Current Account Deficit Exceeds FDI

In March, the current account deficit reached 2.9% of GDP over 12 months, exceeding foreign direct investment (FDI) for the first time since November 2010. The recent deterioration in the balance of payments is taking place both in the current account, with very low trade balances and heftier outflows from the service and income accounts, and in moderating direct investment. The result of this combination can be seen in reserve accumulation over 12 months, at $13 billion vs. $82 billion in August 2012.

The current account gap reached $6.9 billion in March, a little wider than our call and market consensus (both at $6.3 billion). Over 12 months, the deficit adds up to $67 billion or 2.9% of GDP. Once again, the trade balance was weak, at $164 million, though it was the first positive reading of the year. The profit and dividend account posted an outflow of $2.7 billion, up 39% from one year earlier. The main deviation in relation to our expectation was in equipment rentals, as the preliminary figure until March 20 was at $743 million, but ended the month at $1.7 billion.

FDI hit $5.7 billion during the month, topping our estimate ($4 billion) and consensus ($4.3 billion). However, most of the surprise stemmed from intercompany loans, adding up to $3 billion or 53% of the total number, a high reading in the historical series. Nonetheless, these loans were not concentrated, as strong inflows came from several economic sectors. Nothing stood out as far as equity investments, with all deals worth less than $500 million. Over 12 months, FDI stood at $63.6 billion and was thus surpassed by the current account deficit. As of April 22, FDI was at $3.6 billion, according to the Central Bank.

Other medium and long-term borrowings cooled down to $3.2 billion in March, as loans from abroad moderated to $1.8 billion from $4.6 billion in February. Hence, the roll-over rate declined to 138% from 238%.
Foreign portfolio flows sustained a fourth consecutive month of relevant inflows to the Brazilian stock market, with $2.4 billion coming in during March. This figure, which at a first glance could suggest optimism in the capital markets, is in contrast with data on contracts by non-residents in the futures market, which show $4 billion in net short positions. Foreign investment in the fixed income market stood at $564 million.

Brazilian direct investments abroad were down by $2 billion, with $3 billion in outflows related to equity capital transactions and $1.1 billion in inflows in the form of intercompany loans. This large outflow of Brazilian investments was concentrated in the segment comprising financial services and supporting activities, at $2.2 billion. Brazilian investors also put more money into stocks and bonds abroad last month: $1 billion vs. $844 million in February.

International reserves added up to $376.9 billion as of the end of 1Q13. As the repurchase facilities of late last year were repaid, the amounts according to the cash and liquidity concepts are the same again. Unlike the previous month, when the change in parities led to a loss of $2.4 billion in reserves, the loss was only $201 million last month. Depreciation of the Japanese yen in April may lead to another month of losses, though this currency represented only 1% of the allocation of Brazilian reserves by the end of 2011.

In a nutshell, figures on the balance of payments in 1Q13 show deterioration at the margin. Even when ruling out the distortion caused by high fuel imports in 2012 which were only accounted for this year, we forecast a wider current account deficit this year - at 2.9% of GDP in 2013, versus 2.4% in 2012. However, reserves amounting to $376.9 billion (or 16.5% of GDP), in addition to the composition of the external liabilities, with FDI representing 46% of total, warrant a stable international investments position for Brazil.

**Census on Foreign Capital: Advanced Nations Are Still the Largest Investors**

The Census on Foreign Capital for 2010 (only preliminary figures were available for that period) and 2011 was also released today. The numbers show the evolution of FDI stock by origin and sector over the years.

In terms of sectors, the key difference between 2005 and 2010 was the gain in terms of trade thanks to higher commodity prices, which provided incentive to foreign capital in the primary sector. However, between 2010 and 2011, investments in this sector retreated and there was even more concentration in the service sector, which is the main target for FDI in Brazil. The telecom sector stood out, as the stock of investment went up $13 billion during these years.

Breaking down by country, the Central Bank came out with a new feature (which was already available in the preliminary figures for 2010): further specification of the origin of direct investment, aiming to find the final investor. According to this criterion, the U.S. are the biggest investors in Brazil, with 19.6% of the total stock in 2011, followed by Spain, Belgium and the U.K., with 13%, 9% and 7%, respectively. The Eurozone as a whole represents 46% of the total stock of investments in Brazil.

Thus, when it comes to FDI, Brazil is still deeply reliant on advanced nations. Even focusing on the margin, using the change in the stock between 2010 and 2011 as a proxy for the investment flow in the period, we observe a decline in investments from Mexico and India and a slight increase in investments from Argentina ($334 million) and China ($1.4 billion), showing that these countries still represent a small share of investments in Brazil.

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1 This occurs because, previously, the methodology used the immediate investor, which are often branches of big companies domiciled in tax havens. Thus, in 2005, under this criterion, British Virgin Islands and Cayman Islands invested into Brazil more than Japan, UK and Italy together.
FDI Stock: Breakdown by Country Origin and by Sector

Developed Countries Are the Main Investors in Brazil

+ 40% of the FDI stock comes from Brazil.
+ 21% of the FDI stock comes from the United States.
+ 10% of the FDI stock comes from Canada.
+ 6% of the FDI stock comes from the United Kingdom.

Other 10% of the FDI stock comes from other countries.

Source: BCB, Itaú

FDI Stock: Primary Sector is Gaining Ground, but Tertiary Still Dominates

Agriculture, Livestock and Mineral Extraction

Industrial Sector

Services

- 31% of the FDI stock in Agriculture, Livestock and Mineral Extraction was invested in Brazil in 2011.
- 64% of the FDI stock in the Services sector was invested in Brazil in 2011.
- 45% of the FDI stock in the Industrial Sector was invested in Brazil in 2011.

Source: BCB, Itaú

*FDI coming from Brazilian final investors was removed from the sample.

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