Brazil

Economic Watch

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Economic Analysis

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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 reserved 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

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