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Growth and the Terms of Trade

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The latest indicators published on the performance of the Brazilian economy are paradoxical insofar as tax collection is constantly surprising on the upside while GDP growth remains slow and uneven.

The Treasury reported net revenue of BRL 112 billion in May, up 93.4% in real terms (after allowing for inflation measured by the IPCA) compared with BRL 54 billion a year earlier. Considering the reduction in emergency spending associated with efforts to combat the pandemic, with expenditure falling BRL 133 billion in the month, the primary deficit fell 84.7% in real terms. In the first five months of the year, there was a primary surplus of BRL 19 billion, the best result since 2014.

On the other hand, the economy grew 1% in the first quarter year over year. A breakdown by sector shows agriculture expanding 5.2% and industry 3%, while the service sector contracted 0.8%. The unemployment rate remained high on 14.7%.

Here it is relevant to note that in an open economy, foreign trade allows consumption to be different from production, so that favorable dynamics in import and export prices or quantities can produce a sense of improvement even when the economy appears to be advancing more slowly.

An increase in the terms of trade – the ratio of export prices to import prices – allows Brazil to import more for the same amount of exports, raising its level of wealth for the same growth. Deflating nominal GDP, or variables that depend on it such as tax revenue, by a consumer price index such as the IPCA evidently creates gains whenever the prices of the goods produced are higher than the prices of the goods consumed.

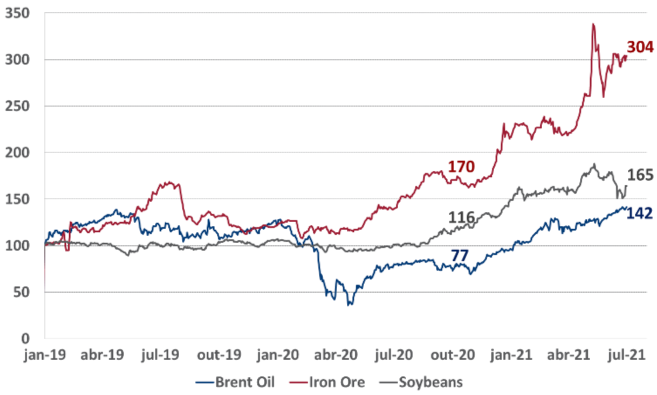
In the previous 12 months, the terms of trade rose an impressive 23%, Figure 1. Part of the gain came from the sharp rise in global demand for commodities, driven largely by expansionary policies in the developed countries, such as the United States, and also by China, which responded promptly to the challenges of the public health crisis, saw its economy relatively unaffected by social isolation and similar restrictions due to the pandemic, and is now growing vigorously. Among commodities, prices of soybeans rose 42% since October 2020, and iron ore rose 78% in the same period, Figure 2.

As an exporter of commodities, Brazil is a major player in the world markets for soybeans, iron ore, crude oil and petroleum products, sugar, and meat, which in aggregate account for more than half of its total exports.

Figure 1: Terms of Trade (2006 = 100)

Source: Ministério do Desenvolvimento, Indústria e Comércio Exterior

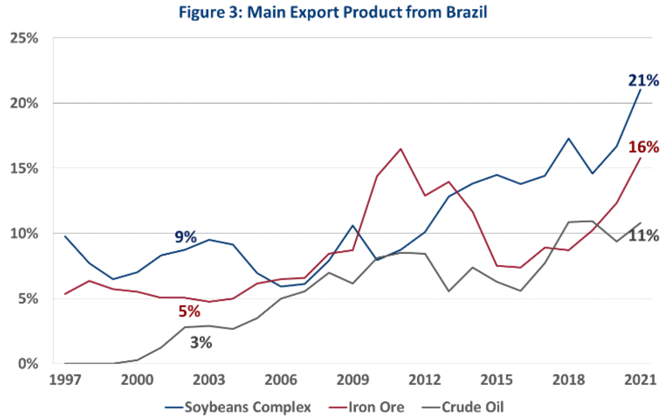
Figure 2: Commodity Prices (jan 2019=100)



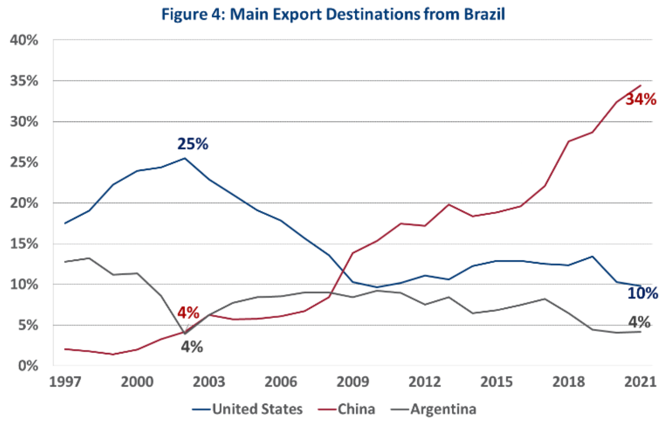
Source: Bloomberg

External conditions have been favorable to Brazil's balance of trade, which has remained in surplus, and export volume has risen sharply, but lack of diversification due to the large share of commodities makes it vulnerable to fluctuations in international trade. Soybeans correspond to 21% of total exports, Figure 3. China is the main destination for Brazil's exports, accounting for 34% of its value, ahead of other important trade partners such as the US (10%) and Argentina (4%), Figure 4.

It is too soon to know how long the ongoing commodity cycle will last, but fluctuations in the terms of trade have left Brazil highly vulnerable over the decades. For example, the terms of trade rose 40% in 2009-11 and fell 40% in the next four years, 2012-16, Figure 1.



Source: Ministério do Desenvolvimento, Indústria e Comércio Exterior



Source: Ministério do Desenvolvimento, Indústria e Comércio Exterior

In light of the improvement in the terms of trade and forecasts for nominal GDP, we now project a debt-to-GDP ratio of 82.6% in 2021 and 83.3% in 2022. The improvement in the terms of trade should also bring exchange-rate relief, after a period of local currency depreciation that has fueled domestic inflation. However, the latest IPCA core data still point to inflation, and in light of this, plus the energy risk and electricity price hikes, we have raised our inflation forecast to 6.1% in 2021 and 3.9% in 2022. In this context, we expect the Central Bank of Brazil to raise its Selic rate at the next several meetings and forecast 6.5% for the Selic in 2021 and 2022.

ECONOMIC FORECASTS	2016	2017	2018	2019	2020	2021F	2022F
GDP Growth (%)	-3,3%	1,3%	1,3%	1,1%	-4,1%	5,3%	2,2%
Inflation (%)	6,3%	2,9%	3,7%	4,3%	4,5%	6,1%	3,9%
Unemployment Rate, SA (eoy ,%)	12,6%	12,4%	12,2%	11,7%	13,9%	13,0%	13,0%
Policy Rate (eoy, %)	13,8%	7,0%	6,5%	4,5%	2,0%	6,5%	6,5%
External Accounts							
Trade Balance (US$ bn)	48	67	53	48	51	70	46
Current Account Balance (US$ bn)	-23	-10	-42	-51	-13	3	-15
Current Account Balance (% of GDP)	-1,3%	-0,7%	-2,2%	-2,8%	-0,9%	0,2%	-0,9%
Fiscal Policy							
Fiscal Primary Balance (% of GDP)	-2,5%	-1,7%	-1,7%	-1,2%	-10,0%	-2,3%	-1,2%
Government Gross Debt (% of GDP)	69,4%	73,7%	75,3%	74,3%	88,8%	82,6%	83,3%