

A case for Brazilian Real (BRL) against the dollar (USD)

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During 2019, the Brazilian Central Bank cut its benchmark interest rates four consecutive times reaching a rate of 4.5%. The move triggered the Brazilian Real to plunge to record lows against the US dollar, leading Donald Trump to accuse the Brazilian government to be intentionally devaluing its currency in order to keep attracting Chinese grain buyers who were impacted by the trading war between the United States (US) and China. Following a lengthy bitter trade battle between both world's largest economies, US and China were able to agree and sign a phase I deal which China agreed to buy hundreds of billions of dollars' worth of products from the US in exchange for a reduction in tariffs on \$120 billion in Chinese products from 15% to 7.5% and promises not to manipulate the currency. Brazilian exports could sustain a hit due to demand concerns from its largest trading partner, with Beijing reliant on agricultural goods, iron ore and crude oil to fuel its economy. On the other hand, Brazil's top economists welcome a greater stability in the international market, hence indirectly favouring Brazil. The 4.2 USD:BRL support level was further strengthened by the recent coronavirus (2019-nCoV) outbreak in China, which has put further pressure on the global economy – as well as a negative spill on Emerging Markets. Moreover, the adopted measures from Beijing to contain the economical disruptions caused by the virus (interest rate cuts, closed markets and liquidity injections) have caused concerns on the potential knock-on effect in the relationship between both US and China, which was further intensified by Chinese officials blaming America for the global reaction to the virus.



Figure 1: Brazil's Selic Rate versus USD:BRL Rate over 1 Year



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Figure 1 shows that the Selic Interest Rate (white) cut from 6.5 to 6 is negatively correlated to the USD:BRL (Yellow) jump from September's 3.7 support level to November's 4.2 support level, which was then volatile but well above 4.0 support level strengthened by further 50bps interest rate cuts at time. Driven by the cost of electricity falling and a slowdown in food prices, Brazil's month on month inflation has also eased after hitting 2019 high in December due to strong demand for Brazilian beef and pork in China and other Asian countries affected by African swine fever. On the other hand, Brazil has also experienced a year full of political tensions as Jair Bolsonaro, a notorious far-right candidate became the 38th president of Brazil. Prior Jair, the country lived a very unstable political scenario driven by scandalous corruption cases which became the theme to many films, tv shows and the first Brazilian documentary ever nominated to the Oscar 'The Edge of Democracy'. Inevitably the country's economy succumbed, and the dollar reached all-time highs against the Real several times in the past 12 months. On the other hand, the Brazilian economy is showing signs of recovery following the solid fourth quarter GDP results driven by growth in retail sales and the dominant services sector. The bullish optimism is backed by the government's decision to raise its 2020 growth outlook to 2.4% from 2.3%, and the promise to implement a series of big economic reforms. There is still on the table a potential trading deal with the European Union and further growing economic partnerships among the BRICS (Brazil, Russia, India, China and South Africa). On the other hand, the US economy has been experiencing a slowdown in the manufacturing index driven by a prolonged trading deal negotiation with China. In addition, it will take some time for the US to negotiate new trading deals with the United Kingdom, handle the tensions with Iran without escalations and while 2020 presidential elections take control of the entire country and attempt of Impeachment gains momentum. I find a downward USD/BRL bias towards the 3.9 mark by mid of 2020 Q2 inevitable!