

External Sector

Uncertain future

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THE QUESTION of what will happen in the Brazilian external sector in 2014 is surrounded by all the uncertainties troubling the international scenario. IBRE economists believe next year will come at a particularly delicate juncture, depending on the performance of such sensitive factors as the exchange rate and imports, particularly of oil—one of the main factors that affected the trade balance in 2013.

The 2013 decline in oil production was expected because of a scheduled maintenance shutdown of oil rigs. Exports of oil and oil products fell by 29% between January and November 2013 compared to the same period in 2012, which explains part of the 2013 increase in imports and the deterioration of the trade balance. The trade deficit of oil and derivatives totaled R$19.5 billion through November, compared with just R$5.6 billion a year earlier.

Even with the possibility that productivity will improve with upgraded oil rigs and new ones coming into operation, Mauricio Canêdo, IBRE researcher, has seen no reason to believe that the current situation will change much. "Oil sector investments are long-term; and there is no significant projected increase in either operating or refining capacity," he said. The lower-than-expected increase in domestic gasoline prices announced in late November plus the lack of a clear policy for raising the prices of domestic oil products to meet international prices continues to stimulate domestic consumption of oil products.

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External sector
(U.S. billions)

	2012	2013 est.	2014 proj.
Trade balance	19.5	1.0	5.4
Exports	243	239	246
Imports	223	238	240
Current account balance deficit	-54	-79	-74
Current account balance (% of GDP)	-2.4	-3.6	-3.4

Source: Brazilian Institute of Economics.

pointed out. "Not to mention the added difficulty for the cash flow of state-controlled oil company Petrobras, which has an ambitious investment program ahead."

The oil trade deficit has helped cause the external current account deficit to deteriorate; for 2013 it was 3.5% of GDP. IBRE economists indicated that correction of the current account imbalance can add pressure for even deeper exchange rate devaluation, even as the exchange rate is more volatile because of the surge in the U.S. dollar. "A stronger dollar could result in further depreciation of the Brazilian *real*. Moreover, the presidential election in 2014 could affect market expectations about government policies and add even more volatility to the exchange rate," explained Lia Valls, IBRE coordinator of External Sector Studies, recalling the sharp exchange rate devaluation in 2002 before former President Lula was elected.

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Import strength in 2014 will also depend on the exchange rate. Devaluation of Brazil's currency in 2013 was not enough to cool external purchases. From January through November accumulated imports were US$221 billion, compared with US$205 billion in 2012. In the period, imports of capital goods increased by 5.6%, durable goods kept pace, and nondurable goods increased by 9.3%. Valls believes that the market reaction may be a sign of caution, anticipating purchases in the expectation of greater exchange rate devaluation. She added, "People nowadays are more exposed to international products, and substitution by national products takes time. I do not expect a huge increase in import substitution next year."

Exchange rate uncertainty is not encouraging for Brazilian manufactures, which could be more competitive with further devaluation. "We still have a fragile export situation," Valls said, pointing out that except for oil Brazil had a very small trade surplus in 2013, reflecting its dependence on commodity exports. In 2013, except for products with high unit value such as oil rigs and aircraft, Brazilian exports were sustained by Chinese demand for soybeans, iron ore, and sugar, which registered an increase of 12% through November compared to the same period of 2012, and by record exports of automobiles, which rose 47% over last year and mostly went to Argentina. "These were good results," Valls said, "but if Brazil's trade is limited to two countries, it is unlikely we will be able to increase exports."

Valls noted that in 2014 the recovery of world demand will not be as vibrant as would be preferable, and in manufacturing Brazil may lose ground in South America now that the Pacific Alliance is consolidating. She said, "Markets like Chile, Colombia, and Peru are important for Brazilian manufacturers, and the Pacific Alliance block will almost immediately promote trade liberalization. We may lose market share in those countries because we export the same products as Mexico, which is also a member of the Pacific Alliance."