

# How will a Lula victory impact investors?

## Bet on Brazil

It will drive the global economy





# Latin America's powerhouse will profit from the two key trends of the next 20 years: **the global energy transition and population growth,**

*says James McKeigue in an article first published in MoneyWeek...*

**B**razilians across the political spectrum reacted passionately to last Sunday's election victory for socialist 'Lula'. The supporters of Luiz Inacio Lula da Silva took to the streets across Latin America's largest economy to celebrate with red flags and convoys of honking cars. Meanwhile those of his defeated rival, outgoing president Jair Bolsonaro held mass prayer meetings for their country's impending challenges.

The passion was understandable, given the bitter election had been billed as a historical crossroads for the country. The market reaction was more muted, with early losses on the Monday morning were recouped by lunch. Perhaps that shows the two rivals are far more similar - in economic terms at least - than their supporters would like to admit. After all, in their respective terms as president, both spent too much, meddled in the national oil company, Petrobras, and faced plenty of corruption claims.

Brazil grows despite - not because - of its politicians and regardless of who won, the country should reward investors. Brazil will benefit from the two major themes driving the world economy over the next two decades - the energy transition and global population growth.

### **Don't fear Lula**

In theory, Lula presents some worries

for investors. One major difference between the two candidates is that Bolsonaro privatised state companies, while Lula wants them to play a bigger role in the economy. Lula is also keen to do away with the fiscal restriction that caps budget growth to the level of inflation in the country. Yet Lula's history proves him a more moderate president than campaigner. And even if he wanted to be radical, Brazil's political system of proportional representation limits his power. No party ever wins a majority in Congress, the federal legislative body, which means the president has to cut deals with the 'Centrao' (big centre) block of lawmakers. It is pork barrel politics, where presidents exchange local funding for supportive votes and, sadly, it probably prevents some of the reforms Brazil needs. But, on the plus side, it prevents presidents from implementing an extremist platform.

Another check on Lula is that while he won the presidency, centre-right politicians secured their power of the senate and the congress in the same election. Bolsonaro's party also controls three of Brazil's most populous states, which is significant in the country's federal system, where most of the regulations that impact businesses are set at a local level. The most valid criticism of Lula is his corruption, as his administration was involved in the largest graft scandal in Brazil's history. However, the consequence of that is improved protocols and increased

scrutiny - it is hard to imagine his government attempting the same this time around.

Lula's handpicked successor oversaw the worst recession in Brazilian history but his own two terms - from 2003 to 2011 - coincided with an economic boom. Judging by historical Brazilian standards you would have to say that Lula - much like Bolsonaro - was a relatively competent, pro-growth president.

### **EM Darling**

The most significant aspect of the Brazilian election, isn't who won but how efficiently the system worked. An incredibly tight vote - 50.9% to Lula and 49.1% to Bolsonaro - was decided within hours and key allies of Bolsonaro quickly congratulated Lula. Brazil is one of the most efficient large democracies in the world and a marked contrast to fellow Brics, Russia and China. The democratic dividend is often ignored by investors when autocracies are going well, but the erratic decisions of Russian leader, Vladimir Putin China's Xi Jiping, show why investors should value democracies.

Indeed, Brazil has shone this year, amidst an historic sell-off of emerging markets. As Julian Rimmer puts it so well in the Financial Times: "At a moment when most of EM is radioactive, Brazil offers something the others can't: democracy and





# BRAZIL: IN-DEPTH

The Amazon rainforest will attract international green finance



growth.” Brazil’s GDP growth is set to come in at 2.6% in 2022, above analyst expectations at the start of the year and only just behind China’s expected 3% growth.

One reason is that Brazil has benefited indirectly from the Ukraine war. Soaring commodity prices for food, fuel and raw materials have fuelled Brazilian exports. As a result, the Brazilian real is one of the few currencies that has managed to gain against the all-powerful dollar and is up 7% so far this year. But while the commodity crunch caused by the war is hopefully a short-lived phenomenon, Brazil’s world-leading agribusiness, mining and energy industries will continue to thrive. They will be driven by the two most powerful trends the world economy – the energy transition and the growing global population.

## Heat and eat

Most economic analysis of Brazil is gloomy. Growth might be good in 2022, concede analysts, such as Capital Economics, but in the coming years it will hover between 1.5% and 2%. Perhaps, but steady growth of almost 2% is better than the recessions awaiting most of the developed world. Brazil is also doing well with inflation,

a traditional bugbear for the Brazilian economy, which declined from a peak of 12% in April and is now at 8%. For the first time in my lifetime Brazil will have lower annual inflation than the UK. The success is down to the central bank – made independent by Bolsonaro – which began to increase rates in March 2021, while the hapless Bank of England was still insisting that inflation was transitory.

Unfortunately, Brazil’s politicians aren’t as thrifty as their central bankers. Bolsonaro pumped the economy with pre-election spending that ratings agency Fitch believes could swell the fiscal deficit to 7.5% by the end of the year. And Lula, a famous proponent of state spending, is hardly likely to be more austere. But I’m not asking you to invest in Brazilian government bonds. What excites me is the country’s booming export sector. Put simply, Brazil makes what the world needs. As population growth and the energy transition reshapes our world, demand for Brazil’s goods will soar.

The world can’t fight climate change without Brazil. And as pressure grows to slow global warming, more money will flow into the country. Its main asset

is the Amazon rainforest, which is home to more biodiversity than anywhere else on the planet. A healthy Amazon rainforest would act as the planet’s lungs, absorbing huge quantities of CO<sub>2</sub> and releasing fresh oxygen. Under Bolsonaro, deforestation increased, which led some scientists to worry that fires in the rainforest were releasing more CO<sub>2</sub> than it could capture.

Lula has a proven track record of combatting deforestation when he was last president and international donor countries, like Norway, have already announced plans to resume funding Amazon projects. Lula’s stance on the environment is great for the planet but it will also yield economic benefits. Deforestation was a major sticking point in ratifying a trade deal between the EU and Mercosur – South American trade bloc of which Brazil is the largest member. As William Jackson of Capital Economics notes, “were Lula to get the trade deal over the line, it would be a move towards trade liberalisation, which is one -among many – factors holding back productivity growth in the country.”

Brazil’s next globally significant climate change asset is its mining industry.

That might seem to contradict the previous paragraph but Brazil's iron ore and nickel are essential for the energy transition. Brazil has the world's fourth-largest reserves of nickel – a metal that is used in electric vehicle batteries. At present the main use of nickel is stainless steel, as adding it to the mix helps make steel more resistant to extreme temperatures and corrosion, while batteries account for just 6% of overall nickel demand. But S&P Global expects that to reach 35% by 2030 as electric vehicle production jumps.

Brazil also has the world's second-largest iron ore reserves. Iron ore isn't a 'clean tech' metal, directly associated with renewable energy. But a little-understood aspect of the ambitious plan to electrify the global economy is that it will turn the world into one big construction project. Switching from internal combustion engines to electric vehicles needs the build-out of a network of charging stations. And if these electric vehicles are going to reduce emissions then they must be powered by renewable energy, which means adding huge amounts of wind and solar plants, which all then have to be hooked up to the grid. The energy transition involves overhauling the entire planet's built environment. It's no coincidence that Brazil's golden decade at the start of this century coincided with China's building boom. The South American iron ore producer will benefit from the electrification building boom too.

## Feed the world

Brazil is well established as an agricultural superpower and, according to credible studies from its state-run agricultural research agency, the country's food production feeds 10% of the world's population. It is the world's largest exporter of beef, soybean, sugar and coffee. It is also very near the top

in corn, cotton and pork. Depending on how it is measured, agribusiness now accounts for 25% of the Brazilian economy. The sector's massive growth has been partly responsible for the increase in deforestation in the Amazon rainforest. Yet Lula has been careful not to declare direct war on the influential agribusiness lobby. Instead, he has been looking for innovative solutions, such as offering subsidised loans to encourage farmers to plant non rainforest land. Without doubt, companies with questionable practices will come under pressure from the new administration as it restores much-needed funding to environmental agencies. But serious players will be able to benefit from growing food demand.

The US Census Bureau estimates the world population will hit 8 billion in mid-November 2022. That will grow to almost 10 billion by 2050 and 11.2 billion by 2100. Over the same period, an increase in extreme weather events – that most scientists attribute to manmade climate change – will undermine farming production. Of course, Brazil isn't the world's only breadbasket but recent conflicts have shown that it is one of the most reliable. Food exports have been used as a weapon in the Russia-Ukraine conflict, and it is likely that something similar could happen if China were ever to attempt to invade Taiwan. Brazil, which happily sells both to the US and China, will see demand increase as the global population rises.

The same dynamics described for food apply to energy. Brazil is the largest oil producer in Latin America, and its production has climbed to 3 million barrels per day, from 2 million barrels of oil per day in 2012. Consultants McKinsey believe it could reach almost 4 million barrels per day by 2035.

The massive growth is down to the giant 'pre-salt' offshore fields that were discovered in Lula's first spell as president but, because of the technical difficulties of extraction, are only starting to be properly exploited.

This oil wealth might seem to contradict Brazil's climate change appeal but hydrocarbons are an important part of the transition. In his recent book, *The New Map*, energy analyst, Daniel Yergin, posits a 'planning scenario' in which the current consumption of 100 million barrels of oil per day, rises to 113 million barrels by 2050. One reason is that cars and light duty vehicles only account for 33% of oil demand, so even if we manage to replace the entire global fleet to EVs we will still need more oil for petrochemicals, aviation fuel, asphalt etc for a rising population. Linked to both energy and food is Brazil's biofuel production. Brazil is the world's second-largest producer and consumer of biofuels. That was led by the sugar industry in the 1970s but now modern biofuels can use a much wider range of feedstock, such as plant waste, dead animals and used vegetable oil. As the technology improves Brazil will be able to extract ever more value from its agricultural waste products.

You wouldn't think it from the press coverage surrounding the election but Brazil has been the standout emerging market in 2022. Despite that success its stockmarket still looks attractive, with the Bovespa trading on a price-to-earnings ratio of just seven compared to the MSCI Emerging Markets average of ten. Commodities – and Brazilian politicians – are inherently volatile and investors can't predict what will happen in two years' time. But if you can afford to take a longer time horizon you can profit as Brazil's exporters feed, heat and move the world. **This article first appeared in MoneyWeek.**



## Brazil's new president begins **stitching the country back together,**

*writes Jeremy Browne, CEO, Canning House*

**O**n Sunday, an election that gripped Brazil long before official campaigns started came to a dramatic close. Luiz Inácio Lula da Silva, better known as Lula, beat the incumbent Jair Bolsonaro with 50.9% of the vote to Bolsonaro's 49.1%. Both candidates harbour genuine hatred for each other, and the bruising campaign has left the country more polarised than ever. Lula now faces the mammoth task of reuniting this fractured nation.

The face of Brazilian left-wing politics for over three decades, Lula served as president from 2003 to 2010, his social policies helping tackle Brazil's acute inequality and lifting millions out of poverty. He left office with sky-high approval ratings, however the Workers' Party (PT) he founded became embroiled in a series of corruption scandals, eventually resulting in his imprisonment in 2018 (although his conviction was overturned in 2019).

Bolsonaro rose to power in 2018 after a long career as a fringe politician. His anti-establishment, socially conservative messaging struck a chord with a population exhausted by economic stagnation, widespread corruption and the inefficiencies of PT

rule. He is a highly divisive figure due to his inflammatory rhetoric targeting minorities and political opponents, his supposed mismanagement of the COVID-19 pandemic, and his pursuit of economic development of the Amazon rainforest, despite the environmental damage it causes.

While many pollsters predicted a comfortable lead for Lula in the first round, with some even declaring the former president would win an outright victory, the result was much closer than expected, with Bolsonaro finishing just 5% behind Lula. Furthermore, many of Bolsonaro's allies were elected to Congress, the Senate, and governorships around the country, potentially inhibiting Lula's ability to govern effectively via coalition. The results from both rounds of voting throw up several interesting questions about Brazil's political future.

### **Right revival**

The first point to mention is that although Lula has

won, Bolsonaro, and more widely 'bolsonarismo', is going nowhere. Bolsonaro's party, the Liberal Party (PL), is the largest in Congress and the Senate, while bolsonaristas won governorship of the key states of Rio de Janeiro, Minas Gerais, and seven other states. This was achieved in spite of an unfavourable economic climate, widely-perceived mismanagement of the pandemic, and what is undoubtedly an anti-incumbent wave throughout Latin America (Bolsonaro's defeat constitutes the 15th consecutive electoral defeat of a sitting president in the region).

The movement that Bolsonaro spearheads is highly sophisticated, effectively utilising social media and



Luiz Inácio Lula da Silva is returning for a third term as Brazil's president

fake news campaigns to communicate with supporters and discredit opponents. Due to the strong political representation of the right and hard right, Lula will likely be forced to dilute some of his policies that are unpalatable for the opposition, such as increasing environmental protections, or state-funded infrastructure projects.

Bolsonaro's message, combining anti-establishment sentiment, social conservatism, and family values, has clearly resonated with a large part of Brazilian society. His incessant attacks on the Left have found a receptive audience with the many Brazilians who view Lula and the PT as unpalatable, blaming their corruption and incompetence for the economic crisis that began in 2014 and from which Brazil has never fully recovered.

Bolsonaro has also understood that the Evangelical Church and agribusiness barons hold the keys to Brazil in 2022. Around a third of Brazilians are now Evangelical, up from a quarter just two decades ago, while agricultural exports

are the largest part of Brazil's economy, equivalent to \$125 billion per year. He has formed a sizeable base with their support, not least in Congress, where Evangelical and agribusiness interests are two of the strongest voting blocs.

### **Lula's in tray**

The continued appeal of bolsonarismo inevitably brings into question the role of the Left in Brazil. Without the figurehead of Lula, it is likely that the Left would have struggled even more in this election. In many ways, Lula is both his party's worst enemy and its greatest asset. His charisma and strength of character, as well as his undoubted political nous, have brought him back to the presidential palace. However, the allegations of corruption that have plagued him and his party have permanently tarnished his reputation among many Brazilians, leading to rejection rates almost, but not quite, as high as those of Bolsonaro. His victory does not change the fact that almost half of the country does not approve of him. Over the next four years, the Left must find a new figurehead to

unite around, not only because Lula is divisive, but due to the more practical reason that he will not be standing for a second term.

As well as negotiating political agreements and coalitions, Lula faces the even greater task of uniting a country that has torn itself apart over the last four years. Both sides of the battle are deeply entrenched, with little to no room for the middle ground (centrist candidates won just 7% of votes in the first round).

To win re-election, Lula asked Brazilians to remember what life was like the last time he was president. But Brazil, and the world, was completely different in 2010. In 2022, Lula will have to deal with a war in Europe and a stagnating global economy, while domestically he must address an economy plagued by an overcomplicated tax system and chronic low productivity, as well as levels of polarisation in Brazilian society that have spilled over into violence in recent months. It is no small task; Brazil needs Lula to be up to it.



## Canning House

For over 75 years, Canning House's mission has been to build understanding and relationships between the UK, Latin America & Iberia.

### We offer our Members:

Weekly briefings • Trade & investment conferences • In-depth reports • Language classes

Please visit our website to find out about our **2022 Events programme**.

For more information email [events@canninghouse.org](mailto:events@canninghouse.org)



## Brazil passed the election test - **what now?**

*Asks Mário Braga Control Risks' lead analyst for Brazil...*

**B**razilian institutions faced their biggest challenge since the re-democratization of the country in 1985. Concerns of a potential unconstitutional regime change, widespread unrest or a Capitol-like incident did not materialise following the run-off presidential election on 30 October. However, companies and investors will continue to face limited institutional and political instability until the next administration is inaugurated in January 2023. In the meantime, all eyes are on what the new government means for the business environment.

Given that President Jair Bolsonaro lacks institutional support (especially among the Armed Forces, the domestic political establishment and the international community), risks of a democratic rupture are very low. That said, the next two months will bring limited threats to overall instability and sporadic social unrest incidents.

The incumbent has not explicitly challenged the election results. Although he hasn't acknowledged former President Luiz Inácio Lula da Silva's (2003-10) electoral victory either. That means Bolsonaro and his allies will likely seek to question Lula's legitimacy to keep right-wing supporters energised. This strategy

will likely result in occasional protests mostly over the next few months – and to a lesser extent throughout the next administration. That said, protests are unlikely to escalate to widespread violence.

### **Government transition**

Lula has appointed Vice-President-elect Geraldo Alckmin to coordinate the government transition. While Bolsonaro's Chief of Staff Ciro Nogueira has taken the initial measures for the transition to occur, in accordance with Brazilian legislation.

Alckmin's track record as a centrist politician who formerly opposed Lula and the Workers' Party (PT) signal an effort by Lula implement a coalition government. It also helps to ease concerns among centrist allies and financial market participants that Lula's next administration would be dominated by leftist, radical appointees, or the PT alone.

Relatively limited risks on the unrest and institutional fronts will reduce financial volatility. The main triggers to shift market sentiment will come from the government transition process and the appointments to cabinet positions.

So far, gains in Ibovespa - Brazil's main stock index - and a strong

performance of the real indicate positive expectations of Lula's third administration – especially among foreign investors. While local investors are unlikely to give the new government the benefit of the doubt, foreign capital inflows are likely to remain positive amid the absence of political turmoil coupled with a nod to fiscal discipline and an ESG-oriented rhetoric. Such an environment is likely to position Brazil ahead of its emerging markets, such as Russia or China, when it comes to investor sentiment.

### **Lula's ESG focus**

Lula's ESG approach starkly contrasts with Bolsonaro's disregard for deforestation, indigenous populations and overall human rights. The president-elect will likely enhance the country's standing before the international community and investors. The quick reaction of foreign governments in acknowledging his electoral win and his participation in the United Nations' Climate Change Conference (COP 27) in Egypt indicate a clear path for a reduction in overall ESG-related reputational and operational risks for companies operating in Brazil. However, fiscal constraints will continue to undermine oversight, and the burden of ensuring compliance to ESG best international practices will still fall on the private sector.



### Policymaking outlook

Lula will be pragmatic vis-à-vis the economy and the business environment. He is unlikely to significantly change Brazil’s monetary, fiscal and trade policies. Brazil’s Central Bank (BC) will remain autonomous and current Governor, Roberto Campos Neto, will be able to finish his term in 2024, should he wish so. That means that interest rates will likely remain stable over the coming months, only starting a gradual easing cycle in 2023. The constitutional spending cap, which was introduced in 2017 to limit public expenditure and work as a fiscal anchor, will be replaced by a new framework. These rules are highly likely to be more flexible and make room for social spending. That said, Lula will seek to demonstrate fiscal discipline to avoid a negative market reaction. A waiver for extraordinary spending in 2023 followed by a clear roadmap of attainable rule for the following years is likely to ease concerns. Moreover, Brazil’s \$326billion of reserves will also limit any risks of default.

On the regulatory front, sector-specific agencies will remain mostly independent, while public banks will occasionally be used for economic policy purposes, such as for subsidised credit in an attempt to boost

consumption and growth.

Given that fiscal constraints will continue to limit public investment capacity over the next four years, the government will rely on the private sector to modernise and expand the country’s infrastructure. That will result in moderate progress of the concession agenda and other public-private partnerships mechanisms. Likewise, contract risks will be very low. Lula is highly unlikely to reverse the privatisation of electricity company Eletrobras.

Renewable energy will continue to be a priority, amid efforts to diversify the Brazilian energy matrix (and reduce the role of hydroelectric power plants). That will also help reinsert the country into the global arena as an important player around discussion around climate change and energy transition. In this sense, tax incentives or subsidised credit lines for the construction of wind farms and solar parks are likely.

The strategic nature of the oil and gas industry will likely result in occasional political interference. Petrobras – and other state-owned companies – will once again be used as policymaking tools. Measures to increase tax collection, such as the introduction of

a windfall tax, are also likely. In a price shock scenario, the government is also likely to adopt extraordinary measures to mitigate impacts on inflation. The government could increase mining taxes or royalties especially while global commodities prices remain elevated.

More broadly, the administration will seek to introduce taxes on dividends and wealth as part of its tax reform to fund increased social spending. Indeed, tax reform will be a priority in 2023. The proposal will seek to substitute several existing taxes with a VAT-like levy, simplifying the country’s complex tax system. That is also likely to entail a shift in terms of tax collection from consumption to income. Top salaries are likely to face higher taxes, while those at the bottom of the payroll pyramid will be exempted from income taxes.

Economic growth, job creation and income distribution will be key to reduce the social inequality exacerbated by the COVID-19 pandemic. It is also Lula’s chance to reduce his rejection rates, which currently stand at 45% of the electorate, and try to reduce heightened political polarisation levels. The question now is whether Lula will pass the test.

### Policy making outlook under Lula’s government

Continuity		Change	
Monetary	Autonomous central bank	Privatisations	No significant progress
Fiscal	Spending cap is replaced by more flexible but credible framework	State-owned enterprises	Strategic political interference
Trade	Diplomatic activism, with limited economic impact	Tax reform	Limited changes and the introduction of taxes on the wealthy
Public-Private Partnerships	Moderate progress	Administrative reform	Not a priority
Sector specific regulation	Autonomous regulatory agencies	Labour reform	Minor changes to the 2017 reform
ESG	The public sector is not a protagonist, but does not undermine initiatives		





# Brazilian elections – back to the past?

*Adam Patterson, our correspondent in Curitiba, worries for the economic implications of Lula's controversial victory...*

After an extraordinarily atypical and polarized election cycle, Brazilians went to the second-round polls on Sunday 30th October to choose their next President. With 50.9% of the votes cast, former head of state Luiz Inácio Lula da Silva, known as Lula, was declared the winner, with incumbent President Jair Bolsonaro receiving 49.1%, the tightest margin in Brazilian election history. That despite Bolsonaro taking the largest share of the votes in four out of five Brazilian regions.

### Controversial victory

Lula, a two term President between 2002-2010, was convicted on corruption and money laundering in one of the world's largest graft scandals and only served three years of an initial 12-year sentence before being controversially freed on a technicality by a supreme court judge his Worker's Party nominated, allowing him to run again in 2022.

A key overlooked development from the first round of voting was a huge and historic "Bolsonaro wave" in congress. Bolsonaro's Liberal Party (PL) elected the largest contingent in the lower house (99 out of 513 seats) and in the Senate – where it now has 14 of the 81 senators. Added to together with centre right parties like PP, Republicanos and União Brasil and both legislative

houses have the most conservative make-up in a generation. Centre-right governors in Every Southern and South-East region state – which total more than 75% of Brazilian GDP – also provide a barrier to radical policy.

According to researcher Oliver Stuenkel, professor of International Relations at Fundação Getúlio Vargas (FGV) "The right has triumphed. The Lula government will have many difficulties with Congress, a lot of resistance. Bolsonarism will be very present in Brazilian political life over the coming years". However, analysts expect negotiation and horse-trading. And yet, as the saying goes, life can only be understood looking at the past but must be lived in the future. Thus, as the dust settles attention turns to what the economic outlook is for the Latam giant with a Lula government.

### Economic prospects












First let us look at the economy Lula inherits. Despite being hamstrung by a weak majority in Congress, dependent on centrist parties, and COVID there has been marked progress. Central bank independence was formalized, corruption vastly reduced, and pension reform was passed which put Brazil on a more sustainable fiscal footing.

There have also been incremental advances in regulation liberalization,

digitalization of government services and privatization. Almost 14 million new companies have been opened since 2019, a record amount. Brazil also had a much smaller economic downturn during the pandemic due to one of the world's largest fiscal and monetary support packages. The Legal Framework for Sanitation helped bring clean water to millions of people.

These macroeconomic measures, supported by early monetary tightening to counter inflation, have put Brazil in an attractive economic position. Real GDP growth is expected at close to 3% in 2022, and with inflation around 5%, it's never been so low relative to the US and Europe. Unemployment at 8.9% is the lowest for a decade.

The government reduced more than 4000 taxes, including on energy and imported goods. The business community would have liked to see more administrative and tax reforms passed but, overall, the economy has advanced from Brazil's worst recession left by the outgoing PT government in 2016. There has also been progress at the social level, murder rates are at the lowest 20 years, as are rural property invasions and burnt areas in the Amazon Forest. It seems likely that history will give Bolsonaro much more credit than the media has over the last few years.

	PT 2015	Bolsonaro 2022
Unemployment 	 14%	 8,9%
Minimum wage 	<b>R\$788</b>	<b>R\$1212</b>
Population below the poverty line 	 17,4%	 10,8%
GDP growth 	<b>-3,55%</b>	<b>3%</b>
Public Accounts 	Loss of <b>R\$32billion</b>	Profit of <b>R\$187billion</b>
Public company accounts 	Deficit of <b>R\$111billion</b>	Surplus of <b>R\$109billion</b>
Monthly Social benefits 	<b>R\$82</b>	<b>R\$600</b>

Yet two major economic challenges await Lula. Firstly, the global scenario: energy shocks and rising interest rates increase the chance of recession in some of the main world economies.

China, Brazil's biggest trade partner is confronting multiple economic crises. The second challenge is internal, and based on fiscal pressures, driven by expenditures already undertaken by the current government and new campaign promises by the incoming PT party which must be managed carefully so as not to lead to upticks in the deficit and public debt dynamics.

### State intervention

Few details about the president-elect's proposals surfaced during the election campaign. At the time of writing the new economic team has not been announced. However, at the macro level, based on PT's economic program submitted to election authorities and their "Letter to Brazil of Tomorrow", the new administration plans to expand the role of the State in the economy, suspend privatizations, modify the

market friendly labour and social security legislation, reformed by both the Temer and Bolsonaro governments, and repeal government spending limits via a more flexible fiscal policy. The plan also seeks to review tax policy - Lula has talked about "taking large fortunes" - and increase social benefits and the minimum wage. Concerns around these interventionist policies and u-turning on privatization weighed on shares of state-controlled companies in the days since the result was announced. Oil giant Petrobras, fell more than 20% in the first three days. Xavier Hovasse, head of emerging equities at Carmignac, said he prefers to stay away from state-owned companies due to expected higher intervention by the government.

However, using the past as a guide. Equities in education, construction and retail sectors, for example, could benefit from the possible expansion of student and housing financing programs and a potential easing of credit, especially by publicly owned banks. There is also talk of reinstating a reformed

Growth Acceleration Program (PAC), with the objective of reactivating civil construction and social infrastructure such as housing and urban mobility.

Launched in 2007, at the beginning of Lula's second term, the PAC increased public investment in infrastructure, but was marked by delays, abandoned projects and corruption.

PT have said they will aim for fiscal responsibility, with "clear and realistic rules". The market is however suspicious of how such a leftist economic wish-list can be financed. For Alejandro Arevalo, head of emerging markets debt at Jupiter Asset Management: "How do they plan to fund social spending? Are we going to see some tax reforms, or where is the windfall going to come from to be able to keep the fiscal deficit in check?"

In summary Lula will face not only a vastly different domestic political climate but an international economic scenario. Gone are the heady days of his first mandates when Brazil, surfed a commodity cycle and global economic stability.

But on the other hand, at least over the near term, Brazil remains attractive relative to the original BRICS countries and other emerging markets. The stock market remains cheap and there is a clear lack of alternatives in terms of a sizable EM equities market. For investors it remains a country too big to ignore.

Assuming Lula can conclude his term given political pressures, Brazil will have to wait for 2026 for an economically liberal President who can help pass the needed macroeconomic reforms and put Brazil back on a market-friendly growth path. Until then it seems that it has chosen to go back to the past.