Brazilian Real Currency Research

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Abstract

In this paper, Brazilian Real (BRL) will be analyzed with data and figures obtained from BIS, Trading Economics, Sistema Especial de Liquidaço e de Custódia, and others regarding currency turnover, trading currency offshore, onshore and implied interest rates, and real valuation of the currency compared with past levels.

Keywords: Turnover, Trading currency offshore, Onshore interest rates, Implied interest rates, Real valuation

Introduction

With the globalization of the world economy, understanding different currencies is crucial. The currency focused on in this paper is the Brazilian Real (BRL). BRL, as the official currency of Brazil, plays important roles in the national economy, international trade, and financial policies. In addition, Brazil, one of the largest exporting countries, has various currency exchange policies and an enormous quantity of currency exchange. Therefore, BRL was opted as a currency to analyze.

Turnover in BRL

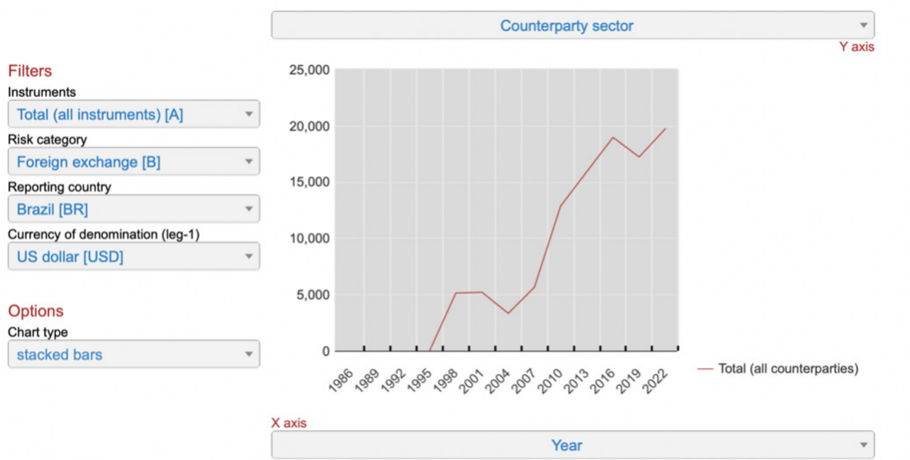

Figure 1 (https://www.bis.org/statistics/rpfx22.htm)

"Turnover is defined as the gross value in U.S. dollar equivalents of purchases and sales entered into during the reporting period" (FXC). The turnover of BRL in USD from 1995 to 2022 is shown in Figure 1, and the unit of the Y axis of Figure 1 is millions of U.S. dollars. Therefore, the turnover of BRL over the last ten years has changed from 15,904 million U.S. dollars in 2013 to 19,723 million U.S. dollars in 2022. The turnover has increased by about 3,819 million U.S. dollars, about 24 percent in ten years. The turnover of BRL has constantly increased from 2004 to 2016 but has started to decline from 2016 to 2019. During this period, Brazil experienced negative economic growth derived from inflation, the political crisis, a high unemployment rate, and others.

Restriction on trading BRL offshore

Restriction on a currency refers to a rule that the government imposes to monitor and control the inflow and outflow of the currency. Offshore currency is defined as a currency that is traded outside of its origin country and jurisdiction. (IMF) The Brazilian government implements various restrictions on offshore currency. In 2021, Brazil enacted Law No. 14,286 on December 29, 2021, to renovate, simplify, and integrate the existing restrictions on the foreign exchange market, which is called the new foreign exchange law". For example, "Maintenance of accounts in Brazilian reals by foreign entities" (IBA) allows foreign central banks and nonresident institutions to open and sustain deposit or custody accounts in BRL on Banco Central do Brasil, also known as the Central Bank of Brazil. Under this restriction, BRL can utilize foreign exchange markets by exchanging funds from those institutions into BRL. Moreover, the "Use of export funds held abroad in loan transactions" permits Brazilian companies to use their export funds and grant loans with the funds, which was formerly prohibited by "cobertura cambial." In other words, the export funds in BRL can be actively used in international trade. Most restrictions on offshore currency trade by the Brazilian government are rather deregulations on offshore currency trade. The Brazilian government desires to expand the usage of BRL in international transactions to achieve the following: Firstly, it will diversify the currency reserves in Brazil. As BRL is often utilized globally, such as in international trade and finance, Brazil can accumulate various currencies from different countries rather than rely on a few. Secondly, it will lessen the risk of exchange rate fluctuations. A widely used currency in the international market tends to have a small range of fluctuations. Thus, the Brazilian government will be able to stabilize its currency. Thirdly, it will promote economic growth in Brazil. As the BRL acquires currency globally with the deregulations, it will lower the barrier to entry and facilitate exporters in Brazil's entry into the international market. Then, their increased exports will contribute to economic growth by increasing national GDP, job opportunities, and others. Fourthly, a globally accepted currency will yield more investments from foreign investors, leading to economic growth. Lastly, the broader use of BRL will reduce transaction costs by making currency swap agreements with foreign banks. Reduced transaction costs in currency exchange and international transactions will make the price of export goods from Brazil more competitive in the global market. Consequently, it will enhance economic development in Brazil.

Onshore and implied offshore interest rates of BRL

The onshore interest rate is set by the Central Bank of a country within its origin country and jurisdiction. Implied offshore interest rate means that the rate is set and fluctuates by the global market. In the case of BRL, there is a difference between the onshore and offshore interest rates. Onshore interest rates are used as a tool for monetary policy in the origin country. For example, the Central Bank of Brazil reduces interest rates to encourage consumption and investment. In addition, onshore interest rates influence domestic economic activities such as savings, stocks, bonds, etc. The standard onshore interest rate in Brazil is called the Selic rate (Sistema Especial de Liquidaço e de Custódia). The fluctuations of the Selic rate are represented in Figure 2. As of July, the Selic rate is currently 13.8%.

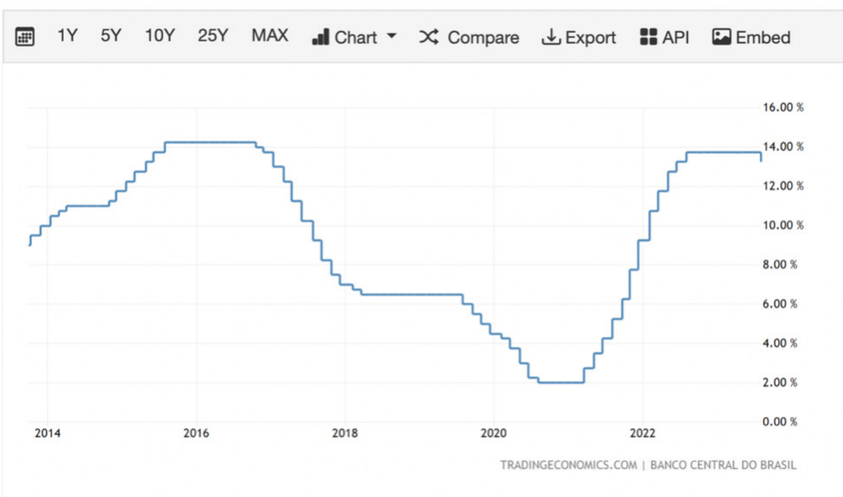

Figure 2 (https://tradingeconomics.com/brazil/interest-rate)

On the other hand, the implied offshore interest rate depends on global market conditions, so it has varied factors that fluctuate the rate, such as the tendency of investments, financial policies, regulations from different countries, wars, worldwide infectious diseases, etc. Therefore, there is a difference between Brazil's onshore interest rate and implied offshore interest rate since they are derived from different bases.

Real valuation of BRL vs past levels in terms of USD

The real valuation of a currency means removing price level effects or adjusting inflation effects on the nominal valuation of a currency (Investopedia). Accordingly, the valuation of a currency can be measured or compared to the extent of the true valuation itself, excluding exterior effects on the valuation, such as inflation or price level. Several factors determine the valuation of a currency: interest rates, inflation rates, economic indicators, political stability, geopolitical factors, market sentiment and speculation, central bank actions, and trade and current account balances (WallStreetMojo). To assess the real valuation of BRL in the present against past levels, it is necessary to exclude the effect of inflation rates in different periods. As the currency exchange rate indicates the valuation of the currency numerically, the exchange rate of BRL to USD is used as a representation of the valuation of BRL.

Figure 3 (https://tradingeconomics.com/brazil/currency)

Figure 3 represents the exchange rate history of BRL to USD from 1992 to 2023. Figure 4 represents the inflation rate history from 1980 to 2023. According to Figure 4, the inflation rate skyrocketed from 1988 to 1994. Assessing the real valuation of BRL in such a period is essential to exclude the inflation rates since a high inflation rate overvalues the currency exchange rate. Otherwise, the assessment and comparison based on the valuations of BRL will not be accurate. Therefore, an assessment of the real valuations of BRL at past levels has to exclude the effects of the inflation rate.

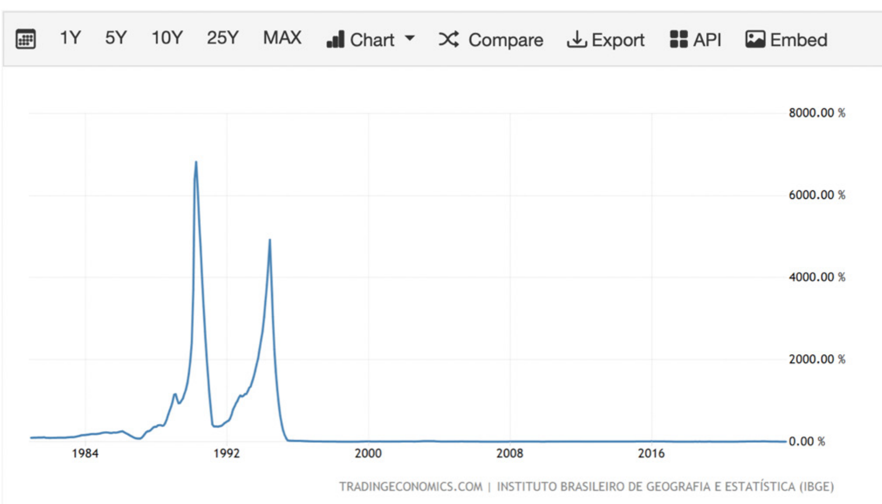

Figure 4 (https://tradingeconomics.com/brazil/inflation-cpi)

Biography:

https://www.bis.org/statistics/rpfx22.htm
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