

Brazilian markets surf in the conservative wave



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Army veteran Bolsonaro won with 55.2% of the votes in the presidential elections runoff, receiving a record 57.7 million votes from Brazilians domestically and abroad. His victory followed the global populist wave of electing conservatives with agendas of radical reform.

In his winning speech, Bolsonaro used the word 'freedom' many times to address allegations from media and his opponents that he represents a threat to democracy. He praised the National Constitution and the diversity of Brazilians, and called upon the

people to unite around Brazil's new government.

As key points, Bolsonaro restated his commitment to fighting corruption and violence, and protecting private property. He highlighted his government's pledge to create the conditions for Brazil to return to growth.

He said the federal Government will streamline its structure and bureaucracy, cut costs and privileges, and simplify its procedures to improve the means of doing business.

He plans reforms to balance public accounts by urgently reducing the

primary deficit and government debt. He also promised to decentralize federal revenues and give them back to the provinces, in order to give state governors enough resources and the capacity to implement measures. Finally, Bolsonaro highlighted the need for openness and trade with developed nations. Brazil should search for bilateral agreements in exchange for access to added value products and technology, he told supporters.

We view his speech as positive, due to his commitments to uphold democracy and make badly needed

reforms. That will certainly be appreciated by the investor community. The successful implementation of these policies will now be key to delivering results.

What can we expect next?

The confirmation as finance minister of Paulo Guedes, an economist whose ideas are considered liberal and reformist, should be well received by the market. Regarding the central bank, current president Ilan Goldfajn should be invited to stay on. The thinking is that he would be willing to remain on board if the new government pushes for a central bank independence bill.

The Central Bank's composition is of key importance, given the more risk-averse global trend that has a direct impact on long-term interest rates. In addition, the current central bank governor enjoys prestige in the market. What is key is that the new government makes sure the market has confidence that the central bank will keep its inflation targeting model as well as a free-floating exchange rate.

The naming of other members of the government's economic team, managers of state-owned enterprises and infrastructure-related ministers should also attract investor interest, since there has been talk about a broad sale of state-owned assets, but the scope of it has not yet been defined.

Brazil has fallen into a vicious circle of rising government debt and expenditures, that has troubled the country since 2009 but was aggravated when the country experienced its worse recession to date in 2015-2016.

Bolsonaro's economic team will try to tackle the imbalance of the country's finances by pushing for social security reform. Their plan is to raise the current minimum retirement age from the current 55 to at least 61 years old. In addition, the pensions system would migrate from defined benefit to defined contribution. The team is also drafting administrative reform in order to reduce current government expenditures. They want to reduce the cost of public servants by cutting the number of ministries from 33 to 15. The proceeds of privatization can be used to reduce government debt.

The team is also working on reforming the tax system, simplifying it but also aiming to increase tax collection. They plan to introduce a tax on the distribution of profits and dividends. Finally, the economic team aims to help with drafting the conditions for the decentralization of tax revenues from the federal government back to the states. Under this plan, states should comply with the fiscal consolidation plan of the federal government, cut the cost of state officials, and formulate a regional

privatization plan to reduce states' debt.

Support in Congress

Bolsonaro's government is already in negotiations with the center-right Democrats Party (DEM) to support the re-election of the current speaker of the Lower House, Rodrigo Maia, who could then put some items of Bolsonaro's reform agenda to the vote in 2018 instead of waiting for the new government to take office.

Among the initial measures, a fiscal package and making the central bank independent are measures that could be voted in 2018.

Broader reforms such as the Social Security or tax plans and the revision of the Federative Pact are most likely to be put to the vote in 2019, by the new Congress. It should be up to the new government to release a strategy for reforms approval next year.

Bolsonaro's party, the Social Liberal Party (PSL), is the second biggest in the Brazilian Congress, and he initially has enough support to continue with reforms.

If social security reform is approved, this could be a game changer for Brazil.

Foreign affairs

After this election, Brazil is positioning itself on the global geopolitical front as an ally of the United States and

Israel. This has brought security consequences for Bolsonaro and could involve the country in conflicts not only within its borders, but on the global stage.

In Bolsonaro's speech, he was very emphatic about shifting foreign affairs policies out of the left-wing ideological bias the country has seen over the past 16 years. Brazil would seek closer relationships with western developed countries, he said.

During his campaign, Bolsonaro was very vocal in giving his full support to Israel. Brazil has a strong Jewish business community who were of key support to Bolsonaro's campaign. The new government intends to have a bilateral agreement with Israel to intensify trade and exchange technology and resources in agriculture, healthcare and military goods. Israel is also set to be the first country that Bolsonaro will visit after taking charge, particularly since Israel's prime minister Netanyahu has been his most enthusiast international supporter.

Since he gave his support to Israel, Bolsonaro became 'persona non grata' to the Arab league and has seen his name blacklisted by extreme groups such as Hezbollah.

As it shares a frontier with Venezuela, Brazil is experiencing its own refugee crisis. Venezuela's humanitarian crisis — which began in late 2014, when a drop in oil prices deprived the

government of its primary source of income — has worsened, with people dying from shortages of food and medicine. Thousands of Venezuelans are crossing the frontier with Brazil, a situation that has raised levels of violence, prostitution and epidemic diseases in Brazil's border regions.

Bolsonaro could join forces with US President Donald Trump within the United Nations calling for an intervention in order to solve Venezuela's humanitarian crisis. Conflicts along the Brazilian border will certainly be a risk to monitor.

Opening foreign trade

In terms of trade policies, we expect Brazil to pursue a closer relationship with the US and other developed nations, seeking bilateral agreements that could form both economic and military partnerships. Bolsonaro's team have mentioned Chile as a good example of having a trade policy that should be followed.

Brazil is a very domestic-orientated economy, with only 12% of its GDP derived from exports. Previous governments had implemented all sort of tariff barriers or subsidies that prevented Brazil becoming member of the OECD and gaining access to technology in different industrial segments. Bolsonaro's campaign has been clear in looking for ways to open up the economy and improve the exports mix to become less reliant on commodities which today account for 80% of the total. He also wants to

reduce Brazil's dependence on China for its exports.

We see the opening up of the economy as a positive that should attract new direct investment to Brazil.

Positioning

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