Rosa & Roubini
ASSOCIATES

MAKING SENSE OF *THIS* WORLD — *29 October 2018*

R&R Weekly Column
By Brunello Rosa

Bolsonaro's Presidency: A Likely Mix of Trump, Peron, and Pinochet

After three weeks, our column now returns to discuss the second round of Brazil's presidential election, which was held yesterday evening. The election resulted in the victory of right-wing candidate Jair Bolsonaro, the leader of the Social Liberal Party, over his opponent Fernando Haddad, of the Workers' Party. Bolsonaro received 55% of the votes, Haddad 45%. Most of the analysis we provided in our previous column on Brazil in early October, when Bolsonaro won the first round of the election with 46% of the votes, is still valid today. Now that he has won the final round of the election, we want to focus on his economic plans, and discuss what type of president he might be. To begin with, the victory of Bolsonaro marks the return of a *sui-generis* "populist" extreme right-wing candidate to power in Latin America, after decades in which populist leaders had been coming mostly from the left of the political spectrum (e.g. Hugo Chavez and Nicolas Maduros in Venezuela, Evo Morales in Bolivia, etc.). His anti-democratic rhetoric and continued defence of the military dictatorship of the 1964-1985 period also make him more akin to leaders like Chile's Augusto Pinochet (whose dictatorship lasted from 1973 to 1990) than to recent examples of left-wing populists.

Second, Bolsonaro's economic plan, which was prepared by Paulo Guedes (a PhD graduate from the University of Chicago, former investment banker at Bozano Investimentos, and one of the founders of BTG Pactual), is to be centred around fiscal reform, budget discipline and the reform of the pension system (in spite of the fact that the military is one of the major beneficiaries of the generous system that currently exists in Brazil). These actions would be accompanied by an aggressive plan of privatising state-owned enterprises (such as Banco do Brasil and oil company Petróleo Brasileiro), which would be expected to raise around 800 billion reais ($215 billion), enough to reduce Brazil's federal debt by a fifth. Very much like Donald Trump, however, Bolsonaro, even while remaining market friendly and appointing market-friendly advisors (such as the former president of Goldman Sachs and current director of the National Economic Council Gary Cohn, in Trump's case), will have to deliver to his electoral base, a population that is among the hardest hit by the economic recession Brazil had faced. In this respect, Bolsonaro is unlikely to deviate too much from the path indicated by the archetype of all right-wing populists in Latin America, namely Juan Domingo Peron of Argentina. (Peron, unlike Pinochet who came to power by way of a military coup in 1973, was elected to office). The US under Trump is likely to remain very sympathetic to Bolsonaro's Brazi, and unlikely to slap tariffs on Brazil's exports. The markets are likely to be enthused by Bolsonaro's victory as well; as can already been seen in the recent excellent performance of Brazilian equities (+7% in a week, +13% year to date, in spite of the ongoing sell-off/correction that has been especially impacting EMs). Bolsonaro's victory is therefore likely to strengthen the BRL relative to the USD and other EM currencies, thereby opening up the space for a cut in interest rates in coming weeks (as inflation in Brazil, at 4.5%, is under control, and *real* policy rates, at around 2%, have room to be trimmed).

As such, assuming that Bolsonaro will be a mix of Trump, Peron, and Pinochet (perhaps even to the point of severely reducing Brazil's democratic rule) how will his presidency be remembered? There have been a number of studies on the economic impact of Pinochet's combination of liberist policies - including his reform of the pension system - and authoritarian governance. Most of these studies were partial, if not heavily biased, especially given the explicit support provided to Pinochet by the then-champions of neo-liberism, Ronald Reagan and Margaret Thatcher. However, even more balanced evaluations suggest that Pinochet's policies had an overall positive impact on Chile's economy, even if the costs in terms of political, social and human rights were immense. At the same time we would consider it wise not to forget the lesson that Rudiger Dornbush and Sebastian Edwards gave us in 1990 in "Macroeconomic Populism in Latin America": "populist policies do ultimately fail; and when they fail it is always at a frightening cost to the very groups who were supposed to be favored... the macroeconomics of various experiences is very much the same, even if the politics differed greatly."

Our Recent Publications

- *REVIEW: ECB Review Rendez-Vous in December for All Decisions, by Brunello Rosa, 25 October 2018*
- *PREVIEW: ECB Likely To Buy More Time Before Committing, by Brunello Rosa, 22 October 2018*
- *BOC REVIEW: Trade Relief Ensures An Autumn Hike and Hawkish Tones, by Joseph Shupac and Brunello Rosa, 24 October 2018*

The Week Ahead

In the US, wage growth is expected to accelerate (average hourly earnings October, c: 3.1% y-o-y; p: 2.8%), the number of new jobs is likely to rise (non-farm payrolls September, c: +190k m-o-m; p: 134k) and the unemployment rate to remain at a 49-year low (October, c: 3.7%; p: 3.7%).

No policy rates changes are expected in Japan, China and the UK. Central banks will keep policy rates on hold in Japan (BoJ, c: -0.1%; p: -0.1%), China (PBoC, c: 4.35%; p: 4.35%), and the UK (BoE, c: 0.75%; p: 0.75%).

The Quarter Ahead

In the US, resilient growth will push the Fed to further tighten policy. Q3 GDP growth beat expectations (a: 3.5% q-o-q ann.; c: 3.3%; p: 4.2%) driven by the strongest increase in consumption in four years. The Fed will raise rates further, despite lower stock prices and rising risks—which reduced the markets' expectations about a hike in December to 70.3% (pw: 83.9%), and the likelihood of "at least 3 additional hikes by October 2019" to 40.7% (pw: 53.0%).

In the EU, political and economic risks will keep rising, increasing the pressure to postpone policy normalization: last week the ECB kept rates on hold (c: 0.0%; p: 0.0%) and discarded a rate hike in H1-2019, as: a) growth is likely to soften—the EZ composite PMI weakened to 52.7 (October, c: 53.9; p: 54.1)—and, next week, Q3 GDP growth is expected to show a deceleration (c: 1.9% y-o-y; p: 2.1%); and b) political tensions continue to rise: i) last week the EC rejected Italy's budget—an unprecedented move; ii) in Germany, the elections in the region of Hesse have further weakened Angela Merkel's coalition government; while iii) in the UK, the government put Brexit negotiations with the EU on hold due to disputes within the British cabinet.

China's expansive fiscal and monetary policy will likely avoid a hard landing. The CNY fell to its lowest level against the USD in a decade (USD/CNY 6.943, -0.2% w-o-w) driven by: a) uncertainty about the trade outlook; and b) monetary policy easing: last week, Chinese authorities announced new lines of credit for SMEs. China is also adopting measures to: a) facilitate foreign access to its capital markets; b) streamline business licensing; and c) reduce taxes.

In Turkey, the economy will further stabilize. Last week, the MPC kept rates on hold (at 24.00%), helped by the recent appreciation of the TRY (+0.9% w-o-w, to USD/TRY 5.592).

MENA bond issuance will remain firm. Sovereign issuance remains steady, even in EMs, as demand seems only marginally affected by rising risks. Last week: a) Tunisia issued a EUR500m 5y-bond at 6.75%, which was 1.5 times oversubscribed; and b) Ukraine sold USD2bn of 5y- and 10y-bonds, at 9 and 9.75% respectively.

Brent oil price will likely remain close to 80 USD/b as supply remains tight. The ongoing slump in stock markets clouded the fuel demand outlook, pushing prices down (Brent 77.6 USD/b, -2.7% w-o-w).

Last Week's Review

Rising risks are driving a rotation from stocks into bonds. Global stocks suffered w-o-w declines (MSCI ACWI, -3.8%) on concerns about rising US rates and trade wars. Risk aversion hit US stocks—erasing y-t-d gains (S&P 500, -3.9%, -0.6% y-t-d)—and most markets (Eurostoxx50, -2.4%; MSCI EMs, -1.8%).

Volatility rose above its 10y average (VIX, +4.3 points to 24.2; 52w avg.: 14.5; 10y avg.: 19.0). Investors rotating into DM bonds (S&P Global DM bond index +0.6% w-o-w) are reducing 10y bond yields in all DMs (UST, -13bps w-o-w to 3.08%; Germany, -8bps to 0.35%) even in countries experiencing distress (Italy, -15bps to 3.44%).

The USD strengthened w-o-w against: 1) a currency basket (DXY, +0.7%); 2) the EUR (EUR/USD -1.0%, to 1.140); and 3) EMs currencies (MSCI EM Currency index, -0.4%).

In Canada, the BoC hiked the policy rate (a: 1.75%; c: 1.75%; p: 1.50%) in line with expectations.

In Brazil, Jair Bolsonaro, the right-wing populist candidate, won the second round of the presidential election. Last week, the BRL appreciated against the USD (to USD/BRL 3.643, +2.0% w-o-w).

Pablo Gallego Cuervo *contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*NAFTA*	*North-American Free Trade Agr.*
bpd	*Barrels per day*	*NATO*	*North Atlantic Treaty Organizat.*
bps	*Basis points*	*OECD*	*Organization for Economic Cooperation and Development*
BS	*Balance sheet*	*Opec*	*Organization of Petroleum Exporting Countries*
c	*Consensus*	*p*	*Previous*
C/A	*Current account*	*P2P*	*Peer-to-peer*
CB	*Central bank*	*PBoC*	*People's Bank of China*
CBB	*Central Bank of Bahrain*	*PCE*	*Personal Consumption Expenditures*
CBK	*Central Bank of Kuwait*	*PE*	*Price to earnings ratio*
CBT	*Central Bank of Turkey*	*PM*	*Prime minister*
CDU	*Christian Democratic Union, Germany*	*PMI*	*Purchasing managers' index*
CNY	*Chinese Yuan*	*pps*	*Percentage points*
CPI	*Consumer Price Index*	*pw*	*Previous week*
DJIA	*Dow Jones Industrial Average Index*	*QCB*	*Qatar Central Bank*
DJEM	*Dow Jones Emerging Markets Index*	*QAR*	*Qatari Riyal*
d-o-d	*Day-on-day*	*QE*	*Quantitative easing*
DXY	*US Dollar Index*	*q-o-q*	*Quarter-on-quarter*
EC	*European Commission*	*RE*	*Real estate*
ECB	*European Central Bank*	*RBA*	*Reserve Bank of Australia*
ECJ	*European Court of Justice*	*RRR*	*Reserve Requirement Ratio*
EIA	*US Energy Information Agency*	*RUB*	*Russian Rouble*
EM	*Emerging Markets*	*SWF*	*Sovereign Wealth Fund*
EP	*European Parliament*	*tn*	*Trillion*
EPS	*Earnings per share*	*TRY*	*Turkish Lira*
EU	*European Union*	*UAE*	*United Arab Emirates*
EUR	*Euro*	*UK*	*United Kingdom*
EZ	*Eurozone*	*US*	*United States*
Fed	*US Federal Reserve*	*USD*	*United States Dollar*
FOMC	*US Federal Open Market Committee*	*USD/b*	*USD per barrel*
FRB	*US Federal Reserve Board*	*UST*	*US Treasury bills/bonds*
FX	*Foreign exchange*	*VAT*	*Value added tax*
FY	*Fiscal Year*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GCC	*Gulf Cooperation Council*	*WTI*	*West Texas Intermediate*
GBP	*British pound*	*WTO*	*World Trade Organisation*
GDP	*Gross domestic product*	*w*	*Week*
IMF	*International Monetary Fund*	*w-o-w*	*Week-on-week*
INR	*Indian Rupee*	*y*	*Year*
IPO	*Initial public offering*	*y-o-y*	*Year-on-year*
IRR	*Iranian Rial*	*y-t-d*	*Year-to-date*
JPY	*Japanese yen*	*ZAR*	*South African Rand*
k	thousand	*2y; 10y*	*2-year; 10-year*
KSA	*Kingdom of Saudi Arabia*		