

After the run-off in Brazil – what lies ahead?

- **Positive indicators for a sustained upswing in Brazilian business cycle**
- **Bolsonaro win would make recovery of Brazilian assets likely to continue**
- **Bolsonaro expected to forge strong alliances with business and create climate of economic liberty and Pension reform set to finally take place**

Frankfurt am Main, 25 October 2018 A victory for the favourite Jair Bolsonaro of the Social Liberal Party (PSL) in the run-off elections in Brazil should give Brazilian real and assets values a boost. Thomas Rutz, fund manager of MainFirst Emerging Markets Corporate Bond Fund Balanced, expects a recovery of the Brazilian Real and a narrowing of credit spreads for Brazilian government bonds for this scenario. "We see positive indicators pointing to a sustained economic upturn in Brazil," said Rutz. Recent surveys, such as those conducted by the Brazilian Institute of Public Opinion and Statistics, predict that Bolsonaro will win the run-off elections on 28 October against Fernando Haddad of the Workers' Party (PT).

Upswing in GDP growth and business cycle likely

A first upswing in the markets had already become apparent shortly before the elections and was further confirmed after Bolsonaro barely missed the majority with 46 percent of the votes in the first round of elections at the beginning of October and his PSL became the second largest party in parliament. Since then, the Brazilian Real (BRL) has already recovered against the US Dollar (USD) from 4.2000 at the beginning of September to 3.7000 by mid-October, while Brazil's credit spread (JP Morgan CEMBI Z-Spread to Worst) has narrowed by around 70 basis points from 430 to 360. Rutz assumes that the USD/BRL range will remain similarly tight until the end of the year. Brazilian assets have also repriced quickly - correcting the overshooting of recent months. "We are likely to experience some further repricing as many shorts are now squared and real money follows might return," adds Rutz.

The Emerging Market expert also sees further potential in the business cycle. "The Brazilian economy has corrected sharply in recent years, inflation is low, the currency is cheap and external balances are healthy. Brazil is therefore ripe for a long and sustained upswing in the business cycle, which could support Brazilian markets long after the turmoil surrounding the election will have passed," the fund manager emphasizes. Brazil's GDP growth is expected to accelerate in the third quarter to 1.8 percent year-on-year and to around 1 percent quarter-on-quarter. The current forecast for 2018 assumes a growth in gross domestic product (GDP) of around 1.5 percent. The forecast for 2019 is even more positive, expecting GDP growth to exceed 3 percent.

Bolsonaro's expected win strengthens positive market sentiment

The markets are particularly in favour of Bolsonaro, because if he wins, he is likely to live up to his nickname "Trumpinho" (little Trump) and form strong alliances with business and create economic liberty. At the same time, he will take measures against corruption and even more so against crime. He has a strong economic team led by Paulo Guedes, a renowned economist, who advocates pension reform and the privatization of state-owned enterprises. Rutz adds: "The stronger than expected performance by Bolsonaro's allies, and the right generally, in the congressional election on 7 October means that pension reform and other changes should be within reach." This is particularly important as the pension reform is by far the most pressing issue in Brazil from an investor perspective due to the massive fiscal cost of the deficit in the public system (about 3% of GDP per year). The topic is therefore sure to retake centre stage when the the election is over. "Bolsonaro has the good fortune of

inheriting an economy that is enjoying a cyclical upturn and a reform initiative to social security that is far enough advanced that it should be hard to reverse,” highlights Rutz.

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