump, since the U.S. tariff wars with China boosted volumes and preserved prices at Brazilian ports.

Quote of the Week

We intend to establish a system of rewards and punishments. Banks that adhere to the rules will have tax advantages. Those that do not will have penalties. That is: we will introduce the concept of progressivity in taxes to induce desirable behaviors in the banking system.

— **Fernando Haddad**, one of the coordinators of PT's government plan explaining how his party plans to force a reduction in credit spreads, in an interview with *Folha* (July 23, 2018).

What We've Been Reading

- "*Outlook for the Americas: A Tougher Recovery*," by Alejandro Werner (IMFBlog, July 23, 2018). IMF's latest update on the region, revising downwards Brazil's 2018 GDP growth estimates.

- "Markets, IMF send Brazil clear message: Reform your economy," by Desmond Lachman (*The Hill*, July 23, 2018). Lachman fears that Brazil will lack political will to keep on with the fiscal consolidation process and avoid future financial crises.

- "The BRICS in a Multipolar World," by Elizabeth Sidiropoulos (*Project Syndicate*, July 25, 2018). What to expect from the ongoing annual BRICS summit, in Johannesburg.

- "International Conditions, Economic Voting and the Context of the 2018 Brazilian Presidential Election" by Daniela Campello (*Brazil Talk*, July 17, 2018). The "Good Economic Times Index", created by the author, sharply reversed recently and should influence the coming presidential election.

- *Under-Rewarded Efforts: The Elusive Quest for Prosperity in Mexico*, by Santiago Levy. A new book by a leading practitioner and thoughtful scholar.

Recent Publications (Available on Our Website)

- *It's Not for a Lack of Credit – Part III: Delinquency, Way Better than it Seems* (July 20, 2018)
- *It's Not for a Lack of Credit – Part II: Companies* (July 20, 2018)
- *It's Not for a Lack of Credit – Part I: Individuals* (July 18, 2018)
- *"Lethal Weapon": How Far Can the BCB Go with Swaps?* (June 15, 2018)
- *Rely on Fundamentals and Carry On* (June 8, 2018)

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