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Bulltick Research and Strategy

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Latin America Strategy:

Brazil Risks Are on the Policy Front

Last Sunday riots broke out in the capital city of Brasilia in an apparent political insurrection against the 10/2022 presidential election outcome where former president Lula da Silva won by a razor-thin margin. While the market reaction seems like it will indeed prove to short-lived after last Sunday's riots in Brasilia, risks remain in this still-young democracy where domestic confidence in the country's political institutions is clearly wrought. The market reaction was minimal in our view because the insurgency was relatively quickly contained, the riots were widely condemned across the political spectrum domestically and internationally, there was no impact to government functioning, and no apparent spread to other regions at least yet.

We think markets will look past the strife to fiscal and economic policies and reforms. The risks we see where the markets would shudder: 1) Indication of a more leftward swing on the agenda from already-leftist Lula (examples: big additions to already sizeable government spending on social welfare transfer payments and on bloated and inefficient government entities in an inflationary environment (+5.79% y/y in December 2022 versus 3.5% target and with 13.75% Selic rate) 2) if riots were to spread to other states (Sao Paulo 1/3 of Brazil's GDP) or 3) if it produces some downstream casualty something like a trucker or other paralyzing real economy strike.

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If these risks do not come to fruition, Brazil stands to benefit this year from China's economic re-opening and its increased demand for commodities. Brazil's local bond BNTNF 10 2033 yields 12.60%, BRAZIL 10.25 2028 yields 12%, USD-denominated BRAZIL 3.75 2031 yields 5.8%, and in equities benchmark equity index 12.1% dividend.

Politically, Lula is likely to get a short-term popularity boost, but in our view, this riot is unlikely to radically change the imminent policies such as the coming proposal to replace Brazil's federal spending cap and tax reform in coming months. The Bovespa is already down 18% since the October 2022 election where Lula won by a razor thin margin. Lula was convicted and spent time in jail for corruption.

Sunday's riots came after months of protests in front of the capital's military installations by Bolsonaro voters claiming election fraud in the razor-thin Lula win back in October. There is an immense distrust by many in Brazil, particularly right of center, of institutions especially of Brazil's Supreme Court. This can be unhealthy and dangerous in a relatively young democracy (40 years). The Supreme Court was largely placed (11 justices) by Lula and many in the opposition contend the entity helped him regain power after being criminally convicted of corruption and going to jail by annulling Lula's corruption charges and censoring "misinformation" about the election in social media and the news.





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