USD/BRL

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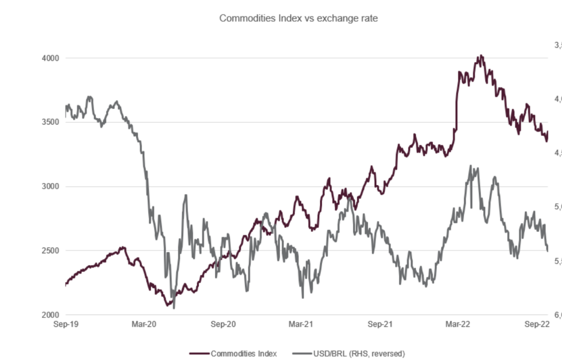
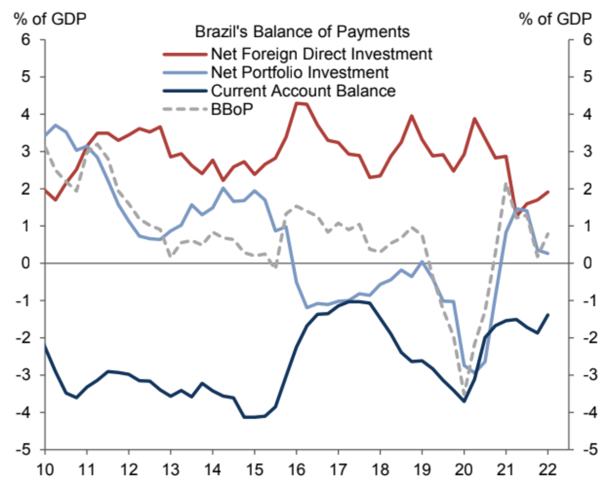
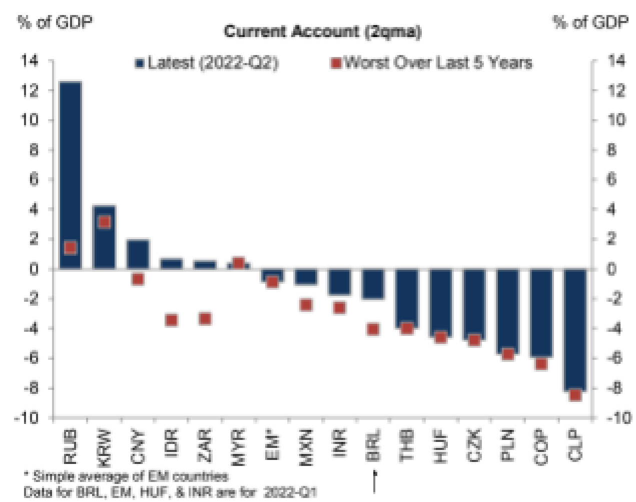
Brazilian Real & Elections

The Brazilian Real has been one of the strongest emerging market currencies this year, appreciating 4% against the dollar YTD, making it the only currency to appreciate against the dollar besides the Mexican Peso. Looking at the US Dollar Index (DXY), an index that measures the value of the dollar against a basket of US trade partner's currencies, is currently up 11% YTD, reaching as high as 19% before the latest CPI report has shifted monetary policy expectations and lowered the expected terminal rate by 25bps. The resilience in the Brazilian Real can be partly attributed to the Central Bank of Brazil's strong stance against inflation, maintaining a policy rate of 13.75%, or a real rate of 7.25%. The relatively high interest rates compared to the United States offered investors an attractive opportunity to borrow from the low yielding US dollar and invest in the higher returning Brazilian Real, which created demand for the currency. The rising prices in commodities and agricultural inputs also caused a surge in exports for Brazil. Looking at the top graph, we can see a positive correlation with commodity prices and BRL/USD. Strong soybean and crude oil demand helped drive flows into the Brazilian Real in 2022. The current account balance for the majority of emerging markets is near the worst it's been over the past 5 years. On the other hand, Brazil has seen an improving current account deficit, reaching a deficit of less than 2% of GDP. Brazil's Balance of Payments has also gone positive, a feat that hasn't been achieved since it went negative in 2016. However, with commodity prices coming down, and a new president that will "prioritize social spending over market concerns", these positive fundamentals that have been working in favor the Brazilian Real could reverse quickly. After President's elect Lula da Silva announced her fiscal spending plans, USD/BRL gained 4% while DXY lost 2%. This divergence in price appears to be the start of a trend reversal in the Brazilian Real, with the policies of the new regime being the catalyst for a bull market in USD/BRL. We expect a global recession to cause price decreases in global commodity prices, although the outlook for agricultural commodities might be more bullish than energy or metals. Considering all of these factors, we recommend going long USD/BRL.

Chart 3. Commodity prices often positively correlated with the BRL vs USD







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