June | 2013

Monthly Economic Outlook

Worsening economic fundamentals warrant higher dollar

There have been plenty of reasons in recent months for the Brazilian exchange rate to depreciate and for the dollar to rise to the level of R$2.00, where it has hovered with brief exceptions since May of 2012: (i) external accounts have shown significant worsening, with Brazil's current account deficit rising from the level of 2.3% of GDP, last August, to more than 3.0% of GDP currently; (ii) in the international arena, the U.S. Federal Reserve has made it clear that the time is approaching when it will begin to gradually reduce the unconventional monetary stimulus of (QE-3), the anticipation of which has recently contributed to the weakening of the dollar against a number of other currencies, and (iii) the disclosure of Brazilian GDP for the first quarter of 2013, which once again came in below market expectations, has sparked another round of downward revisions for GDP growth in 2013, that now stands at 2.5%. This low level of growth, following two years of slow economic expansion (2.7% in 2011 and 0.9% in 2012), seems to have significantly impacted both the expectations of private sector agents and those of the Brazilian economic authorities themselves. In light of these three factors, the dollar could have surged above the R$2.20 level. However, at such levels, the inflationary impact would more than likely push the IPCA very close to the Central Bank's target ceiling of (6.50%). The Central Bank's strong dollar auction activity, and the Finance Ministry's bold removal of the 6% IOF tax on foreigners who want to invest in Brazilian fixed income securities, seem to indicate that the country's economic policy makers are more comfortable with the exchange rate hovering around the R$2.10 level for the next few months.

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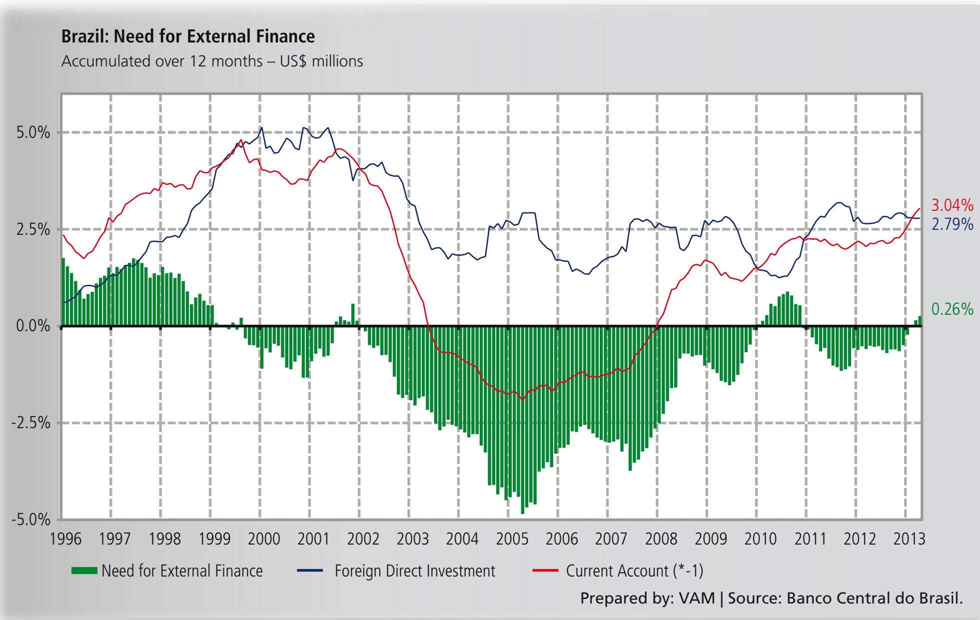
The first graph shows a strong, rapid rise in the Brazilian current account deficit, and an analysis of the factors behind this deterioration, which has taken place over the last few months, appears to point one main culprit: the current account deficit has risen to US$18.5 billion in the last twelve months, and US$18.1 of this increase was caused by a drop in the trade balance, which during this time has plunged from US$28.1 to less than US$10.0 billion. The second chart details the part of this problem which is related to recent weaknesses in the export sector. Brazil's industrial exports currently stand at US$91 billion, which is quickly approaching a level that is lower than that of 2008. Until 2012, the problem of Brazil's weak industrial competitiveness was masked by a trade balance surplus from commodity exports



Prepared by: VAM | Source: Banco Central do Brasil.

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(mainly soybeans and iron ore exported to China), which grew at an average annual rate of 17.1%. With the current slowdown of the Chinese economy, those commodity exports have begun to stagnate, and in turn pull down the export sector as a whole. However, part the problem reflected in the current account deficit comes from the fact that imports have not slowed down, and for quite some time now diagnostics have shown that the problem with the Brazilian economy is more a lack of international competitiveness than a lack of domestic demand. Therefore it seems increasingly clear that the country must continue to advance an agenda to enhance its global competitiveness, by making the necessary improvements to its infrastructure, reducing its tax burden, investing in education, et cetera. In addition to these fundamentals that will provide the potential for GDP growth to accelerate, such structural advances would also seem to be of fundamental importance in order for the country to continue to be able to attract the high volume of foreign direct investment that is needed to finance the current account deficit. Otherwise, it is inevitable that a new round of currency devaluation will occur.

Evolution of Exportation
Values in US$ billions - FOB

		2013	2012	2011	2010	2009	2008	2007	2006	Weight in 2012*
Exportation	Variation (%)	3,0%	-5,3%	26,8%	32,0%	-22,7%	23,2%	16,6%	16,3%	100,00%
	Value (bi)	$250	$243	$256	$202	$153	$198	$161	$138	
Basics	Variation (%)	5,2%	-7,4%	36,1%	45,3%	-15,2%	41,5%	28,1%	16,0%	46,77%
	Value (bi)	$119	$113	$122	$90	$62	$73	$52	$40	
Iron Ore	Variation (%)	6,8%	-25,9%	44,6%	118,3%	-19,9%	56,6%	18,0%	22,6%	12,77%
	Value (bi)	$33,1	$31,0	$41,8	$28,9	$13,2	$16,5	$10,6	$8,9	
Soybeans (grain + Meal)	Variation (%)	19,6%	9,2%	39,7%	-1,6%	4,6%	58,4%	19,6%	-1,6%	9,91%
	Value (bi)	$28,8	$24,1	$22,0	$15,8	$16,0	$15,3	$9,7	$8,1	
Semi-manufactured Goods	Variation (%)	2,0%	-8,3%	27,7%	37,6%	-24,3%	24,2%	11,7%	22,3%	13,62%
	Value (bi)	$33,7	$33,0	$36,0	$28,2	$20,5	$27,1	$21,8	$19,5	
Manufactured Goods	Variation (%)	0,8%	-1,7%	16,0%	18,1%	-27,3%	10,4%	11,9%	14,8%	37,39%
	Value (bi)	$91	$91	$92	$80	$67	$93	$84	$75	
Trade Balance	Variation (%)	-60%	-35%	48%	-20%	1%	-38%	-14%	3%	
	Value (bi)	R$ 7,8	R$ 19,4	R$ 29,8	R$ 20,1	R$ 25,3	R$ 25,0	R$ 40,0	R$ 46,5	

*Note: The group "Special Operations" is not included in this table, therefore, the sum of "basics", "semi" and "manufactured" repersent 97.95% of total exports.

Source: SECEX | MDIC.