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Brazil Is (Still) Not for Beginners: 2022 Outlook

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Intelligence

Brazil's Outlook for 2022

On October 2, 2022, Brazil will have a watershed presidential election. The result will dictate whether the southern hemisphere's largest economy continues to stagnate or returns to growth. No matter the outcome, the democratic pillars of Latin America's biggest country will be further pressure tested before and well after the votes are in. The business community has good reason to be concerned, but also optimistic. After the tribulations of a national election, economic growth is expected to return.

Political landscape

Jair Bolsonaro – the incumbent

In his fourth year in office, **President Jair Bolsonaro** looks weak. His support according to a recent poll¹ is at 31 percent. His disapproval rate, at 54 percent, is the result of a sluggish economy, inability to build coalitions and pass necessary reforms, and corruption investigations into Bolsonaro and his family. Brazilians are also irritated at Bolsonaro's conduct during the pandemic.

COVID-19 claimed over 640,000 lives in Brazil. Displaying little compassion, Bolsonaro posited that Covid is a "little flu," and that the country is best served by herd contagion. Two years in, he is still attacking Brazil's equivalent of the FDA (Anvisa) and recently tried to halt vaccinations among children. His attempts at winning over Brazilians include pushing demonstrably ineffective treatments and organizing mass public gatherings. After a slow start, the national vaccination efforts did pickup, and Brazil has now fully inoculated over 70 percent of its population against COVID-19, which is in line with the EU percentage and about 6 points higher than the US. But given the fact the country has had a respected national vaccination plan for diseases such as polio, measles and tuberculosis for 50 years, the relative success of distributing COVID-19 vaccines is not attributed to Bolsonaro's administration but to existing pillars in the public healthcare system.

The best candidate in the eyes of most Brazilians is anyone but Bolsonaro.

Lula – the frontrunner and challenger

Leading the pack and checking the "not-Bolsonaro" box is **Luiz Inácio Lula da Silva, Lula**. Currently 40 percent of voters favour Lula. Four years ago, the two-term former president was in jail, convicted of money laundering and receiving illegal kickbacks for government contracts. Back then, most of the electorate strongly rejected Lula's Workers Party (PT) and the systemic corruption that marred everything it touched. Lula was in a similar position to Bolsonaro's today: anyone he didn't support was seen as the preferred option.

Lula today is not only "not-Bolsonaro," but he enjoys a loyal base of supporters who never abandoned him. They remember that under Lula, Brazil's internal market was booming, and the commodity economy benefitted from strong tailwinds. In 2009, during Lula's presidency, The Economist published a cover showing a rocket-propelled Christ the Redeemer in Rio de Janeiro with the title "Brazil takes off".

Voting for Lula now will still be hard for a large portion of the electorate who remain convinced the former president orchestrated the largest corruption scheme in Brazil's history and caused long lasting damage to its economy, reputation and government institutions. His disapproval rate is at 43%.

¹ Poder Data from 02/16/2022

Option 3 – neither Bolsonaro nor Lula

While a centrist third option is appealing to voters and the market, all other candidates are polling 9 percent or lower.

The top contender in this group is a former federal judge, **Sérgio Moro**, intimately and ironically involved with both Lula and Bolsonaro. From his bench, he led most of the Lava Jato corruption investigation and convicted 45 people, including Lula. He was considered a national hero for sending a message that crime would no longer pay. For a fleeting moment many Brazilians believed the country was about to be able to function without the parasitic weight of wide-spread corruption.

But Moro overplayed his hand. First, he joined Bolsonaro as his justice minister, eyeing a future nomination to the supreme court and strengthening the impression that Lula's trial was political persecution. Soon after, faced with leaked messages between Moro and Lava Jato's prosecutors, the supreme court overturned important convictions on the grounds that the judge was biased and working outside his jurisdiction.

In the end, Lula was not acquitted, but he wasn't convicted either, allowing him to claim innocence and vindication. In sum, Moro is damaged goods, unlikely to amass the kind of support needed to surpass 50 percent of the votes.

Ciro Gomes, at 4 percent in the polls, is again throwing his hat into the ring. Gomes is center-left, a long-time politician from the country's northeastern state of Ceará, and was once seen as a possible successor to Lula. Albeit capable and moderate, Gomes has failed to gain traction nationally in the past three presidential races he entered.

Finally, there is an interesting dynamic brewing between two weaker candidates. **João Doria**, considered center-right and pro-business, is the current governor of São Paulo, Brazil's most populous and richest state. He is polling around 3 percent and represents PSDB, a legacy party with national recognition, albeit in an unfavorable position. **Simone Tebet**, also center-right and polling below Doria, is a first-term senator from Brazil's agricultural region. She is well respected and is the candidate of MDB, another powerful legacy party apparently unable to capture votes for president.

There is talk that Doria and Tebet might join the same ticket to unify the center.

Lula is currently best positioned for October's election, but with almost seven months until the elections, there is plenty of time for public opinion to shift and consolidate around another candidate.

The long-term legacy of Lava Jato

It is still not possible to talk of Brazil without talking of Lava Jato. The corruption investigation, which began in 2014, had a profound and lasting impact on the country. It charged over 500 people and cost billions of dollars to some of Brazil's largest sectors. It lasted years, put a popular former president, Lula, in jail, and helped bring a sitting president, Dilma Rousseff, down through impeachment. It also catapulted Bolsonaro, a contrarian, rabble-rousing congressman, to the presidency.

During Lava Jato, the supreme court reinterpreted the constitution and revolutionized sentencing laws. Then, that same high court retreated on its own interpretation and allowed Lula and other criminals to be released from jail. Not long after, the court went further and overturned Lava Jato's convictions and cleared Lula and several others of all crimes.

It is hard to overstate the emptiness and despair this rollercoaster inflicted on Brazilians. The underlying crimes were proven. Evidence and confessions demonstrated that kickbacks were a normal cost of doing business with the federal government from top to bottom. Yet there was also compelling evidence showing prosecutors and the presiding judge illegally conspired, and that some of the proceedings, including Lula's, should not have been assigned to Moro's court.

The Lava Jato saga weakened the justice system's ability to fight white collar crimes. The silver lining, perhaps, is that when the next fight comes, courts may be less likely to make costly mistakes, putting them in a better position to win lasting outcomes. The result may be slightly less uncertainty and volatility, which is usually attractive to long-term investments.

The months ahead

Bolsonaro will use the final stretch of his current term to continue feeding doubt about the electoral system and fabricate fear of a "socialist" takeover. Even though electronic voting machines have been used in Brazil in the past 25 years without a hitch, the unproven theory of the system being vulnerable to tampering has gained traction. For a period, there was considerable concern that Bolsonaro might coerce the military into extending his presidency. But the rank and file has made it clear they will not cooperate.

If Lula continues to consolidate his position, corporations and the business community will likely swing behind him despite his leftist leaning. We saw a similar alliance between Lula and the market when he first won the presidential election in 2002. Worryingly for business, Lula chose his former finance minister, Guido Mantega, to sign an op-ed in Brazil's most influential broadsheet, Folha de São Paulo, defending what Mantega called a "social welfare state" and an "ambitious" government investment plan to improve infrastructure, productivity, and job creation. The response from business was negative.

Lula knows he is more likely to attract national support by moving to the center and is openly looking for a business-friendly running mate. But he is being vague and making conflicting statements about his economic policies, leaving open the possibility he may play more to his loyal base on the left if a strong third-option ticket arises.

Post-October outlook

Victory for anyone other than Bolsonaro would feel like a national relief. Brazil is eager simply to have a better-functioning government. In 2021, Brazil saw an 23 percent increase in foreign direct investment (FDI) year-over-year, with the market attracting US\$46 billion in FDI. This number is 34 percent lower than pre-pandemic levels and 55 percent lower than Brazil's peak in 2011, during President Dilma Rousseff's first year in office. Brazil's Central Bank expects tepid FDI growth in 2022 because of the risk of rising inflation and interest rates as well as uncertainty around the elections. After the votes are counted – pandemic permitting – the expectation is for foreign investments to flow back in.

After retreating 4.1 percent in 2020, Brazil's economy rebounded in 2021 and grew 4.5 percent, according to an official preliminary analysis. The 2022 outlook is flat, with most in the market predicting 0.5 percent GDP growth and some predicting a slight retreat. One of the main challenges will be to contain inflation, at over 10 percent now. To contain it, interest rates have grown from 2 percent to 10.75 percent in less than one year and are likely to increase.

If Lula wins in October, he will still carry the stain of corruption. Guido Mantega's op-ed gives some clues as to his direction. But anyone other than Bolsonaro should bring enough stability to draw investment.

Opportunities

Brazil is the largest economy in Latin America, historically attracting over half of all FDI the region. São Paulo, with its 12.4 million inhabitants, is the financial hub of the entire continent. While 2022 will likely be a slow year for foreign investments in Brazil, Brunswick is well-positioned to leverage its presence in São Paulo to advise multinationals already operating in or considering new business in that market.

Last year, a wave of Brazilian companies flowed to the US in search of capital, culminating with Nubank's IPO in December 2021. We will likely continue to see this trend, and it could pick up in 2023.

Brazil's next "not-Bolsonaro" government would give greater attention to environmentally sustainable programs and businesses as a way to engage with the rest of the world. Large infrastructure projects, agriculture and energy will continue to be main drivers of investments in the region.

As the great maestro Tom Jobim once famously said: "Brazil is not for beginners." But in its complexities, there is a lot of opportunity for an experienced team.

To continue the conversation:

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