

## Brazil votes: Bolsonaro wins big in round 1; falls short of majority

### Key views



Far-right populist Jair Bolsonaro decisively won the first round, and will now face his left-wing opponent in an Oct. 28 runoff election.



Bolsonaro's economic team is perceived to be market-friendly, and favors reducing the size of Brazil's government.



We expect Brazilian assets to rally in the near term, though longer-term prospects will hinge on the new government's ability to implement reforms.

Far-right candidate Jair Bolsonaro won a decisive lead in the first round of Brazil's presidential election, but fell short of the majority needed to avoid a runoff contest. Bolsonaro will now face his left-wing opponent Fernando Haddad in Round 2 on Oct 28 in a contest that will lay the course for Latin America's largest economy. We see Bolsonaro's unexpectedly strong showing in the first round leading to a near-term rally in Brazilian assets, given his economic team's perceived market-friendly orientation.

The Brazilian economy remains in a fragile state despite recovering from a 2015-2016 recession. Brazilian risk assets had gained over the past week as Bolsonaro's prospects improved in polling. He was a politically divisive figure during much of the campaign, but Bolsonaro's economic team appears committed to building on the reform agenda in place over the past two years. These reforms have been seen as supporting a gradual economic recovery. Yet if, as some fear, Bolsonaro were to act in ways that damaged institutions, this could pose longer-term risks to Brazil's growth.

Bolsonaro has promised to tackle Brazil's debt problem through pension reform, halving the number of government ministries, and extending privatization of state enterprises. A Bolsonaro administration would need congressional support to tackle such a reform agenda. Gaining such support would be no easy task given the 35 parties in Brazil's political system, but Bolsonaro's party had a stronger than expected showing on Sunday, becoming the second largest party in the lower house.

A victory by Haddad – who represents the Workers' Party (PT) – could spark market fears that he would be more hesitant to press on with the fiscal consolidation process started by the outgoing government. Haddad's proposals include capital controls and a roll-back of reforms including privatizations. Yet the candidate has recently been striking a softer tone, making him somewhat of an unknown for investors.

Brazil's economy is making some progress, but the new president's approach to pension reform and public spending will be crucial in determining the country's growth potential. A growing debt burden, driven by massive social security obligations, is the key challenge. We see wide support to reform social security. The president of Brazil's lower chamber has recently said he would bring a pension reform bill up for a vote if the new president-elect publicly supported it. A key focus for investors will be the net present value of fiscal savings from future cuts to benefits.

Bolsonaro represents the right-wing Social Liberal Party and was seen as the favorite leading into the election. The populist and former military captain has tapped into widespread discontent with the status quo, but faced high individual disapproval levels due to his often provocative views. The most popular politician in this election, Luiz Inácio Lula da Silva (aka "Lula"), remains behind bars on corruption charges. Haddad was Lula's vice presidential candidate and replacement on the ballot.

Bottom line: We see Brazilian risk assets rallying in the near term as markets price in a Bolsonaro victory in round 2, which would likely be seen as a mandate to press ahead with economic reforms. Longer-term prospects will depend on the new government's progress in tackling Brazil's debt dynamics. The conclusion of the Brazilian election will mark the end of a string of contentious Latin American political matches. We remain risk-on and see the lifting of political clouds in emerging markets supporting the long-term case for EM assets.

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