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Economic Repercussions of Brazil's Presidential Election

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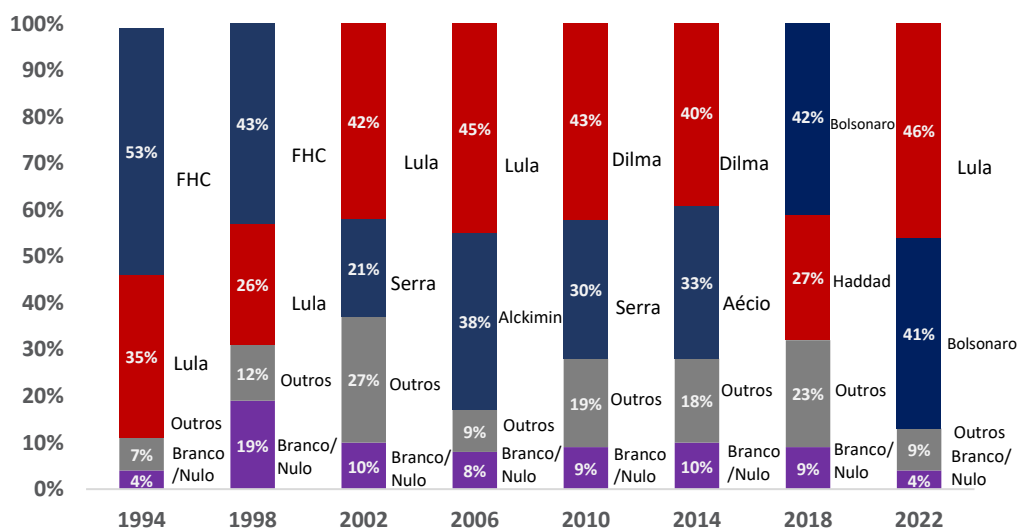
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Although the next president of Brazil and the governors of several states – such as São Paulo, Rio Grande do Sul and Bahia – will not be known until the October 30 runoff, the voting round held on October 2 determined the composition of the next Congress, in which the center-right will predominate. Moreover, it is already possible to discern certain trends that could decide the winner of the presidential election and the prospects for governability in the next four years.

Leaving aside the electoral competitiveness of the presidential candidates, this was the most closely contested first round since redemocratization in 1989, with a difference of only 5.2 percentage points between the front-runners, contrary to many of the voter intention polls published in the week of the election, some of which suggested that Lula would win outright on October 2 (Figure 1).

Figure 1: History of the first round



Source: TSE, BOCOM BBM

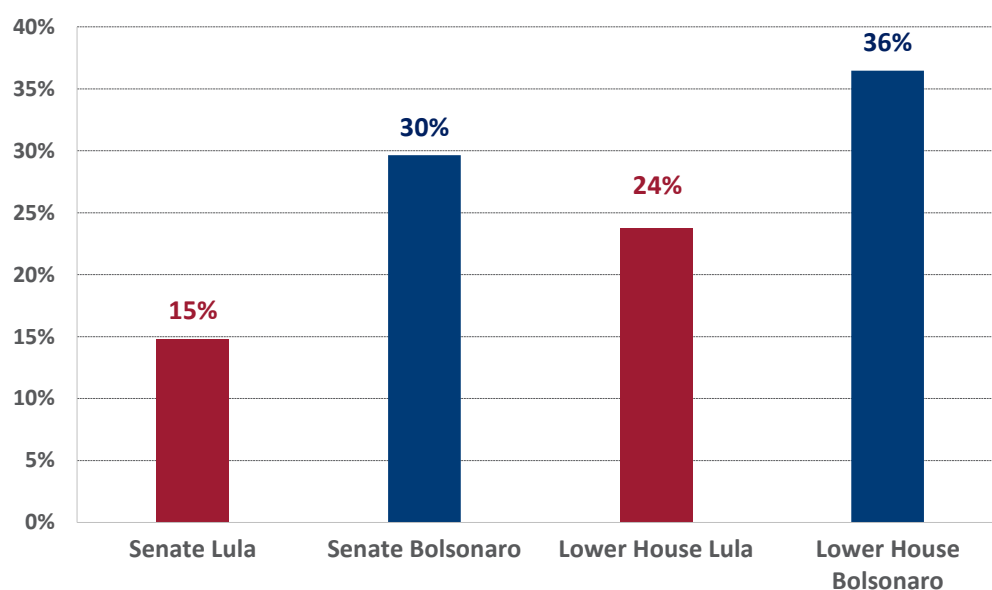
The significant discrepancy between the polling numbers and the actual votes cast shows that opinion polls are an unreliable guide to voter intentions, especially in close-run elections, probably owing to differences in sample representativity and the failure of many interviews to capture intended votes for Bolsonaro. The latest voter surveys point to Lula as the favorite in the runoff. Indeed, he does not need to swing a very large number of votes to win. However, pledges of support from some of the

presidential hopefuls who lost, as well as state governors and other leading politicians, suggest the runoff could turn out to be even more competitive than the first round.

The candidates are busy building alliances with governors, some of whom have been elected outright while others are still campaigning. They will make a substantial contribution to the winning of hearts and minds in their states. In Minas Gerais, for example, Lula won a comfortable majority in the presidential race but Governor Romeu Zema was re-elected by a wide margin and immediately backed Bolsonaro. In 2018, Bolsonaro defeated Haddad in Minas Gerais in both rounds. In sum, Minas is an important Brazilian-type swing state.

While the direction to be taken by the executive branch remains undefined, there can be no doubts about the composition of the next Congress, where both the lower house (Chamber of Deputies) and the upper house (Senate) will be more center-right. Bolsonaro's party, the PL, will have 99 deputies and 15 senators. Considering the PL's alliances with other center-right parties, Lula would face far more resistance from Congress than Bolsonaro (Figure 2), but both will need to negotiate deals with "independent" parties to have any chance of implementing their economic agenda.

Figure 2: Participation of the allied base in the congress



*Bolsonaro's coalition: PL, Republicanos e PP. Lula's coalition: PT, PSB, PCdoB, PV, PSOL, Rede, Solidariedade, Avante, Agir, PROS.

Source: TSE, BOCOM BBM

The candidates' economic proposals were only superficially discussed in the runup to October 2 but should be clarified in the remaining weeks of the campaign. Both advocate tax reform, for example, but its content is quite different in either case. Lula wants to raise taxes on the wealthy, while Bolsonaro is in favor of lower taxes

all round and a simplified tax system, although his campaign team have yet to disclose details of the proposal. Lula's manifesto proposes to abolish the spending cap and replace it with a different fiscal responsibility arrangement, whereas Bolsonaro's manifesto omits this topic altogether, although a proposal by members of the incumbent administration is circulating.

The actual shape taken by a new fiscal system will be relevant to execution of the budget in 2023. Several proposed items of expenditure cannot be considered lawful under current fiscal and tax rules. The budget bill sent to Congress would adjust the spending cap for projected inflation of 7.2% in 2022, but the market consensus is below 6%, and recent revisions suggest the actual number will be lower still, allowing even less room for a rise in spending. Furthermore, the budget bill as it stands does not account for a series of spending items that the government has pledged to continue in 2023, such as disbursement of the Auxílio Brasil conditional cash transfer at BRL 600, whereas the budget bill stipulates BRL 400 (Figure 3).

Figure 3: Spending cap (R\$ bn)



Source: National treasure, BOCOM BBM

The fiscal risks remain the key challenge to inflation convergence in 2023. The significant deceleration of inflation seen in the last several months was due largely to tax breaks implemented by the government to lower energy and fuel prices at the point of consumption, as well as a fall in prices of manufactures thanks to normalization of supply chains and regularization of food production and supply. Additional tax breaks and fiscal stimulus measures will therefore tend to drive up aggregate demand, hindering disinflation in 2023, when the temporary forces that are currently acting on prices will have dissipated. We have revised down our inflation projections to 5.4% in 2022 and 4.7% in 2023, suggesting that there should be room for the Central Bank of Brazil to lower its policy rate (Selic) by at least 2 percentage points in 2023, as the effects of this year's monetary tightening materialize. Although

GDP growth is set to decelerate in 2023, our current projection of 0.7% could well improve in light of the prospect of strong growth for the agricultural sector next year.

ECONOMIC FORECASTS	2019	2020	2021	2022F	2023F
GDP Growth (%)	1.1%	-3.9%	4.6%	2.8%	0.7%
Inflation (%)	4.3%	4.5%	10.1%	5.4%	4.7%
Unemployment Rate (eoy, %)	11.7%	13.9%	11.1%	8.7%	8.5%
Policy Rate (eoy, %)	4.5%	2.0%	9.3%	13.75%	11.25%
External Accounts					
Trade Balance (US\$ bn)	48	32	36	44	50
Current Account Balance (US\$ bn)	-65	-24	-28	-41	-40
Current Account Balance (% of GDP)	-2.8%	-0.9%	-1.8%	-2.2%	-2.0%
Fiscal Policy					
Central Government Primary Balance (% of GDP)	-1.2%	-10.0%	-0.4%	0.8%	-0.8%
Government Gross Debt (% of GDP)	74.3%	88.8%	80.3%	77.7%	82.9%

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