

PRESS RELEASE

Presidential elections in Brazil: immediate risks for financial markets largely priced in

- Right-wing populist PSL and left-wing Labour Party PT pulling in different directions**
- Reforms absolutely necessary to avoid threat of a deep recession**

Frankfurt am Main, 5 October 2018 - Around 145 million Brazilians will be voting for their new president next Sunday and on 24 October in the general elections. "The country needs drastic, unpopular economic reforms to reduce the bloated government, counter the high budget deficit and reduce rising social security spending," says Thomas Rutz, fund manager of the MainFirst Emerging Markets Corporate Bond Fund Balanced. However, the expert sees the widening of the spread of the credit default swap (CDS) in Brazil and the correction of the Brazilian equity market as a sign that the financial markets have already priced in the risks associated with the outcome of the presidential elections and should remain stable for the time being after next Sunday. In the medium term, however, investors would take a very close look at whether the next elected president is pursuing a credible and reform-friendly economic program. "If this is not the case, a worsening of the situation will have to be expected," said Rutz.

Two candidates currently stand a good chance of taking office: Jair Bolsonaro, a former military leader and member of parliament, who belongs to the right-wing populist Partido Social Liberal (PSL), and Fernando Haddad, the former mayor of Sao Paulo, who will run for the left-wing Workers' Party (PT). Haddad was nominated as a candidate for the PT at short notice after the popular ex-president Luiz Inácio Lula da Silva had resigned because of his conviction in a corruption trial. "A run-off among these two candidates already seems almost certain," says Rutz. Geraldo Alckmin, the favorite of investors and candidate of the middle class, by contrast, "practically does not stand a chance".

The financial markets are following the election campaign closely. After a severe recession in 2015 and 2016, Brazil has recently experienced a slight upswing. "But the effects are not yet really felt by the population," explains Rutz. In the past four years, the budget deficit amounted to more than seven percent of gross domestic product (GDP). According to the expert, high social security contributions and rising pension expenditure are preventing urgently needed investments in the country's physical and social infrastructure.

Frustration about unemployment, corruption and crime among the population is correspondingly high. "Bolsonaro exploits this for populist slogans," says Rutz. The former captain of the army promises to crack down on crime, fight corruption and restore economic growth. His presumed future finance minister, Paulo Guedes, is liberal, wants to cut spending and buy back debt with income from privatizations of profitable state-owned enterprises and the public pension system. "For many hope that he will implement the necessary reforms makes him the favorite of the two front runners.

Lula's candidate Haddad has worked his way up to second place since his nomination on 11 September. He promises to reverse many of the unpopular (but necessary) reforms of the highly disliked President Michel Temer to cut social spending. Temer had moved to the head of state in 2016 after the dismissal of President Dilma Rousseff. "Instead of pushing ahead with privatisation and pension reform, Haddad wants to boost the economy through investment. The markets hope that, like Antonio Manuel Lopez Obrador in Mexico, he will not implement his more drastic ideas for reform," says Rutz.

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