

## BRAZIL: LULA'S FIRST MONTH AS PRESIDENT WAS EVENTFUL WITH BRIEF UNREST AND THE ANNOUNCEMENT OF A CURRENCY UNION



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### Event

President Luiz Inácio Lula da Silva was sworn in on 1 January, twenty years after taking office the first time. His first month in office has already been eventful. First of all, on 8 January, radical supporters of former President Bolsonaro stormed the (unoccupied) Congress, supreme court and presidential palace. They called the elections rigged and wanted a military intervention to oust Lula. The unrest died down quickly, but highlighted the high grade of political polarisation and challenging task Lula has to govern a divided country. Secondly, on 22 January, the Brazilian and Argentinean presidents announced they would start preparations for a common currency, which will be used alongside their current legal tenders (the Brazilian real and Argentine peso). Early talks are focusing on developing a shared unit of value for bilateral trade only, to reduce reliance on the US dollar. The presidents even announced a full currency union could be a possibility in the coming decades.

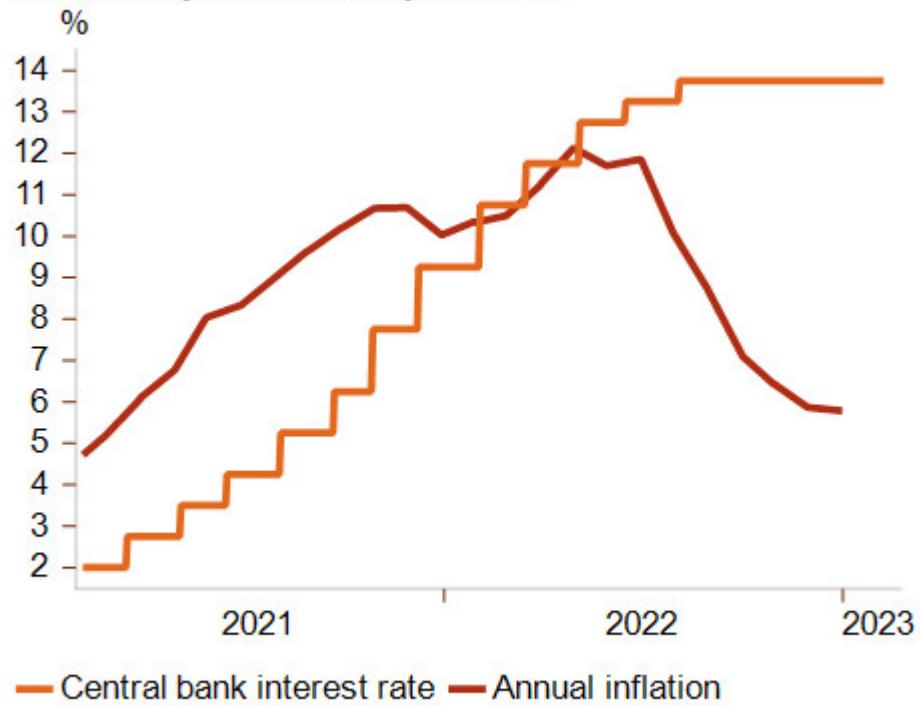
### Impact

Lula's presidential term **was not expected to start with a honeymoon**, given the high levels of polarisation. That being said, Brazil's democratic institutions are relatively strong and withstood the brief unrest well. Looking forward, further unrest and regular road blockades severely disrupting supply chains are possible during Lula's term and will not be uncommon in the rest of South America either.

The rapprochement between Brazil and its neighbours after relations were strained under Bolsonaro's presidential term, isn't unexpected either, especially as many South American countries also elected left-wing governments in recent years. The announcement of a common legal tender between Argentina and Brazil can be seen in this context. It is expected to give Lula a reputational boost and might even revive regional co-operation. It remains to be seen if a common currency will actually be created. In the past, similar ideas, e.g. the 'gaucho' or the 'sucre', were abandoned. Moreover, how the common currency will be developed practically is also under debate, with the latest idea being Argentina providing collateral for the currency via hard assets such as grain, gas or oil. Indeed, a common currency union as in the Eurozone still seems far off.

Lula's term is also expected to be challenging on the economic front. First of all, as **social spending will be a clear priority** under Lula, this will prove to be a balancing act **given the elevated public debt**. Moreover, the economy is expected to face headwinds. Copious pre-election stimulus spending boosted real GDP growth to 3.2% in 2022, but this growth is expected to drop to 1.2% in 2023, despite the fact that China's reopening in December is supporting commodity prices. On the upside, inflation has fallen from a peak of 12% in April to 5.8% in December, as shown on the graph below. Hence, there might be some room for monetary policy loosening as the central bank's interest rates stand at an eight-year high. In turn, lower interest rates might stimulate economic growth. However, fiscal policies will be key,

## Inflation peaked in April 2022



Source: IBGE, BCB

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