



R&R Weekly Column
By Brunello Rosa



Will The World's Next Strongman Come From Brazil?

Jair Bolsonaro, the populist leader of Brazil's right-wing Social-Liberal Party (PSL), won the first round of the country's presidential election last night, with around 46 percent of the votes. His closest rival, the Workers' party (PT) candidate and former mayor of São Paulo Fernando Haddad, trailed behind Bolsonaro with only 29 percent of the votes. Bolsonaro's party is also expected to receive the most votes in the accompanying parliamentary elections. Other presidential candidates are even further behind in the polls. For the first time since 1994, Brazil's president might not come from either of the two major parties, the centrist Brazilian Social Democracy Party (PSDB) or the leftist Workers' Party (PT). The incumbent president Michel Temer, of the Brazilian Democratic Movement Party (PMDB), decided not to run when his approval rating sank into the single digits. As we discussed in [a detailed country report published last week](#), Brazil's enormous political divisions are currently preventing the country from capitalizing on its equally huge economic potential (an example of which is Brazil's successful aeronautical industry, which competes efficiently on the world stage). After experiencing the worst recession in the country's recent history, a recession in which it lost around 8% of its GDP between 2015 and 2016 and witnessed one of its worst ever corruption scandals (which, in turn, led to the imprisonment of former President Inácio Lula da Silva and the impeachment of his successor and protégé Dilma Rousseff), Brazil has been left with deep political scars, negatively influencing what had already been a massively divided society to begin with.

Congressman Bolsonaro has used rhetoric typical of right-wing populists around the globe, resorting to so-called "politically incorrect" expressions against women, minority groups, and disadvantaged people generally. On the other hand, unlike other right-wing populists, Bolsonaro's agenda is [fiscally conservative](#), focused on the reduction of public spending and taxes, as well as on privatisation. He is also in favour of structural reform, such as the reform of the pension system. If his agenda were implemented and worked, Brazil's growth potential could be revitalised. Perhaps as result of this focus, the Brazilian real (BRL) appreciated against the USD last week, with USD/BRL falling by 5.4% on a weekly basis (to 3.841). Brazilian equity prices are also up, by more than 8% since the beginning of the year. It is still possible for other candidates to win the second round of the election, three weeks from now. If the support for other left-wing and centrist candidates is consolidated by Haddad, and if Haddad then manages to stage a comeback (helped also by support from numerous political groups, such as EleNãO, that have emerged in the past few months to protest the ascent of Bolsonaro), then Bolsonaro might still not become Brazil's next president. At this stage, this seems to be a relatively improbable scenario, however. Bolsonaro's popularity has increased dramatically during the past few months, especially after being stabbed by a left-wing extremist during an election rally in early September. Bolsonaro's efficient social media campaigners managed to use that event to his favour.

If Bolsonaro's victory in the first round is followed by another victory in the second round, there will be yet another strongman on the world stage, this time in a key BRIC and G-20 economy. Bolsonaro would join an already numerous group that includes Trump, Putin, Xi Jinping, Orbán, Kaczynski, Erdoğan, Duterte, and Modi - to name only the most preeminent of such politicians. Bolsonaro might even be one of this group's most explicit believers in the desirability of autocracy: "I am in favor of a dictatorship ... We will never resolve serious national problems with this irresponsible democracy," [he once said](#). Bolsonaro might also set the stage for the return of populist right-wing leaders in Latin America, a year before [Argentina's presidential elections will be held](#). We have discussed in a previous column (on March 19th, 2018) the risks the world faces from the increasing number of autocratic leaders, at a time when tariffs and protectionism are rising and global economic growth is slowing. By definition, strongmen do not want to avoid engaging in overt confrontation (on borders, tariffs, policy actions, etc). As such, their ascendance means that open conflicts, of various types, could unsurprisingly ensue.

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The Week Ahead

In the US, inflation will accelerate (September CPI, c: 2.8%; p: 2.7%), further supporting the prospects of higher interest rates.

In Brazil, Mr. Jair Bolsonaro, the populist candidate, is likely to win the first round of the presidential election. His party, the right-wing PSL, is expected to be the most voted in the parliamentary elections. Last week, the BRL appreciated against the USD (to USD/BRL 3.841, -5.4% w-o-w).

The Quarter Ahead

In December, the Fed will likely hike the policy rate to 2.25-2.50%. Last week, the market-implied likelihood of a hike in December 2018 rose to 82.1% (pw: 79.2%), while the probability of “at least 3 additional hikes by September 2019” rose to 58.9% (pw: 45.4%). In September 2018, US-listed ETFs registered the 2nd-largest monthly inflow of the year (+USD36.7bn): the largest contribution came from US equity ETFs (+USD28.8bn), with US fixed-income ETFs in second place - despite the Fed hiking interest rates and yields on 10-y and 30-y UST approaching their highest level this year.

In the EU, political and economic risk will rise: a) in the UK, a no-deal Brexit is increasingly likely: with the October EU summit nearing, [neither the UK nor the EU are taking steps to break the current negotiation deadlock](#); b) in Italy, government spending plans will: i) trigger EC demands and warnings; and ii) increase the likelihood of downgrades by credit rating agencies; and c) in Spain, the probability of early elections will grow, as budget negotiations are likely to fail.

The US-China trade dispute will continue, but is unlikely to develop into a global trade war. Negotiations will prevent a global escalation of tariffs: last week, Canada agreed to revise the NAFTA agreement to incorporate US demands.

EM weakness is likely to continue. CBOE data show that investors are positioning for further USD strengthening: last week, the amount of non-USD currencies shorts reached its highest level since Q1-2017.

In Turkey, the TRY will continue to depreciate. The TRY depreciated by 1.3% w-o-w against the USD (to USD/TRY 6.132), due to: a) September CPI inflation exceeding expectations (a: 24.5% y-o-y; c: 21.2%; p: 17.9%); b) Fitch’s downgrading of 20 Turkish banks; and c) PMI dropping to its lowest level since March 2009 (September, a: 42.7; p: 46.4). Next week, a court hearing could improve US-Turkey relations, by increasing the probability of US pastor Brunson’s release.

In MENA, geopolitical tension will remain high. In Iraq, the nomination of a new PM—former finance minister Adel Abdul Mahdi—will not prevent further unrest over corruption and poor services.

In 2019, GCC countries will increase spending. Supported by higher oil prices, KSA and UAE announced y-o-y government budget expansions of 7.4 and 17.0%, respectively. KSA, UAE and Kuwait will support Bahrain’s economic reforms with up to USD 10bn. Bahrain has committed to adopt a program of fiscal consolidation.

Brent oil price will remain close to 80 USD/b. Last week, the price of Brent oil rose to 84.1 USD/b (+1.6% w-o-w) amid fears of supply uncertainties driven by US sanctions on oil exports from Iran—to come into force in November.

Last Week’s Review

US bonds and global equities were hit by expectations of further Fed hikes. In the US: a) The unemployment rate fell to its lowest level since 1969 (September, a: 3.7%; c: 3.8%; p: 3.9%); b) average hourly earnings remained firm (September, a: 2.8% y-o-y; c: 2.8% y-o-y; p: 2.9%); c) non-farm payrolls suffered the temporary impact of Hurricane Florence (September, a: +134k m-o-m; c: +185k; p: 201k). As a result (in w-o-w terms): a) US treasuries experienced significant outflows (UST 10y yield, +17bps to 3.23%); b) global stocks fell (MSCI AWCI, -1.8%), mostly driven by US stocks (S&P500, -1.0%); c) volatility increased (VIX, +2.7 points to 14.8; 52w avg.: 13.6; 10y avg.: 19.5); d) the USD strengthened against: 1) a currency basket (DXY, +0.5%); and 2) the EUR (EUR/USD 1.152, -0.7%); and e) EMs suffered outflows that hit stocks (MSCI EM, -4.5%), bonds (BAML Sov. EMs index, -1.4%), and currencies (MSCI EM Currency index -0.8%).

In the EZ, renewed concerns about Italy’s fiscal policy and deficit targets weighed on EZ stocks (Eurostoxx 50, -1.6%) and Italian assets (FTSEMIB, -1.8%; 10y sov. bond yields, +27bps, to 3.41%).

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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	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		