



Brazil Election Preview

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Executive Summary

- **Elections are still too early to call**
 - Presidential election should go to run-off vote on October 28th
 - Undecided voters still represent c.25%
 - Key question: how much of Lula's support will Haddad inherit?
- **Bolsonaro seems to be heading to the 2nd round**
 - But Bolsonaro has high rejection rates
 - How will he perform in a 2nd round run-off vote?
- **Four other candidates tied for 2nd place, within the margin of error**
 - 3 leftist candidates and one pro-business candidate
 - How will TV airtime assist Alckmin and Haddad?
- **Governability is a key concern and a focus point for markets**
 - Brazil urgently needs to pass Pension Reform
 - Three remarkably different macro scenarios after the elections, depending on elected candidate and governability profile

Key Presidential Candidates

Bolsonaro (PSL)	Haddad (PT)	Alckmin (PSDB)	Marina (REDE)
Adviser: Paulo Guedes – orthodox	Adviser: Marcio Pochman – unorthodox	Adviser: Persio Arida – orthodox	Adviser: Andre Lara Resende – orthodox
<p>Growth and inflation:</p> <ul style="list-style-type: none"> Guedes to be “super” economy minister Full autonomy to BCB for inflation-only target Free floating fuel prices (Petrobras to buy hedge to smooth vol as Pemex) Open economy to trade <p>Fiscal policy:</p> <ul style="list-style-type: none"> Achieve primary surplus by end of mandate Raise BRL700bn via privatisation Unify/simplify taxes <p>Pension:</p> <ul style="list-style-type: none"> Create two systems, give new entrants option to join new one capitalised with money raise from privatisation 	<p>Growth and inflation:</p> <ul style="list-style-type: none"> Emergency program to create jobs via re-starting public works & boosting investment in Petrobras Gov’t to take up HH debt in bankruptcy so they can borrow again Boost minimum salary Use 10% of reserves to fund infrastructure works Revoke labour reform Petrobras to control fuel prices again CB with dual mandate <p>Fiscal policy:</p> <ul style="list-style-type: none"> Revoke budget freeze Tax banks spreads to force down credit cost Unify taxes into VAT <p>Pension:</p> <ul style="list-style-type: none"> No min retirement age, prefers 85/95 rule 	<p>Growth and inflation:</p> <ul style="list-style-type: none"> Open economy to X+M > 50% (now <30%) Invest FGTS in TLP to boost HH savings <p>Fiscal policy:</p> <ul style="list-style-type: none"> Keep budget freeze and move to primary surplus by 2021 Unify taxes into VAT Cut spending, no tax hike Cut income tax on firms but raise tax on dividends Privatise firms (not Petro) <p>Pension:</p> <ul style="list-style-type: none"> Approve it in 1st year Replicate UK model-ish Unify public/private systems Rising min retirement age 	<p>Growth and inflation:</p> <ul style="list-style-type: none"> Cut costs to hire workers Boost infrastructure with rapid employment generation (sanitation and transportation) BCB autonomy but not in constitution Against floating fuel price Changes to labour reform Cuts to export tariffs <p>Fiscal policy:</p> <ul style="list-style-type: none"> Unify taxes into GST Raise inheritance tax and dividends tax Revoke budget freeze <p>Pension:</p> <ul style="list-style-type: none"> Priority for her gov’t Unify public/private systems Min retirement age of 62/65

Source: Oxford Economics

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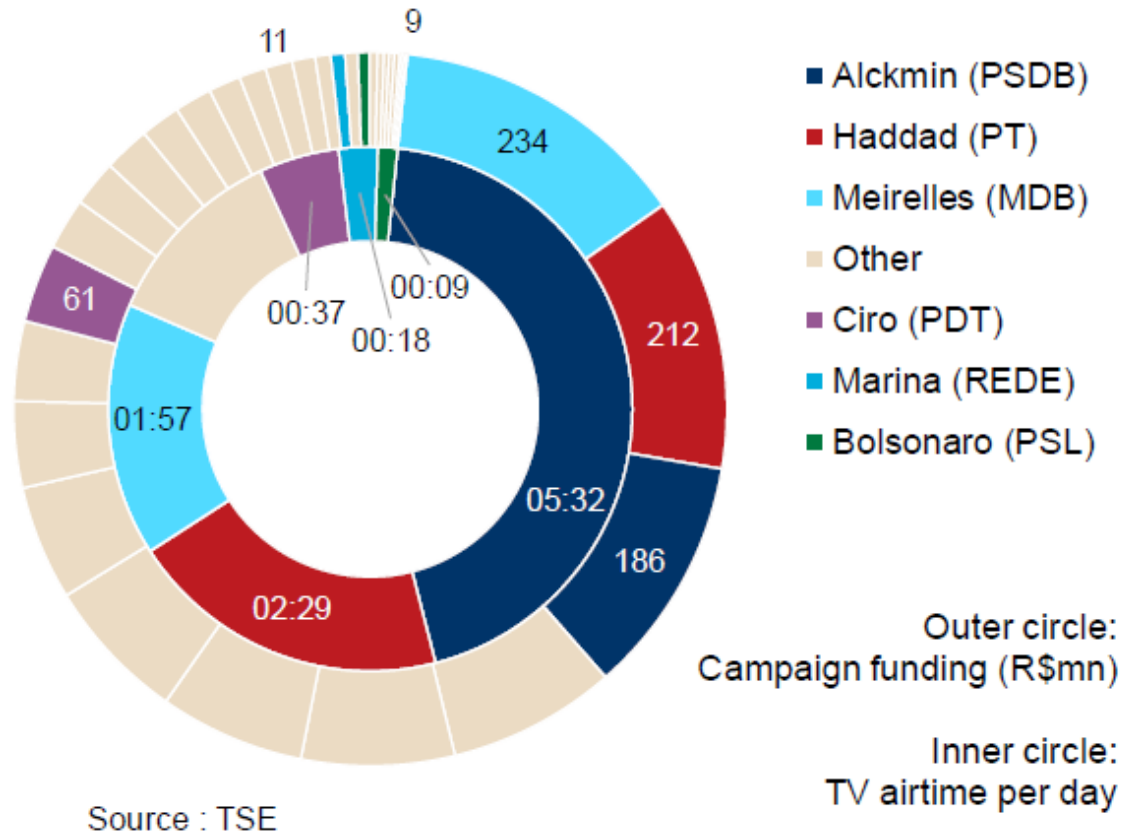
Brazil Election Timeline

Date	Days before election	Description
1-Jan-18	279 days	- From this date forth (and until the end of the elections), all polls must be registered at the Electoral Court.
2-Apr-18	188 days	- Last day for candidates to register with a political party - Last day to register political parties at Brazil's Electoral Court
4-May-18	156 days	- Last day for Brazilians to register themselves as voters or request the transfer of registration domicile
20/Jul to 05/Aug	79 days	- Start of period in which party conventions can be held to define coalitions and officially name the candidates who will run for president, vice-president, state governor, federal deputy and senator
15-Aug-18	53 days	- Last day for political parties and coalitions to submit to Federal Electoral Court, by 7pm, the request to register presidential and vice-presidential candidates - Last day for political parties and coalitions to submit to Regional Electoral Courts, by 7pm, the request to register candidates for state governor and deputy state governor, senator and respective reserves, federal deputy, state deputy or city councilor
16-Aug-18	52 days	- Electoral propaganda is allowed
31-Aug-18	37 days	- Beginning of the period of free electoral propaganda on radio and TV
5-Oct-18	2 days	- Last day of free electoral propaganda on radio and TV - Last day for for 1st round Presidential Debates to take place
6-Oct-18	1 days	- Last day for paid disclosure, in the printed press and in newspapers' online sites, of electoral propaganda
7-Oct-18		Elections - 1st Round
26-Oct-18	2 days before 2nd round	- Last day of free electoral propaganda, on radio and television, relative to the 2nd round - Last day for for 2nd round Presidential Debates to take place
27-Oct-18	1 days before 2nd round	- Last day for paid disclosure, in the printed press and in newspapers' online sites, of electoral propaganda relative to the 2nd round
28-Oct-18		Elections - 2nd Round

Will TV Airtime Matter?

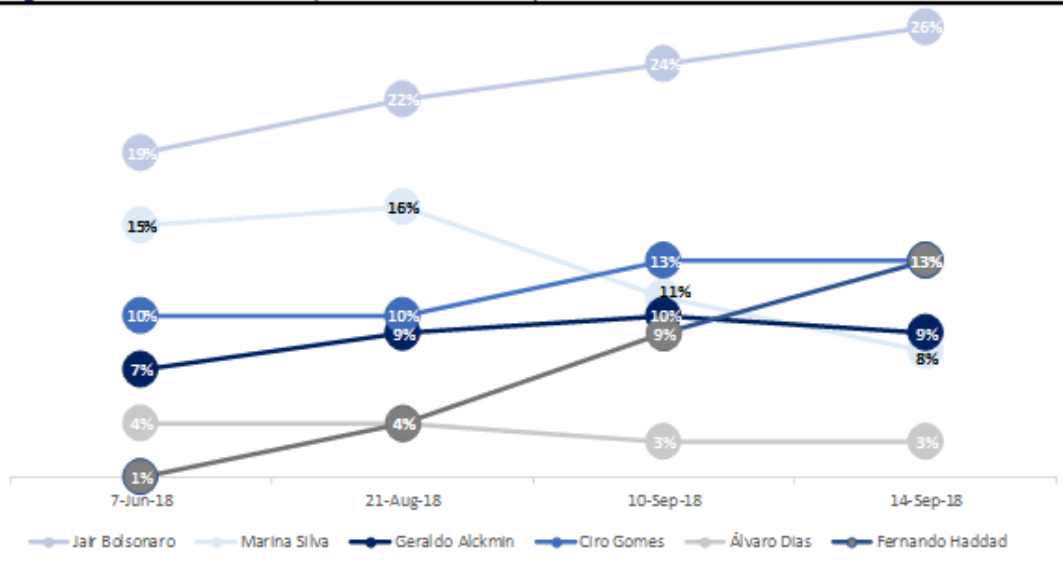
- PT: 2nd largest campaign fund & TV airtime
- PSDB: 3rd largest campaign fund & largest TV airtime

Brazil: TV time and campaign funding



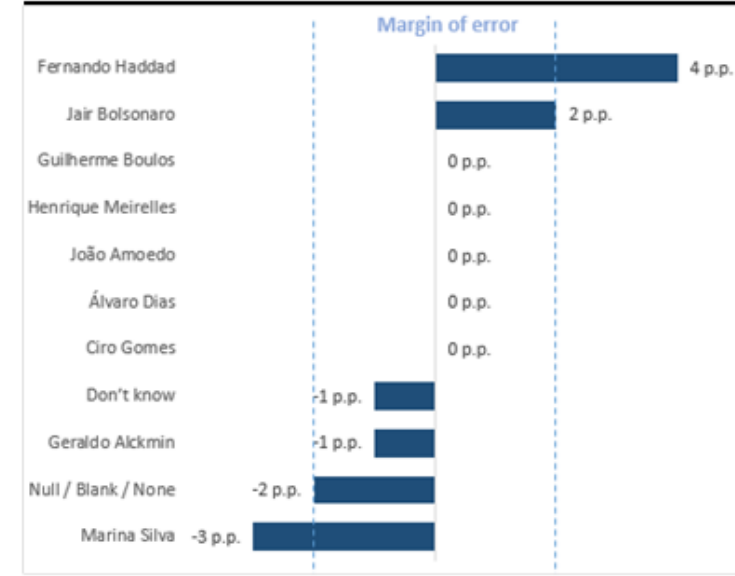
Latest Polling Results for Main Candidates

Voting intentions evolution (Datafolha's Polls)



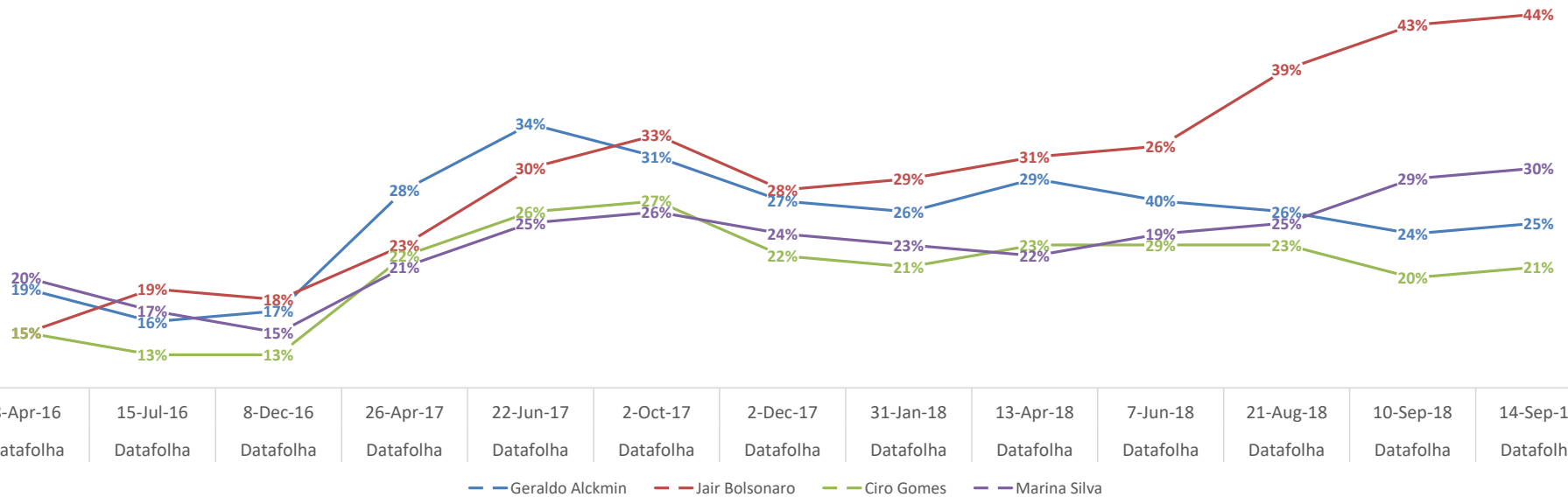
Source: Datafolha, BTGPactual

Difference from last Datafolha's Poll



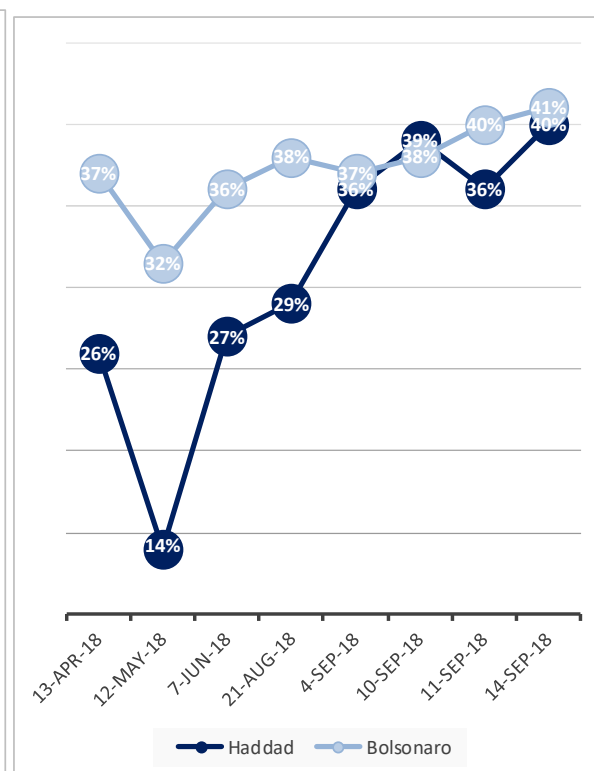
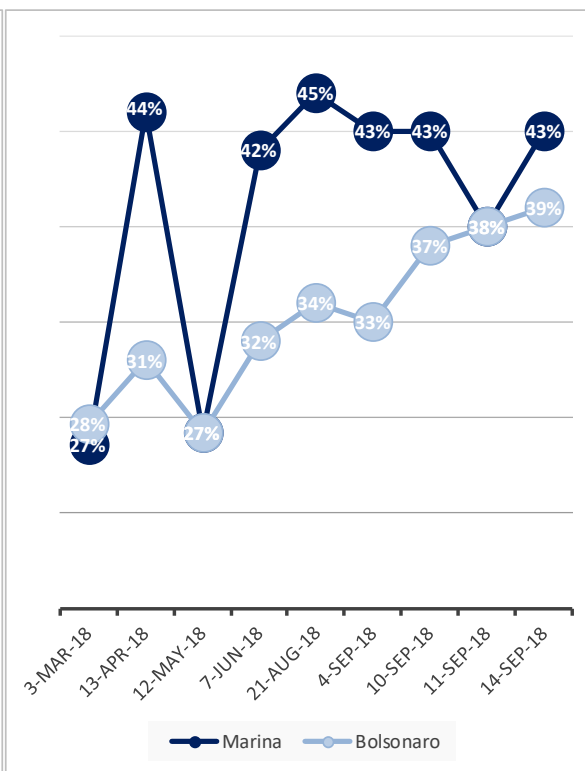
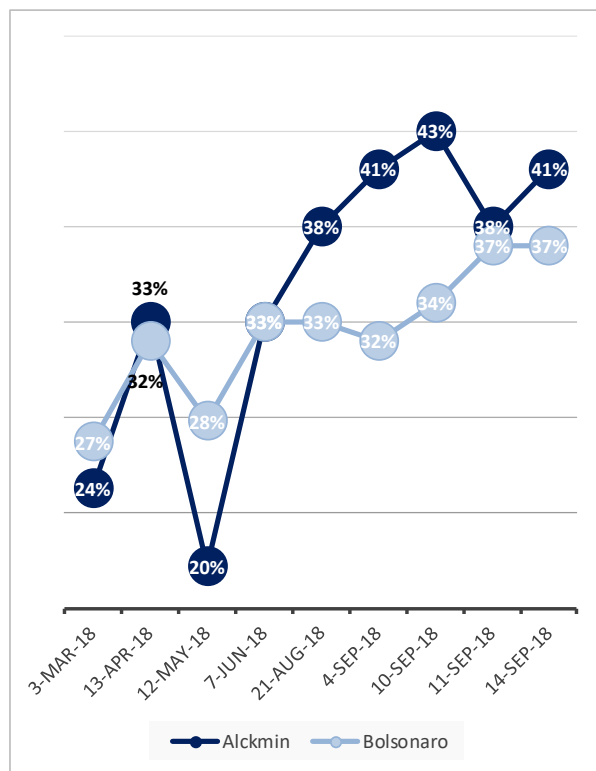
Source: Datafolha, BTGPactual

Rejection Rates Are High



Potential 2nd Round Scenarios

- Bolsonaro should head to the 2nd round
- There are 4 plausible scenarios for 2nd round, all involving Bolsonaro
- Will Bolsonaro be able to close the gap with other candidates in 2nd round simulations? Still unclear at this stage

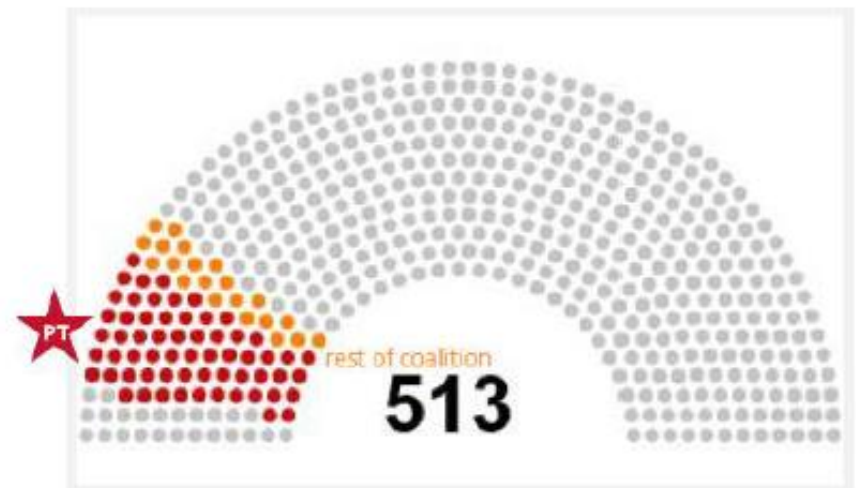


Source: BTG Pactual; Brazilian Poll Figures

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Governability is a Key Concern in Brazil

- **Alckmin:** PSDB + Centrao could control >50% of the lower house of Congress
- **Haddad:** PT+PCdoB + Pros should control 15-20%
- **Marina:** REDE + PV have only 6 seats



Source: BNP Paribas Research

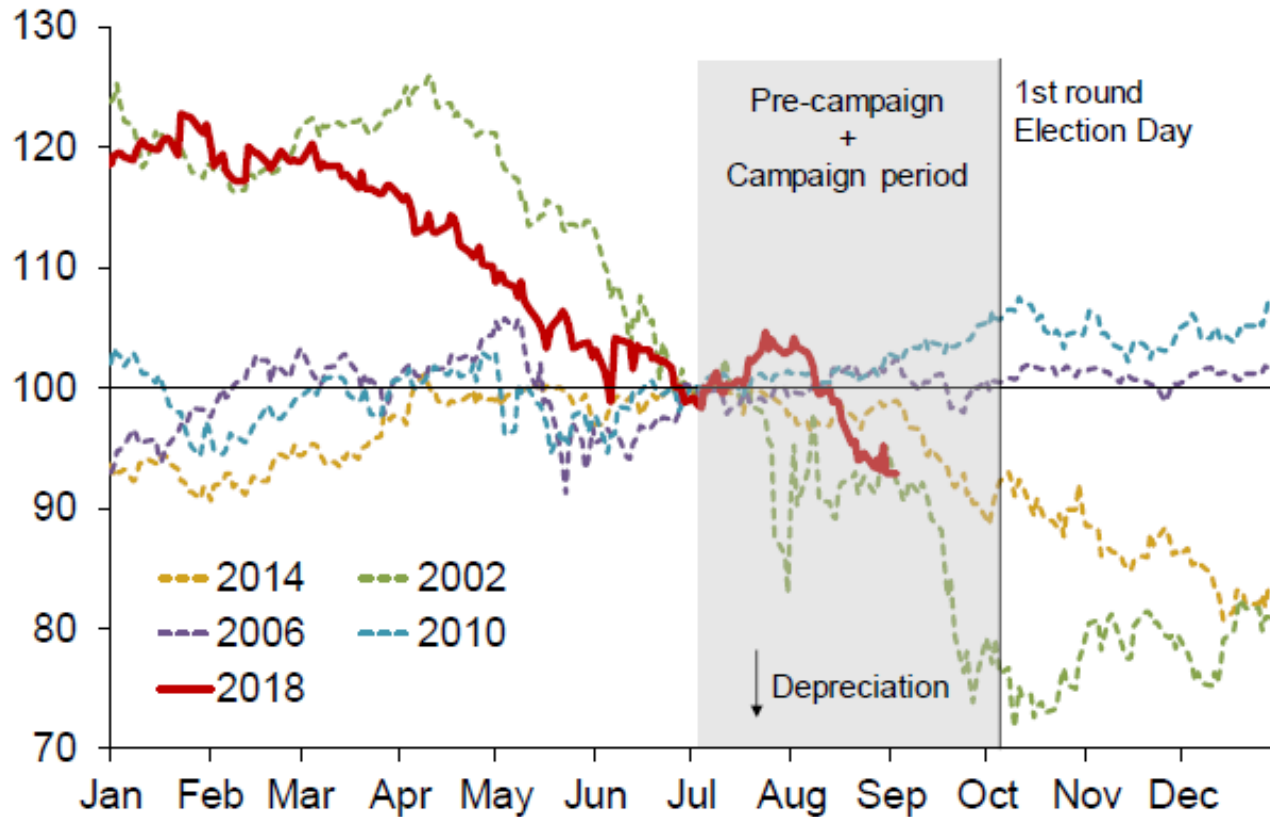
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Like in 2002, PSDB's poor showing is keeping markets nervous

- If left-wing candidates take-off, could BRL weaken another 20%+?

Brazil: FX rate during electoral years

BRL/USD Index, July 5th = 100



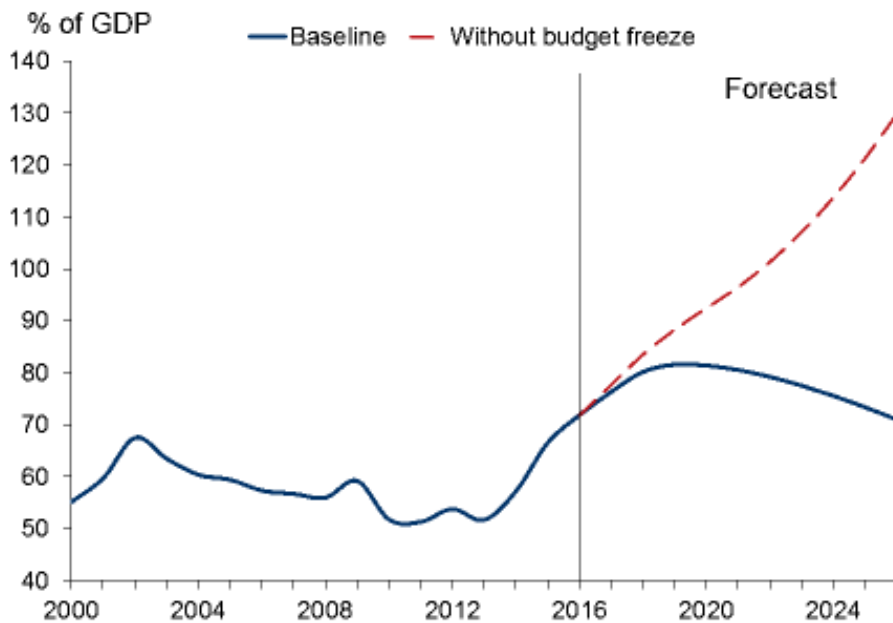
Source: Oxford Economics; Banco do Brasil

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Market Anxiety is about the Fiscal Time Bomb

- Without pension reform Government debt load is not sustainable
- Outside of Alckmin, can other candidates proactively build an alliance in congress to approve reforms?

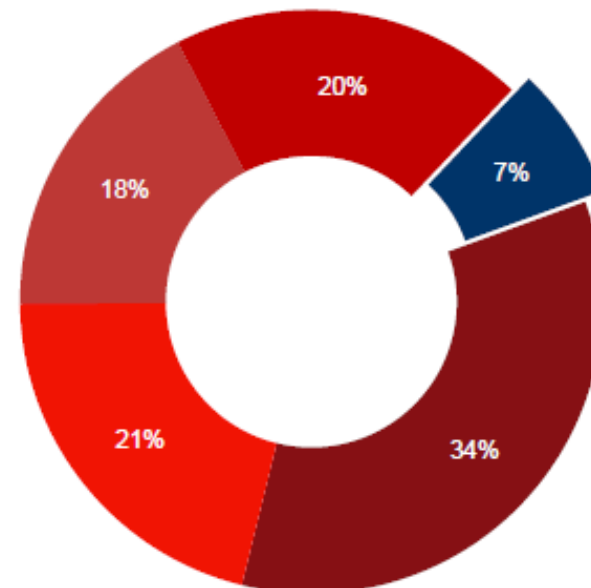
Brazil: Gross government debt



Source: Oxford Economics

Brazil: Total government expenditure (2017)

■ Pensions ■ Interest ■ Payroll ■ Other ring-fenced ■ Discretionary



Source: Secretaria do Tesouro Nacional, Banco Central do Brasil

Potential Macro Scenarios

- Three remarkably different scenarios after the elections

	Bull case		Neutral case		Bear case	
	2018	2019	2018	2019	2018	2019
GDP growth	1.6%	4.0%	1.5%	2.5%	1.0%	-1.0%
Inflation	3.7%	3.9%	4.0%	4.2%	4.5%	7.0%
Policy rate	6.50%	6.50%	6.50%	7.75%	8.50%	12.50%
FX rate	3.50	3.60	3.90	4.00	4.70	5.50
5y CDS	150	160	240	250	450	500

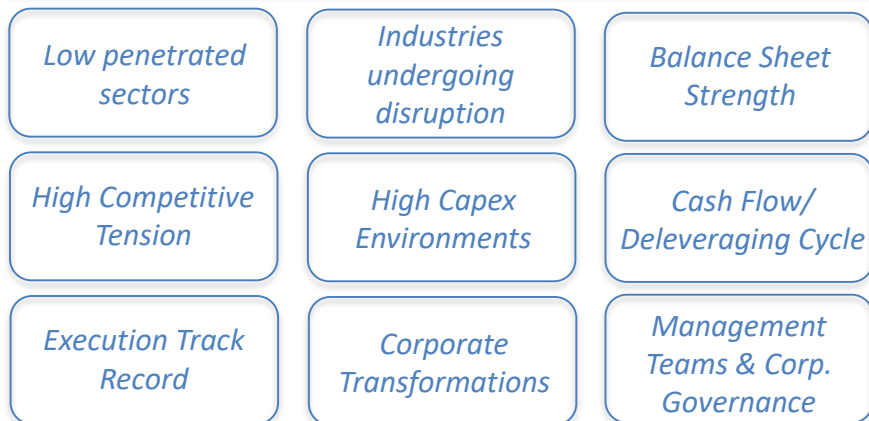
Source: BAML Research

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Equity Market Considerations

- Brazilian corporates generally in good shape
- Attractive valuations, but...
- Macro and political uncertainty are strong headwinds

Examples of Areas of Interest



Themes Recently Analyzed

- Diversified global growth
- Healthcare vertical integration
- E-commerce growth
- Payments disruption
- Airline competition
- Education new entrants

Key Ongoing Headwinds/Tailwinds Impacting Investment Thesis



Source: Pembroke Research

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