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BRAZIL: BALANCE OF PAYMENTS REVEALS DETERIORATION

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Balance of payments: May 2013 results

- On the back of strong domestic demand and capital controls, Brazil has over the last three years registered a narrowing surplus in the balance of payments—the balance of financial transactions and trade of goods, services, and income with rest of the world. (Figure 1.)
- The balance of payments posted a modest surplus of US$2bn in the 12-months through May, down from US$40bn in May 2012. This is a result of the widening trend of the current account deficit that has accentuated since the start of 2013, coupled with lower capital inflows.
- The current account deficit is now larger than inflows of foreign direct investment (FDI). In the 12-months through May, the current account deficit came in at 3.2% of GDP, versus net FDI inflows of 2.8% of GDP.
- The increase of the current account deficit is one of the factors behind the recent BRL weakness. Importantly, this dynamic is occurring in the midst of significant external developments: 1) the Chinese economy is showing signs of slower growth, thus weighing on the outlook for commodity prices, and 2) the US Federal Reserve has signaled that it may taper QE measures in the near term, with ensuing implications on global liquidity and capital flows.

Widening current account deficit

- The 12-month current account deficit widened to US$73bn, or 3.2% of GDP in May, upon the narrowing trade balance and wide deficit in the services and income balances. (Figure 2.) The narrowing trade surplus reflects weak global demand, lower commodity prices, the loss of competitiveness of Brazilian industry, and strong internal demand.
- May's result marks the largest current account deficit since 2002, having widened from 3.1% of GDP in April and 2.4% of GDP in December 2012. Going forward, the pace of current account deficit deterioration should lose momentum to stay in line with present levels owed to gradual recovery of global trade, slow economic growth (due to a higher SELIC rate) and BRL weakness. The Central Bank's 2Q13 Inflation Report released this morning forecasts a current account deficit of 3.2% of GDP for the year.
- There are, nonetheless, considerable downside risks from the balance of the uncertain external environment and focus of domestic policies on stimulating aggregate demand.
- Emerging signs of softer growth in China, along with prospects for a stronger USD, are less supportive of higher commodity prices going forward, thereby weighing on Brazil's favorable terms of trade (the price received for exports in relation to the price paid for imports).
- Moreover, while the external environment remains weak, Brazilian aggregate demand (and imports) continues to be stimulated by fiscal and quasi-fiscal policies such as tax cuts, price controls, and the strong lending growth of government-controlled banks even as the economy is operating at record low unemployment.

FDI is mostly financing the current account deficit, but no longer completely

- External financing is available to Brazil. The current account deficit is financed by net inflows to the financial account, which totaled US$75bn in the 12-months through May.
- However, the composition of financing has changed given that the larger current account deficit is not fully financed by longer-term foreign direct investment inflows. Net inflows of FDI totaled US$64bn in the 12-months through May, or 2.8% of GDP. Despite these firm results, the increasing current account deficit now requires that shorter-term portfolio and other capital flows cover the financing gap. (Figure 3.)
- The challenge is—as the latest bout of global market volatility shows—that short-term capital flows to emerging markets, including Brazil, are quick to change in terms of their direction and magnitude. Indeed, monthly financial FX flows to Brazil have recorded net outflows since February, with the year-to-date net withdrawal totaling US$6.5bn thru June 21st. (Figure 4.)
- In a policy shift, the government has loosened several capital controls in 2013 in attempt to recapture inflows and curb BRL weakness in an environment of high inflation. Yet there is the downside is that, with the outlook for financial inflows depending on monetary policy decisions in advanced economies, external financing could become less abundant and more expensive.

Figure 1: Balance of payments

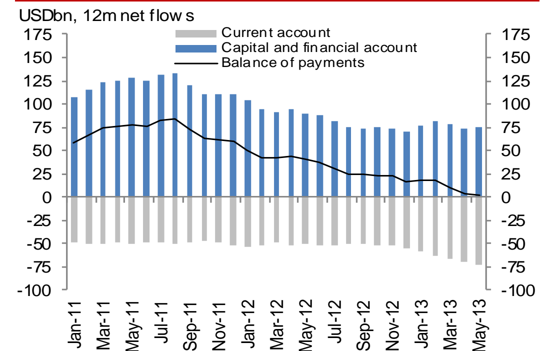


Figure 2: Widening current account deficit

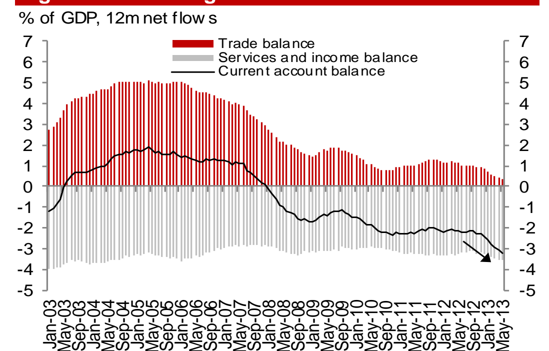
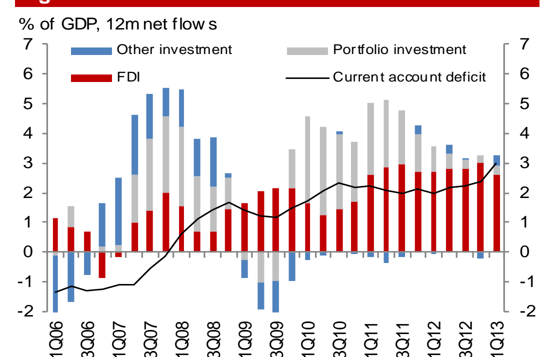
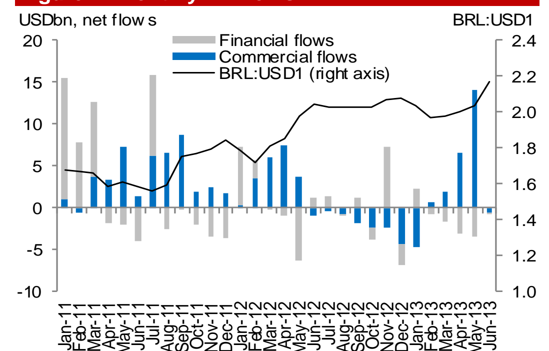


Figure 3: Flows of the Financial Account



Note: (+) Current account deficit; (-) Current account surplus.

Figure 4: Monthly FX flows



Note: Data through June 21st 2013.

Source for all charts: Central Bank; BTMU Economic Research.

For historical data and commentary following BTMU's Economic News Releases, see our website at: https://reports.us.bk.mufg.jp/portal/site.

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