

BRAZIL: PRESIDENT-ELECT LULA WILL LIKELY
ABANDON PUBLIC-SPENDING CAP, AN
ANCHOR FOR FISCAL POLICY CREDIBILITY,
BEFORE HIS TERM BEGINS



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Event

On 30 October, the left-leaning Lula da Silva won with 50.9% to incumbent president Bolsonaro's 49.1%; the tightest margin since Brazil's return to democratic elections in 1989. It is the first time that an incumbent president has failed to win re-election. **Unsurprisingly**, Lula's razor-thin margin of victory led to unrest. Some radical lorry drivers blocked roads for a few days in support of Bolsonaro. Though the protest group was relatively small, the blockades were highly disruptive to supply chains as more than 60% of cargo is moved by road. Despite the fact that lorry drivers have yielded, an extended period of unrest across different groups of die-hard supporters is probable, especially as Bolsonaro challenged the election result on 22 November, three weeks after the outcome. That being said, Brazil's courts as well as national and international political leaders have already accepted the result. Moreover, given the relatively strong institutions and history of peaceful transition of power, unrest is expected to be temporary and relatively limited.

Impact

Lula inherited a polarised country, a divided Congress and a powerful right-wing movement. The far-right party of outgoing President Bolsonaro will be the largest single force in both houses of Congress as of January. Before taking office on 1 January, Lula is seeking a coalition that will have a simple majority in Congress. He will likely succeed as Brazil has a long history of working majorities in Congress with presidents from diverse ideologies.

Lula has said that his top priority is to boost social spending. Moreover, Lula already announced that he plans to build alliances in order to abandon Brazil's public-spending cap rules. These rules have served as an anchor for fiscal policy credibility since 2016. The constitutionally mandated spending cap limits budget increases to inflation and was an important fiscal reform to keep public debt at a sustainable level. That being said, the cap has recently been (temporarily) circumvented. This bypass was accepted rather quickly in Congress. Hence, it is very probable the spending cap will be abandoned in the coming month, especially as Bolsonaro's party is also against it. Nevertheless, another mechanism or alternative fiscal rules that bolster confidence in public debt sustainability are highly likely. **Public debt is already relatively high** and is estimated to reach around 88% of GDP end 2022. Since Lula's announcement, financial markets have been volatile and the Brazilian real has started to depreciate. The financial markets are likely to remain jittery given tighter global financing conditions and the possibility public debt will be pushed to very high levels.

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