

Brazil: election outlook

Managing the country's challenge of "abundance"

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Main conclusions

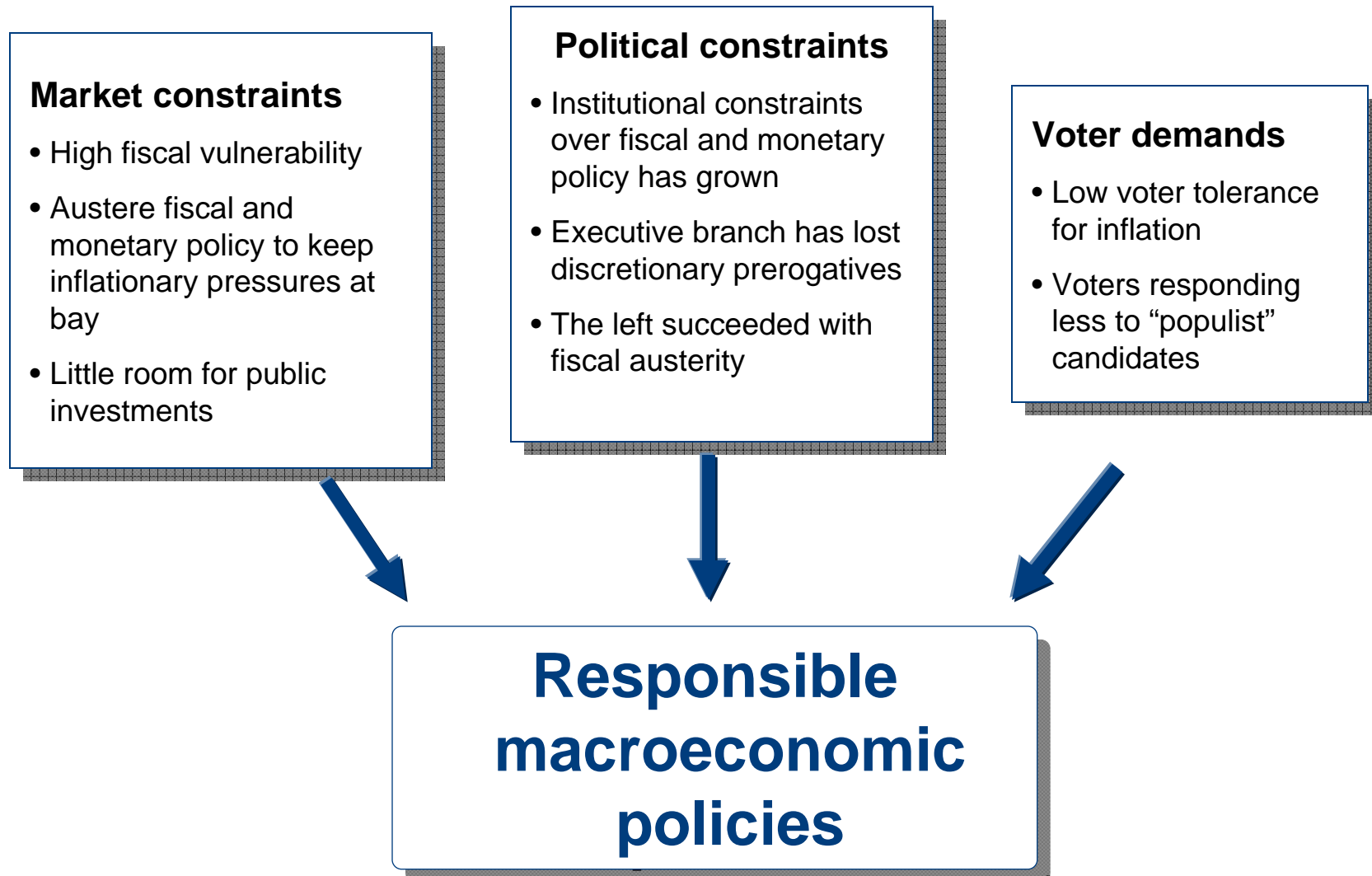
There is more at stake in this election than meets the eye

Dilma Rousseff is favored and poised for large congressional majority

Post-election outlook: some hyperbole and some real differences

- **Dilma Rousseff:** Investors will be pleasantly surprised with signaling on fiscal policy, but frustrated over ability to implement. State-owned enterprises will have a growing role, but much will depend on the sector.
- **Jose Serra:** Fiscal policy will have larger up-side, and concerns over monetary and exchange rate policy somewhat overblown. Regulatory policy will see greater private sector competition with focus on revenue collection.

Drivers to economic policymaking



Economic policy in a context of “abundance”

Complacency on reforms

Government is ‘tinkering’ with macroeconomic policies

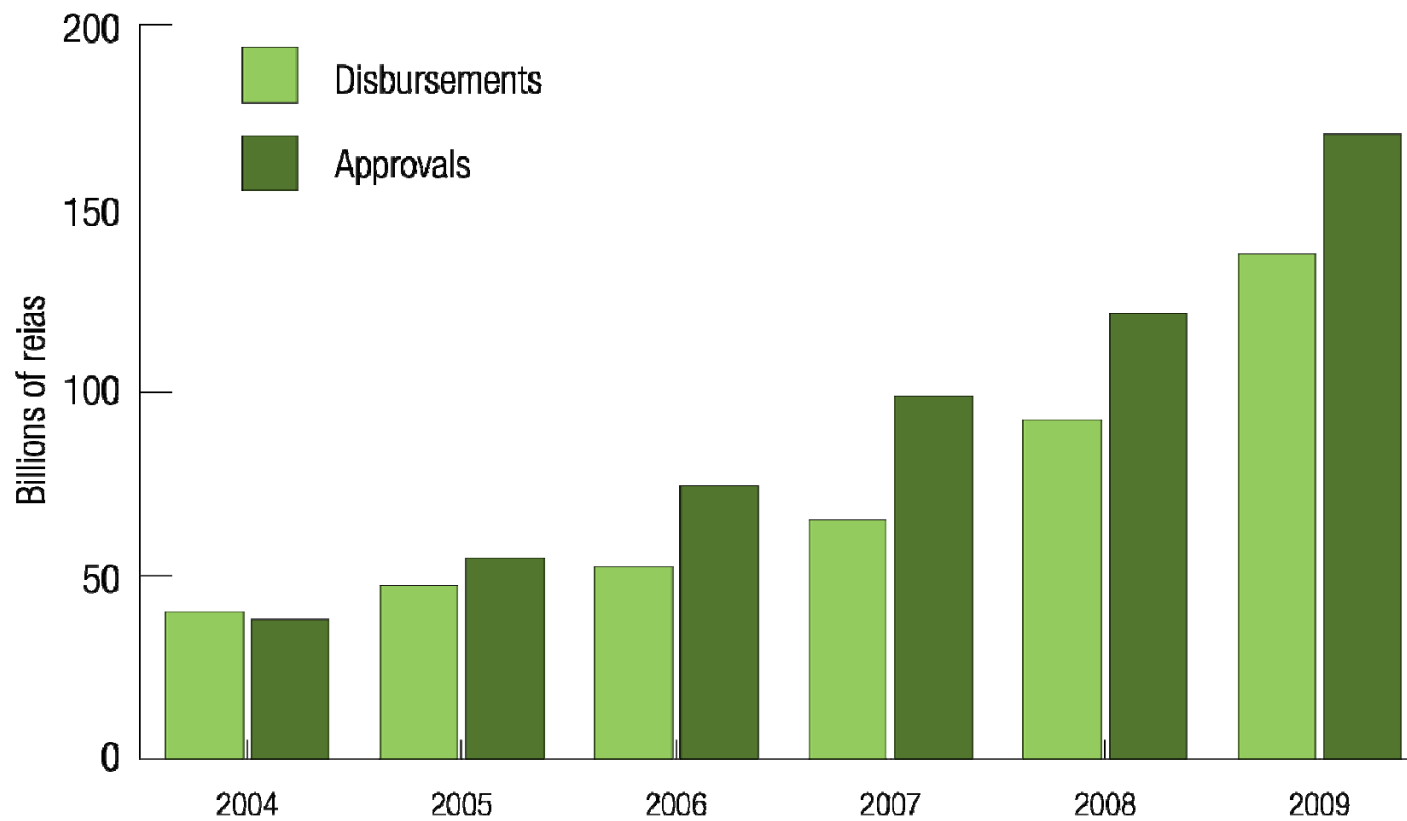
- *Fiscal Policy*: Government committed to keeping a debt/GDP ratio stable, but declining little commitment to roll back current expenditure growth
- *Exchange Rate*: 2% IOF tax and creation of SWF indicative that more intervention could be at play

Industrial policy is back, and so are state-owned enterprises

- Tremendous growth of federally directed credit through the National Development Bank (BNDES), Bank of Brazil (BB) and Federal Savings Bank (CEF)
- Government strengthening SOEs in oil & gas, utilities, and telecom.

Industrial policy with eye to create national champions

BNDES disbursements and approval

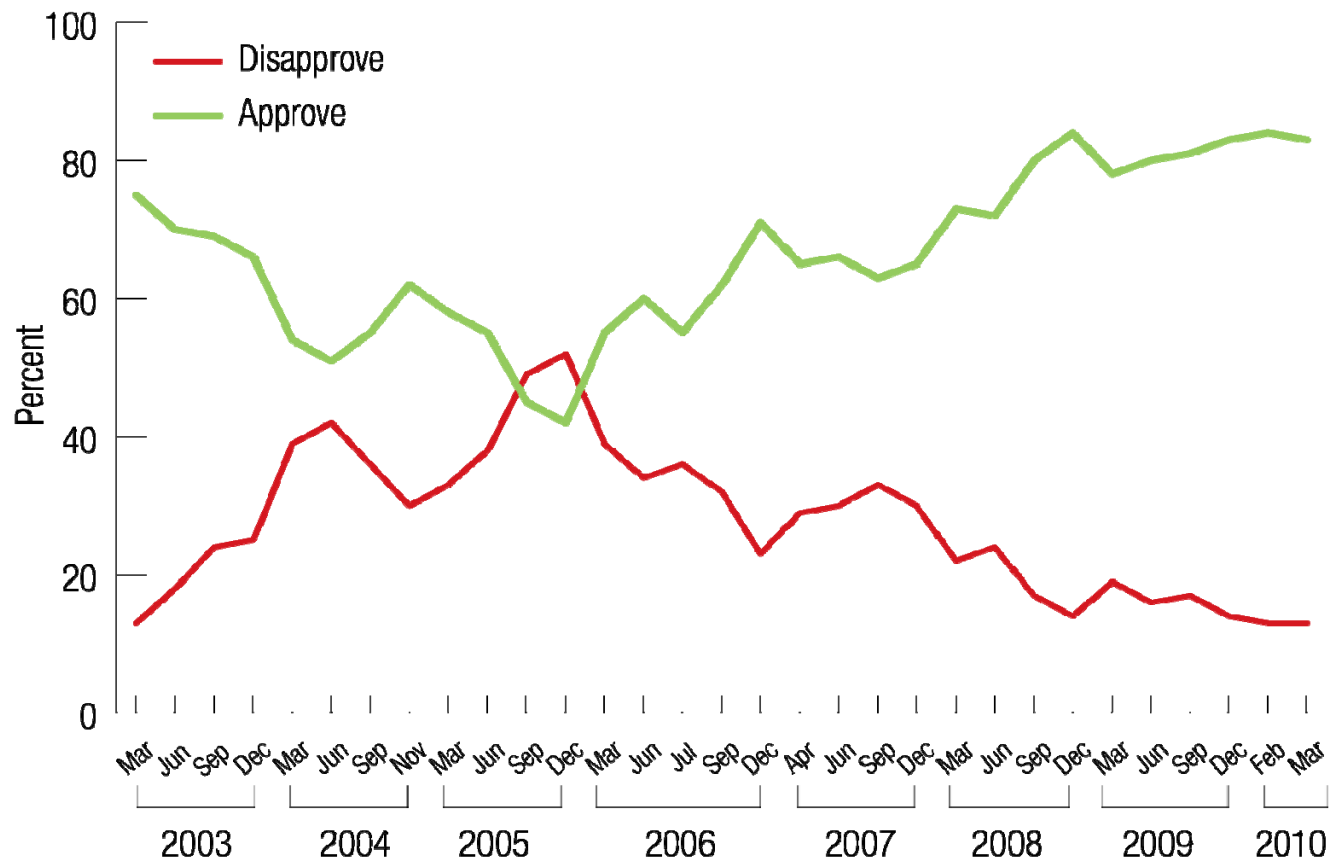


Source: BNDES

The 2010 election

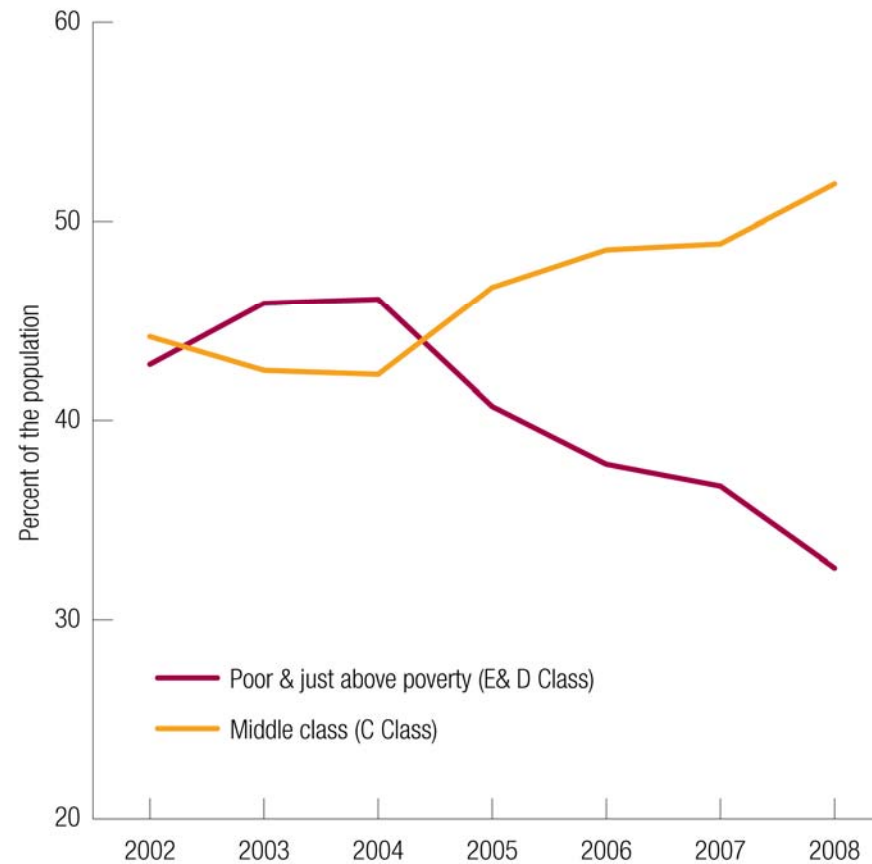
Lula's approval ratings: charisma or economics?

Lula's approval ratings



Source: IBOPE

Demographic transformation beyond GDP growth



Source: FGV

Congressional Outlook

- *The left will continue to grow, but base of support with shift*
- *The opposition will lose seats in the Senate*
- *If Rousseff wins, the opposition will lose 20%-25% of seats through party switching in the lower house*

Party	1990	1994	1998	2002	2005	2006
PT (Workers Party)	35	49	59	91	82	70
PDT (Democratic Workers Party)	46	34	25	21	21	42
PSB (Brazilian Socialist Party)	11	16	18	22	28	40
PPS (Socialist Progressive Party)	3	2	3	15	15	20
PCdoB (Brazilian Communist Party)	5	10	7	12	11	10
PV	–	1	1	5	8	5
PSOL	–	–	–	–	7	7
Total Seats	100	112	113	166	172	194
Percentage	19%	22%	22%	32%	34%	38%

Source: Eurasia Group

Post-election scenarios:
some hyperbole and some real differences

Macroeconomic Policy Outlook

Dilma Rousseff

- ***Fiscal Policy***: Investors will be pleasantly surprised with Rousseff's stance on fiscal policy, but frustrated over her ability to implement
- ***Exchange Rate and Monetary policy***: voices in favor of curbing appreciation will grow, but overtures will be incremental.
- ***Monetary Policy***: Slightly more dovish CB, but gradual overtures

Jose Serra

- ***Fiscal Policy***: Stronger conviction over the need to curb rising expenditures, and more leeway politically to do so.
- ***Exchange Rate and Monetary policy***: government will probably view fiscal policy as precondition for lower interest rates and less appreciated currency. Risk of interventionist measures on currency, however, probably higher than those in a Rousseff administration.

Industrial policy and role of state-owned enterprises

	Dilma Rousseff	Jose Serra
Oil & Gas	Petrobras heavy. Government will execute proposal that grants Petrobras exclusive operatorship of new E&P activity. Approval of oil reform by 2010 (more likely) or 2011. More active industrial policy, slower pace of production, less revenue collection.	Greater role for IOCs. Any oil reform approved by this year will be revisited. Administration will calibrate more competition to maximize revenue collection.
Utilities	Eletrobras heavy. Government likely to allow for more favorable renewal of concessions representing 20% of the country's power generation park in a manner to strengthen Eletrobras.	Lesser emphasis on Eletrobras. Government may allow for renewal of concessions, but less emphasis on Eletrobras. Industrial policy could focus on creating national champion.
Telecommunications/ IT	State-run backbone network. Government set to announce new National Broadband Plan with public network and probably revival of Telebras. Driver for reform, however, is to increase competition and lower costs to consumers.	Smaller state presence. Government may very well use a new state-owned entity to manage national fiber optic network, but government will work more with private sector.
Mining	Greater state control. Government announced mining reform proposal to enact greater control over concessions with an eye to increase domestic added-value activities. Focus on steel production through Vale.	Higher taxes. Less emphasis on domestic steel production and risk of higher taxes, but less 'interference' over Vale.
Transport Infrastructure	Overtures to private investors. Concession model for ports, airport, rail and federal highway with emphasis on low tariffs.	Overtures to private investors. Concession model for ports, airport, rail and federal highway with emphasis on new investments.

Source: Eurasia Group

Reform Outlook

Dilma Rousseff

- **Political outlook:** Overarching majority, but she will be challenged to manage tensions between the PT and PMDB
- **More micro than macro reforms:**
 - Microeconomic reform agenda focused on overcoming hurdles to investments
 - Regulate the 2003 pension reform
 - Tax reform could be revisited, but more piecemeal

Jose Serra

- **Political outlook:** Smaller majority, but fewer tensions within coalition
- **The left will have a veto over constitutional reforms:**
 - Tax reform likely to figure as the largest structural reform
 - Fiscal reform agenda focused on issues that only require simple majorities
 - Microeconomic reform agenda may get new push

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