

Brazil

Economic Watch

Madrid, 26 January 2011

Economic Analysis

Enestor Dos Santos
enestor.dossantos@grupobbva.com
+34 91 537 68 87

Brazil: strong current account deficit and abundant capital inflows in 2010

- The Brazilian current account deficit practically doubled to USD 47.5 billion in 2010 in comparison to USD 24.3 billion in 2009. As a percent of GDP, the deficit jumped to 2.3% in 2010 from 1.5% in 2009. This was the worst result since 2001 when the current account deficit reached 4.2% of GDP.
- The deterioration of the current account was a direct consequence of a robust expansion in domestic demand (11.3%/y/y according to our estimates) and the strengthening of the Brazilian Real (10% in comparison to 2009).
- The current account deficit in 2010 was in line with BBVA forecasts (USD 47 billion; 2.3% of GDP) and slightly lower than markets expected (USD 50 billion; 2.5% of GDP).
- The positive performance of trade terms in 2010 allowed the trade balance to outperform estimates and reach USD 20 billion (instead of USD 15 billion as expected by most). However, in spite of this positive surprise, 2010's trade surplus declined 20% in comparison to 2009.
- Although the better than expected performance of the trade balance prevented the current account from deteriorating even more, the income and services balance put intense pressures on the Brazilian external accounts in 2010. More precisely, the income and services account deficit increased to USD 70.6 billion from USD 52.9 billion in 2009. The main items that contributed to this deterioration were travel expenditures (+88%/y/y) and remittances of profits and dividends (+18%/y/y).
- The current global optimism towards the Brazilian economy as well as the international abundance of liquidity generated capital inflows into Brazil that more than compensate the current account deficit.
- The surplus in the capital and financial account reached USD 100.1 billion in 2010. This surplus represented 4.9% of GDP in 2010, more than the results observed in the two previous years (4.4% in 2009 and 1.8% in 2008) but lower than in 2007 (6.5%).

FDI inflows outperformed expectations and reached USD 48.5 billion or 2.4% of GDP (by itself enough to finance the current account deficit), but the main bulk of capital inflows was in the form of portfolio investments, which amounted to USD 64.5 billion (3.2% of GDP). Portfolio investments in equities accounted for 68% of total portfolio investments while investments in fixed income, which were affected by the measures to control capital inflows announced last year, accounted for 32%.

International reserves continued to expand and reached USD288.5billions (14% of GDP), higher than Brazil's total external debt (USD255billions).

Overall, 2010's external accounts show a deterioration of the current account in line with a gap between the pace of domestic and external demand and also with the appreciation of the Brazilian Real. They also show that external capital is more than pleased to finance the current account deficit, at least at this macroeconomic juncture. Finally, they show that results were positively impacted by very beneficial terms of trade and that, therefore, a reversion of these terms of trade could imply an even sharper deterioration of the current account (which could then force a sudden depreciation of the currency).

BBVA's forecasts for 2011 are presented in the table above. We see an intensification of the main trends in place since 2009, namely, the deterioration of the trade balance and of the current account, and also an external environment that allows a smooth funding of the current account (which will increasingly depend on short-term capital).

In our base-scenario, therefore, we foresee a positive scenario for external accounts, meaning that the continuous deterioration of the current account deficit (which would reach 2.8% of the GDP in 2011 and then gradually converge to around 4.0% in next years) will not generate disturbing concerns about its sustainability. However, we need to be aware that the widening of the current account deficit increases the potential negative impacts that a deterioration of terms of trade or a crisis of confidence in Brazil could have.

Table 1

Brazil: Balance of Payments 2009-2011

Balance of Payments (USD millions)	2009	2010	2011(f)
1) Current Account	-24,320	-47,518	-65,178
1.1) Trade Balance	25,347	20,266	9,510
1.1.1) Exports	152,995	201,915	214,771
1.1.2) Imports	127,647	181,649	205,261
1.2) Income and Services Balance	-52,930	-70,630	-80,344
1.2.1) Services	-19,245	-30,573	-34,069
1.2.2) Income	-33,684	-40,057	-46,276
1.3) International Transfers	3,263	2,845	5,656
2) Capital and Financial Account	70,551	100,102	92,812
2.1) Capital Account	1,129	1,119	2,812
2.2) Financial Account	69,423	98,984	90,000
2.2.1) Foreign Direct Investment	36,033	36,962	25,000
2.2.1.1) Abroad	10,084	-11,500	-15,000
2.2.1.2) In Brazil	25,949	48,462	40,000
2.2.2) Portfolio Investment	49,133	64,458	65,000
2.2.3) Derivatives	156	-112	0
2.2.4) Other	-15,900	-2,324	0
3) Errors and Discrepancies	434	-3,484	0
4) Current, Capital and Fin. Accounts (1+2+3)	46,666	49,100	27,634
5) Reserves Variation (- = increase)	-46,666	-49,100	-27,634

Source: BBVA Research

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA and the rest of entities in the BBVA Group which are not members of the New York Stock Exchange or the National Association of Securities Dealers, Inc., are not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".