There's a silver lining in Brazil's weak currency

João Augusto de Castro Neves, *Washington D.C.*

THE BRAZILIAN *REAL* IS ONE of the worst-performing emerging market currencies this year, having fallen more than 20% against the dollar since January. While the Central Bank has announced some interventions in the foreign-exchange market, the government has few tools to bolster the currency considering that global liquidity is likely to diminish after the U.S. unwinds monetary easing.

Considering that not only the government in Brasilia but also investors are increasingly concerned about Brazil's growth and policy outlook, the prospect of the currency staying weaker for the foreseeable future is starting to accelerate positive changes to energy and trade policies that were already underway.

On trade, a weaker *real* means that the government is already less willing to enact more protectionist measures. In July Brasilia decided not to renew the tariffs on 100 products that were raised last year; they represented about 4% of Brazil's total imports. The decision was driven mainly by concerns about the rising costs of inputs to industry. Earlier this year, Minister of Finance Guido Mantega had announced that the government was going to lower import tariffs in order to fight inflation. While some sectors of local industry will continue to demand protection from imports, the current economic environment is likely to diminish government responsiveness to the demands.

The government has few tools to bolster the currency considering that global liquidity is likely to diminish after the U.S. unwinds monetary easing.

More meaningful changes to Brazil's trade negotiation agenda, however, are unlikely in the short term. The country has logged a trade deficit of almost US$4 billion this year through August—the worst result since 2001. The possibility of a slowdown in Chinese growth may exacerbate the situation, given the likely impact on commodity prices and the fact that China is now Brazil's main trading partner.

Despite persistent disputes within the bloc, so far Brasilia continues to be very committed to Mercosur. But a more challenging global economic environment, coupled with such US-led trade initiatives as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, is likely to push Brazil to review its trade policy in the next few years.

joao@castroneves.net

The weaker currency is likely also to have a less obvious consequence—on energy policy. Much of the attention in terms of energy justifiably focuses on one prominent victim of a depreciated currency, the state-controlled oil giant Petrobras. With the *real* much weaker than it anticipated in its 2013 business plan, the company has to shoulder the cost of an even wider gap between international oil prices and domestic fuel prices. The burden will continue as the government's concern about inflation increases and is likely to worsen as the company prepares for its role as lead operator in the first deep sea oil auction in October; the company is expected to pay at least 30% of the minimum signing bonus of R$15 billion (about US$6.5 billion) stipulated by the government.

As fuel pricing policy remains constricted and operational and financial constraints on Petrobras grow, the odds of the government altering its policy on deep sea oil production will rise. In addition to concern about Petrobras capabilities, two other reasons seem to be driving the likely revision of the policy. The first is a frustratingly tepid economic recovery in 2013, which is pushing the government to place a larger premium on enacting measures to ensure a pipeline of investments to drive a more robust recovery. Lifting Petrobras obligations on all new deep sea oil would allow the government to give international oil companies more opportunities to participate on an equal footing. The government, for example, could very well announce a second round of bids for 2014 if the restriction that Petrobras must be lead operator is lifted.

While some sectors of local industry will continue to demand protection from imports, the current economic environment is likely to diminish government responsiveness to the demands.

The second reason is the technological revolution that has occurred in the global energy market in the last several years, thanks to expanded production of shale gas and tight oil in the US. This, along with proposed energy reforms in Mexico and elsewhere, has somewhat diminished Brazil's leverage in global energy markets.

The idea that Brazil won a lottery ticket with the discovery of the deep sea oil reserves may still be true. But in an ever-changing and highly competitive world, it is becoming more evident that the prize has an expiration date.

As fuel pricing policy remains constricted and operational and financial constraints on Petrobras grow, the odds of the government altering its policy on deep sea oil production will rise.