

## Brazil: Anti-establishment wave prevails

Election results diverged materially from the latest polls, with a strong anti-establishment wave helping unseat many traditional forces. In the presidential race, right-leaning candidate Bolsonaro led left-leaning runner-up Haddad by 17pts. Bolsonaro's strong momentum gives him an edge, but a more moderate Haddad also bodes well for local assets



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### Bolsonaro's edge is reaffirmed by first-round results

The most surprising element of this weekend's elections in Brazil was the stronger-than-expected anti-establishment bias, which prevailed in many races, particularly in the populous Southeast. State governor races in Minas Gerais and Rio de Janeiro, led by virtual unknowns with strong grass-roots support, are emblematic. Senate races in these states also stood out, with the left-leaning PT party losing traditional senators from Rio and São Paulo, while former president Dilma Rousseff failed to get elected for a senate seat through Minas Gerais.

The anti-establishment wave mirrors similar developments across the world, and reflects, in Brazil's case, the economic recession and the deep discontentment with the political class, amid the widespread corruption brought to light by the Lava-Jato investigations.

Jair Bolsonaro's 46% voter support, 4pts shy of a first-round victory, was materially larger than the latest polls suggested, about 5-6pts higher. This upside surprise possibly reflects the strong stigma among part of the electorate, notably among women, associated with the support to the candidate. This probably led pollsters to underestimate his support, during face-to-face surveys. Fernando Haddad also performed better than polls suggested, but by a slightly smaller 4pts.

Overall, this result leaves Bolsonaro with strong momentum heading into the second-round, on 28 October. It also suggests that second-round simulations, which indicated a tie between Haddad and Bolsonaro, probably slightly underestimated Bolsonaro's support.

Lastly, congressional results also suggest somewhat improved prospects for the eventual construction of a centre-right base in Congress, should Bolsonaro get elected. His larger-than-expected victory should enhance his political capital, increasing the likelihood that, should he get elected, he will be able to negotiate a working majority in Congress, encompassing much of the Congressional base that supported President Temer at the beginning of his mandate and increasing the chance that his fiscal austerity measures will be approved.

## Getting ready for 28 October

Over the next couple of weeks, both candidates are likely to soften their rhetoric, in an effort to reduce their high rejection rates.

We continue to think that Bolsonaro has an edge, judging by the election result and the fact that popular enthusiasm with his candidacy should more than compensate for Haddad's somewhat broader appeal.

Having said that, with second-round simulations suggesting a tie between the two candidates, any number of factors, including Bolsonaro's recovering health and his ability to participate actively in the campaign and participate in debates, could alter the final result. A high-confidence call on the final election result may not be possible for some time yet.

In any case, as we have discussed in our last report, the expected moderation of Haddad's economic policy rhetoric, together with Bolsonaro's improved momentum, justifies the improvement in Brazil's near-term risk-profile, as evidenced by the rally in local assets.

In particular, we continue to expect the Brazilian real (BRL) to trend with a constructive (but still volatile) bias, with some risk of the USD/BRL temporarily dropping below our year-end forecast of 3.7. But given the sharp rally that has already occurred, room for additional BRL appreciation is more limited.

We also continue to expect the central bank to keep its policy rate on hold this year, despite the more hawkish guidance recently adopted. A policy tightening next year, when the USD/BRL may test levels above 4 again- on the back of uncertainty over the approval of fiscal austerity measures- seems more likely in our view.