CAPITAL ECONOMICS

LATIN AMERICA ECONOMICS UPDATE

Brazil’s export boom likely to fade

- **The surge in Brazil’s exports since the start of the pandemic has helped the economy recover more quickly than we and most others had anticipated. And unlike previous spikes in exports, some of the windfall has been saved, which has caused the current account deficit to narrow and provided support to the currency. But these developments are likely to go into reverse over the second half of the year.**

- The latest trade figures for June showed that Brazil’s goods exports dipped from May’s record high. But the big picture is that the monthly figures have been running at around the $30bn mark for some time now, some 50% higher than their pre-pandemic level. Imports haven’t risen as far as exports, causing Brazil’s goods trade surplus to increase too. (See Chart 1.)

- **The sharp rise in exports has been driven by commodities (mining and, most of all, food products)**. (See Chart 2 – note that detailed figures for June have yet to be released.) About 40% of that increase has been a result of higher export volumes; 60% has been due to higher export prices. In the last few months, volumes – mainly resulting from a strong harvest – have played the key role in supporting exports.

- **One point to note is that the improvement in the trade surplus has little to do with a weaker real boosting Brazil’s competitiveness**. Through the pandemic, the real exchange rate has been low compared with its average over the past 15 years. But the country’s manufactured goods exports – which should be most sensitive to the real’s valuation – have hardly risen since 2019. (See Chart 2 again.)

- And there’s been little evidence of import substitution either. As Chart 3 shows, the relationship between imports and industrial production has remained steady. Had a weaker currency prompted Brazilians to buy more domestically-produced goods rather than imported goods, we would have expected to see industrial production stronger (and imports weaker) than the historic relationship would have suggested.

- **The surge in exports has provided a significant boost to Brazil’s economy**. The rise in incomes generated from higher exports has allowed consumption and investment to increase, which helps to explain why the post-pandemic recovery has been stronger than we and many others had expected.

- **And some of the windfall from higher exports has been saved, helping the current account deficit to narrow by about 1.5% of GDP (to c.2.5% of GDP on a 12 month sum basis) since 2019**. That’s smaller than the rise in exports over the same period (c.4% of GDP), as stronger domestic demand has lifted imports. But it’s a notable difference from previous export spikes, such as in the early 2010s, when the rise in export incomes (and more) was spent, causing the current account deficit to *widen*.

- In turn, the improvement in the current account deficit has provided some support to the real, although in the near term we think other factors – including a deterioration in global risk appetite – will cause it to weaken against the dollar. (For more, see our forthcoming *FX Update*.)

- **While these developments provide rare positive news for Brazil’s economy, the surge in exports also underlines the country’s commodity dependence**. Prospects for the country’s trade (and the currency and GDP) will remain at the whims of commodity prices and harvests. In this regard, it looks like the recent surge in exports may reverse over the second half of the year.

- To start with, we expect that the prices of Brazil’s main metals and agricultural exports (iron ore and soybeans, respectively) will fall back over the rest of the year and in 2024. (See our *Commodities Outlook*. Note that, although we expect stimulus in China to put a floor under base metals prices in general, we think that iron ore prices will decline further.) What’s more, the country’s agricultural exports typically fare poorly during El Niño episodes – as will be the case in the coming quarters. (See Chart 4.)

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Chart 1: Goods Exports, Imports & Trade Balance ($bn, Monthly)

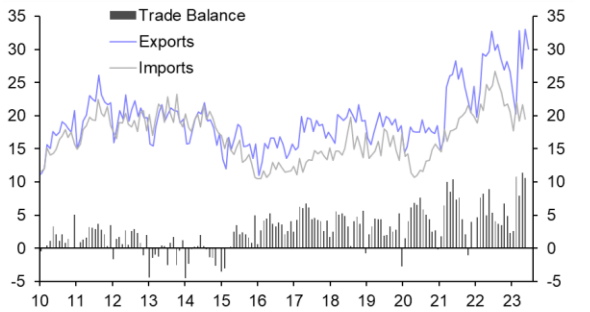


Chart 2: Contribution to Change in Goods Exports (Dec-19 to May-23, $bn 12m Sum Basis)

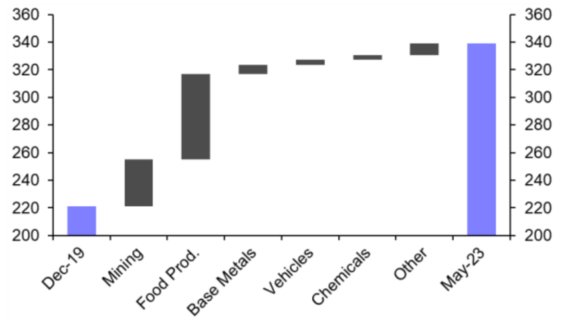


Chart 3: Industrial Production & Imports (% y/y)

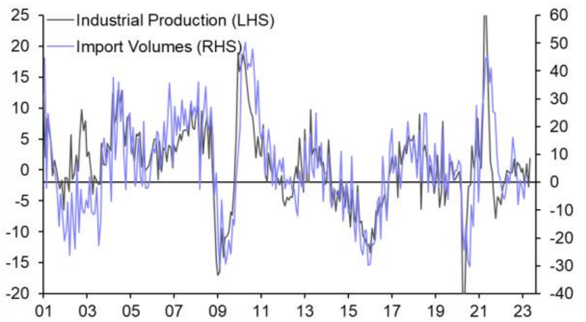
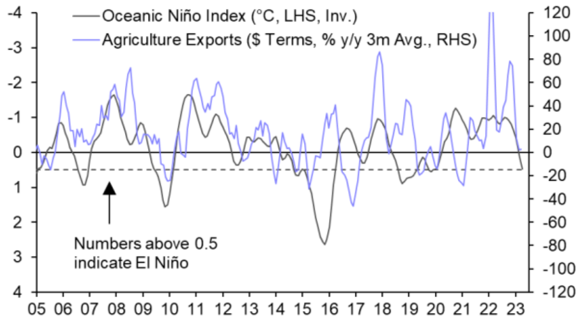


Chart 4: Oceanic Niño Index & Brazil Agricultural Exports



Sources: Refinitiv, MDIC, NOAA, Capital Economics