Flash

Brazil

Current account deficit reaches lowest level in more than a year in September

The current account deficit dropped 55%m/m (44%y/y) in September following the sharp depreciation of the real and the moderation of domestic demand. Overall capital inflows decelerated markedly, but FDI remained very strong (13%m/m and 17%y/y).

- **External deficit reached 2.05% of GDP; markets surprised to the downside.**
  The current account deficit was equal to USD 2.2bn in September (the lowest deficit since May of 2010), significantly less than markets expected (USD 3.2bn). The external deficit accumulates now USD 48bn in the last 12-months, which represents 2.05% of GDP (the lowest ratio since June of 2010). The main support for this correction came from both service and income accounts. More precisely, the service account deficit declined 10%m/m and the income account deficit dropped 54%m/m due to the depreciation of the real (which averaged 1,75 in September in comparison to 1,60 in August) and to the moderation of domestic demand. The trade balance surplus shrank to USD 3.1bn from USD 3.9bn in August as exports contracted more than imports, at least at some extent, due to lower terms of trade.

- **FDI inflows: up; other capital inflows: sharply down.**
  The capital and financial account surplus dropped to USD 3.1bn in September from USD 10.1bn in August (USD 15.2bn in September of 2010) as global risk aversion skyrocket due to the concerns with the crisis in Europe. FDI inflows, however, came up at USD 6.3bn, significantly more than both markets and the CB had forecasted. Portfolio investments recorded net outflows of USD 0.3bn (in contrast with net inflows of USD 0.6bn in August and of USD 8.7bn one year ago) while other investments, which include trade credit and other loans, recorded net outflows of USD 3.2bn (inflows of USD 3.5bn in August and of USD 1.1bn in September of 2010).

- **A further improvement of the current account should not be taken for granted.**
  Even though the downward correction of the current account deficit was higher than expected, it was broadly in line with what was observed in previous episodes of sharp depreciation of the real and increase of the risk aversion. But a continuous improvement of the current account should not be taken for granted. If developed economies are able to avoid another recession (our base scenario), both a positive growth differential between Brazil and its partners and lower terms of trade should drive the current account deficit up to 2.8% of GDP in the end of 2012 from 2.1% in the end of this year. And even if the global economy double dips, the negative impact on the current account of a sharp fall in Brazil's terms of trade and "accountancy effects" (GDP measured in dollars fall when the real depreciates…) could be more important (at least in the short-term) than the positive impact derived from the weakening of the currency and the easing of domestic activity. However, in any situation Central Bank's international reserves, which reached USD 350bn in the end of September, will be available to cushion the country against any turbulence.

For more on Brazil, click here.

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