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EM SQUARED

March 15, 2016 7:26 pm

## Lula and Brazil: investors' twisted logic

Jonathan Wheatley

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Investors were wrong to believe in change for the better; Brazil is stuck for at least two years



Former president Luiz Inácio Lula da Silva, who was indicted last week, with incumbent Dilma Rousseff at a 2012 event

**B**razil's currency, stocks and bonds all plummeted on Tuesday on reports that former president Luiz Inácio Lula da Silva was about to be made a minister by Dilma Rousseff, Brazil's beleaguered president.

Such a move would be an act of desperation, designed to protect Ms Rousseff from impeachment and to keep Lula (as he is known by all) out of jail under the protection of ministerial privilege.



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Both of their downfalls have come to seem inevitable under the increasingly far-reaching and fast-moving *lava jato* corruption investigation that has gripped the nation as it sinks deeper into economic and political crisis.

Investors may have got their logic in a twist. They were dismayed on Tuesday because saving Lula and Ms Rousseff would up-end the rationale for the rally in Brazilian assets in recent weeks: that impeachment would bring a swift end to the disastrous Rousseff administration — the economy shrank by 4 per cent last year and is about to do the same in 2016 — and put the country back on a path to growth.

Yet there is almost no reason to expect such an outcome.

Millions of people took part in demonstrations at the weekend, calling for Ms Rousseff to go. But the president and her party, the PT, were not their only targets. Other politicians, including former and would-be presidential candidates from the reform-minded, market-friendly opposition, were booed and jeered and forced to abandon their planned speeches.

Marco Ruediger, head of a public policy unit at the Fundação Getúlio Vargas (FGV), a university in Rio de Janeiro, described the demonstrations as a Pandora's box.

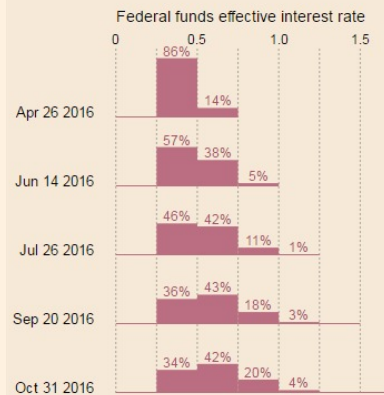
"Everything changed," he says. "This was a rejection of all politicians."

He and his colleagues analysed activity on Twitter over the weekend. (For their analysis of the events of the previous week, [see this story](#).)

On Saturday March 12, the day before the demonstrations, they found what they have found before: pro and anti-government activity among two polarised groups that scarcely communicate with each other, if at all. In the first image, the red lines are tweets and retweets in favour of the government, while the blue lines are those of

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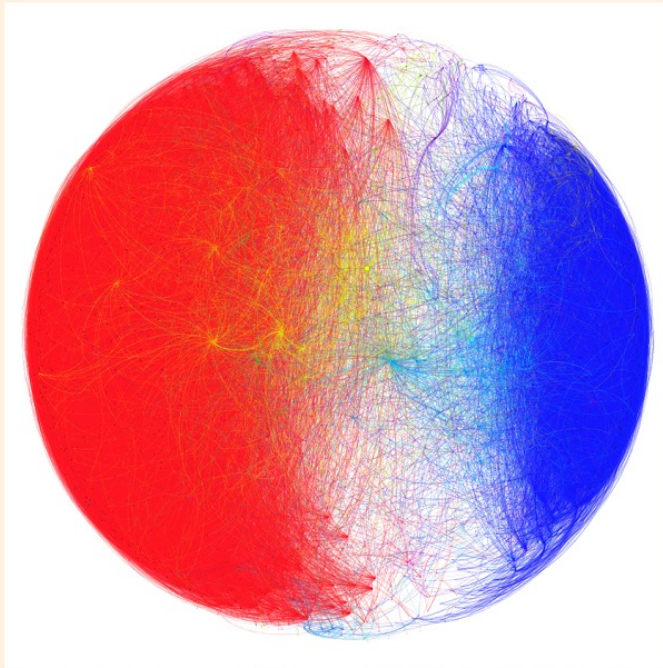
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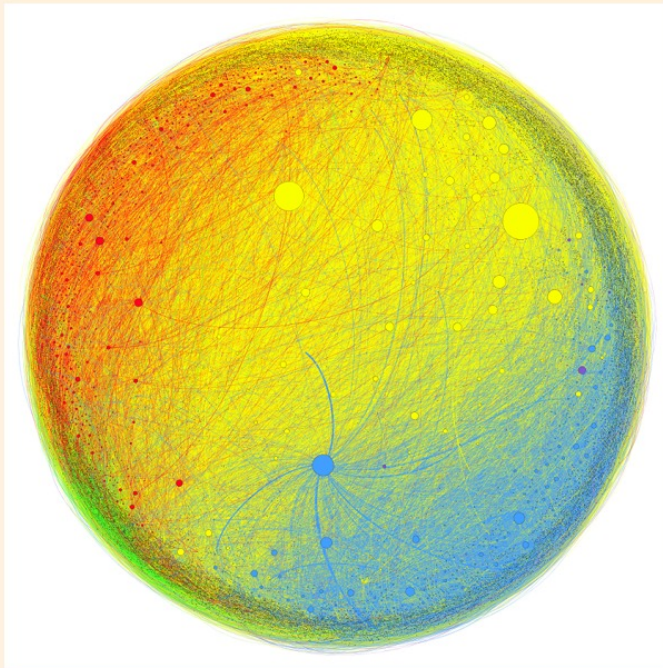
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the opposition.



But on Sunday, when an estimated 3.5m people took to the streets, they found something different. In the second image, the two opposing groups still exist but they are dwarfed by a new, nonaligned group, consisting of tweets that are neither for nor against the government, says Mr Ruediger, but treat the *lava jato* and the broader crisis as objects of ridicule.



This dominant group, the FGV researchers found, consisted of “new emerging actors of undefined political alignment”.

Mr Ruediger says the consequences will be far-reaching: “The opposition is beginning to understand that it might not benefit from this process as it imagined. Of course the PT is the focus but it extends to the others, too.”

One conclusion is that, even if the government were to fall quickly and new elections called, there is no guarantee that Brazilians would elect parties that have been ineffective in opposition and whose policies, were they to stretch to reform of Brazil’s [disastrously generous public sector](#), would hurt many voters just as they are going through the worst economic downturn in living memory.

Such an outcome seems to be an increasingly distant prospect.

It is possible that Ms Rousseff will limp on to finish her mandate at the end of 2018. With the tainted but still politically powerful Lula in her government, that possibility increases.

If Ms Rousseff is impeached, the process will take at least six months, probably more. She would be replaced by Michel Temer, her vice-president, a leader of the ill-defined PMDB party, an agglomeration of regional and sectoral interests.

The best that can be expected of a Temer administration, says João Augusto de Castro Neves of Eurasia Group, is that it might not make the current situation any worse.

Even if Ms Rousseff goes quickly — which could happen if the courts find her re-election in 2014 to have been fraudulent — uncertainty will prevail, he says.

That is because politics will be all but paralysed by the *lava jato* investigations.

The judiciary, says Mr Neves, is emerging as the only branch of government with an ability to function. “The pressure is on the courts to step in and fix the problem,” he says.

But it would be wrong to see the *lava jato* as an operation to bring down the Rousseff administration. Its work will continue, reaching politicians across the spectrum. The prospects of a reformist government delivering growth under such conditions are remote.

“We see no favourable outlook in the next two years, regardless of who is in the presidential palace,” says Mr Neves.

Even Lula’s bid for ministerial protection may not work. The Supreme Court moves slowly but it is no longer an escape route for the well-connected.

The other courts may yet stop it happening. Within hours of reports that Lula and Ms Rousseff were to meet on Tuesday to reach agreement, evidence was leaked from the *lava jato* that a close Rousseff associate tried to bribe a key witness not to testify — a loud warning shot, says Mr Neves. Their meeting was subsequently postponed to Wednesday, according to local reports.

Even if Lula’s rescue is foiled, however, investors should avoid getting carried away again.

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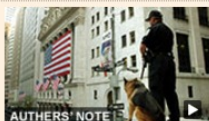
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"Don't be told what you want, don't be told what you need  
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**I'm a libertarian get me out of here**

7 days ago

Nice article, and the research about the “new emerging actors of undefined political alignment” is interesting.

Your central point is quite right. It would be dangerous and misguided of investors to assume that there is a stifled public demand for economic and political reform, that would be brought to bear if only the public will could be translated into policy.

The public are keen to express their anger at government corruption and incompetence. Whether they have the political stomach to vote for a cut in pension entitlements, a reduction in



their workers' rights and a period of austerity is much less clear.

The problem in Brazil goes much deeper than its politicians.

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**cfmzfm**

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Brazil, "the country of the future" is a basket case. Everybody drank President Lula's Kool-aid when commodity prices supported the economy, but investors forgot that none of the necessary reforms were undertaken in the more than 10 year's of Lula's party's rule:

- no tax reform: Brazil has the most complicated and onerous tax system in the world, with the average company spending more than 2000 (!) hours on tax filings every year
- no reform of the arcane judiciary: Brazil spends 0.67% of its GDP on its legal system, compared to 0.1 % to 0.25% for most OECD countries, including the US.
- no infrastructure or capital investment: Brazil has over decades had one of the lowest investment rates in the world, well below 20% of GDP.
- No pension reform: overly generous pensions eat away more than 50% of the federal budget (until recently, Judge's daughters could continue to receive their fathers' pensions after their death... no comment)
- No political reform: there are 38 (!) parties in congress. No wonder corruption is rife, as it is the only way to keep political coalitions together.
- No administration reform: public servants are among the best paid employee in Brazil, with salaries equal to or greater than those of SME executives, and the state sector is bloated, courtesy of a bureaucracy that would put the Soviet Union to shame.

In other words: another Bolivarian populist nightmare.

The pain will be felt for years to come. I feel sorry for the many poor, who are usually the worst affected by economic downturns, but maybe that's what it takes to wake up the Brazilians to their duty to demand better governance, to stop voting for notoriously corrupt politicians and abandon the "jeitinho", the "Brazilian way of doing things", which usually involves using trickery, relationships and ethically questionable ways to reach one's objectives.

Poor Brazil - so beautiful and so messed up.

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▼  
**PhilIB**

7 days ago

**@cfmzfm** Your analysis is spot on, except for the part about feeling sorry for the poor. Not that we shouldn't always feel sorry for the poor, but Lula's (PTs) pandering to the lower classes through unsustainable social policies and increased government hand out, is typical populist economic flawed policy that created 14, maybe 16 years of consecutive PT rule.

The real sufferer here is the middle class (a common theme in most of the world these days). Its their future and their kids that gets sold down the timeline with these false promises of economic hope.

In the odd event that Brazil got serious and did clean house against all these corrupt political parties and corporate entities and persons, something along the lines of a "mani pulite" done by Italy in the 80's, we would expect political vacuums and paralysis. But the chance for the unexpected would be there, and markets would begin to price hope instead of despair.

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