

Brazil Narrowly Elected Lula: What's Next?

By: Emerging Markets Debt | November 16, 2022

Boston - Elections in Brazil are over, with Luiz Inacio Lula da Silva, known as "Lula," emerging the victor by a narrow margin — in line with poll predictions and the EMD team's expectations. After a few days of uncertainty, the succession process appears to be on track, with Bolsonaro giving a short speech where he did not technically concede, but said he would respect the transition of power.

With the elections now over, markets and politicians are focused on potential Cabinet appointments and policy announcements. So far, Lula hasn't given many details on either, but we offer the following observations:

A right-leaning Congress will serve as a check on Lula's agenda.

In the first-round elections, which took place October 2, Bolsonaro gained a strong foothold in the lower chamber of Congress. The Senate (81 seats) saw the same rightward shift. Currently, Lula's coalition controls about 123 seats in the lower chamber and 27 in the upper chamber, well short of the number required to pass legislation (257 votes in Congress and 41 in the Senate). Lula may be able to piece together a Petro-like coalition to get simple majorities, but that will require both political tact and resources. To the latter point, Lula's government could dole out Cabinet positions to potential allies, or pursue the same strategy as Bolsonaro did, using a "secret budget" to entice ideologically fluid centrist parties (centrão) to support his administration. The legality of the "secret budget" is currently under review by the Supreme Court.

Fiscal announcements are likely to be made relatively quickly, even prior to Lula's actual inauguration (scheduled for January 1, 2023).

Lula's priority will be to extend the social welfare program Auxilio Brasil (BRL600/month) into next year, at an extra fiscal cost of BRL50bn, as well as to increase the minimum wage and provide tax benefits. The total cost of such policies could exceed BRL200bn — more than 2% of Brazil's GDP and double initial projections. The markets are likely to respond negatively to these announcements if they are not accompanied by potential funding sources. Furthermore, implementation of these measures will require delicate political maneuvering to circumvent a constitutionally mandated spending cap, which limits public expenditure growth to the past year's inflation. Beyond fiscal policy, Lula's administration will focus heavily on environmental issues, primarily on reversing the deforestation of the Amazon, which was supported by Bolsonaro.

Markets will react positively to an orthodox pick for Minister of Finance.

Lula has sent mixed messages to markets, vowing to increase the role of the state in the economy and expand social welfare, while simultaneously maintaining a free market economy and fiscal prudence. Therefore, his choice of Finance Minister will be a critical indication of which sentiment will dominate, and a signal to ensure market support for his administration's plans.

One market-friendly option could be Henrique Meirelles, who has a good mix of political as well as technocratic experience. He was previously head of the central bank during Lula's first and second terms, and is seen as pretty orthodox. He also hails from the more centrist, right-leaning side of the bench, which could be a plus for Lula. One drawback is that Lula has previously pledged to do away with the fiscal spending cap, a rule that Meirelles helped to author. Other technocratic alternatives, though more of a long shot, could come from VP-elect Alckmin's economic team of advisors.

Other potential names in the hat include Fernando Haddad and Alexandre Padilha — both of whom are PT (Workers' Party) members. These two have more political than economic experience, which could benefit Lula, because he will definitely need someone who knows how to work with Congress to garner support for the government's reform proposals. In recent days, Padilha has taken to Twitter with very ministerial-sounding tweets.

President-elect Lula faces a different set of domestic and geopolitical conditions than he did when he became president for the first time 20 years ago.

He will likely be constrained by these starting circumstances, which we believe is a positive, and, if prudent, will pick an orthodox Finance Minister and conduct his government in a pragmatic fashion. Otherwise, Lula risks facing deteriorating market sentiment and a floundering government agenda before he gets out of the gate. We saw a hint of this in the recent, sharp sell-off in Brazilian assets, which reacted to Lula's statements signaling fiscal irresponsibility, as well as a few market-unfriendly appointments to his transition team.

Bottom line: The EMD team will continue to monitor ongoing developments for clues about just what kind of Lula administration we will see this time around. Despite ongoing uncertainties, we think Lula's government will eventually strike a balance between his pre-election promises and fiscal rectitude, given challenging initial conditions, his party's weak representation in a right-leaning Congress and a vigilant market that will punish deviations toward a more radical agenda.

Risk Considerations: The value of investments may increase or decrease in response to economic and financial events (whether real or perceived) in the U.S. and global markets. The strategy employs an "absolute return" investment approach, benchmarking itself to an index of cash instruments and seeking to achieve returns that are largely independent of broad movements in stocks and bonds. Investments in foreign instruments or currencies can involve greater risk and volatility than U.S. investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. In emerging or frontier countries, these risks may be more significant. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. Exposure to derivatives involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other investments. As interest rates rise, the value of certain income investments is likely to decline. The value of commodities investments will generally be affected by overall market movements and factors specific to a particular industry or commodity, including weather, embargoes, tariffs, or health, political, international and regulatory developments.



Emerging Markets Debt
Eaton Vance Management

"Despite ongoing uncertainties, we think Lula's government will eventually strike a balance between his pre-election promises and fiscal rectitude, given a right-leaning Congress and a vigilant market that will punish deviations toward a more radical agenda."

The views expressed in these posts are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance strategy. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness.



To report a website vulnerability, please go to [Responsible Disclosure](#).

Eaton Vance is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley.

For USA PATRIOT Act Disclosure Notice please click [here](#).

The information on this Web site is for U.S. residents only. The information on this Web site does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer.

There are no guarantees regarding the achievement of investment objectives, target returns, portfolio construction, allocations or measurements such as alpha, tracking error, stock weightings and other information ratios. The views and strategies described may not be suitable for all investors. Not all of Eaton Vance's recommendations have been or will be profitable. Eaton Vance does not provide tax or legal advice. Investing entails risks and there can be no assurance that Eaton Vance (and its affiliates) will achieve profits or avoid incurring losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

© Eaton Vance Management. All rights reserved. Two International Place, Boston, MA 02110.